



Just in Time

Guidelines for Integrating ESG Risks into Stress Testing

August 2025



Executive Summary

- The Joint Guidelines developed by the European Supervisory Authorities (ESAs) aim to ensure the consistent integration of environmental, social, and governance (ESG) risks into supervisory stress testing by competent authorities.
- These guidelines provide a structured approach for incorporating ESG risks either within existing frameworks or through complementary assessments. They emphasize the importance of clear methodological principles, adequate resource allocation, robust data infrastructure, and effective governance.
- The initiative is grounded in EU legislative mandates and seeks to promote harmonized, forward-looking, and pragmatic ESG stress testing practices across the financial sector.



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Keywords: Joint Guidelines, ESG Risks and Stress Test Results, Supervisory Process



01

Objectives

Regulatory Context

Objectives of the Guidelines

Scope of Application and General Principles



Objectives 1/3

Regulatory Context

The **Capital Requirements Directive IV** (CRD IV, Art. 100(4)) and the **Solvency II Directive** (Art. 304c(3)) require the ESAs (EBA, EIOPA, ESMA) to develop joint guidelines for integrating **ESG risks** into supervisory stress tests. The aim is to provide a uniform regulatory framework that ensures consistency, transparency and proportionality in the approach to **ESG risks** among national supervisory authorities and the banking and insurance sectors.



REGULATORY OBJECTIVE

- The integration of ESG risks into supervised stress tests responds to the growing need to strengthen the resilience of the financial sector to environmental, social and governance challenges.
- Through these Guidelines, the ESAs aim to harmonise the approach of national authorities, bridging current methodological divergences and promoting a long-term vision consistent with the European Union's objectives on sustainable finance.



“Towards more consistent, transparent and forward-looking ESG stress tests”

This aim can be achieved by improving:

- ✓ the legal certainty of approval processes,
- ✓ the clarity and transparency of the ESG stress testing framework,
- ✓ establish a forward-looking, long-term approach capable of accommodating progressive methodological developments and improvements in the availability of ESG data,
- ✓ provide precise guidance on:
 1. ESG scenario design,
 2. governance,
 3. organizational structures,
 4. use of specialist expertise and reliable data,
 5. appropriate timing for scenario analysis.

Objectives 2/3

Objectives of the Guidelines

The joint guidelines developed by the ESAs were created with the aim of providing a **common** and **consistent** framework for integrating **ESG risks** into supervisory testing.

They aim to support supervisory authorities in adopting a **structured, gradual** and **harmonised approach**, in line with the regulatory mandates deriving from **CRD VI** and **Solvency II**.

- **Legal clarity and consistency**

The Guidelines aim to ensure uniform and transparent application of ESG requirements in supervisory testing, strengthening legal certainty for authorities and supervised entities. The objective is to create a common framework that avoids fragmentation in interpretation between different Member States.



- **Integration of ESG risks**

One of the central objectives is the structural integration of ESG risks – in particular climate risks, but also social and governance risks in the future – into supervisory processes. The Guidelines support the use of stress tests not only as a technical exercise, but as a tool to guide prudential supervision in a sustainable manner.



- **Gradual approach, starting with climate risk**

Given the complexity of ESG risks, the Guidelines propose a progressive approach: starting with the integration of climate risk and then extending the analysis to other ESG factors. This allows authorities to build expertise and methodologies in a realistic manner, without compromising the effectiveness of the process.



“The Guidelines are not merely technical in nature, but represent a paradigm shift in ESG risk supervision”

Objectives 3/3

Scope of Application and General Principles

Target Audience of the Guidelines



The Guidelines are primarily addressed to competent supervisory authorities in the **banking**, **insurance** and **financial markets** sectors. They are designed to support these authorities in integrating ESG risks into their supervisory stress testing exercises, in line with the mandate set out in CRD VI and Solvency II.

Proportional and materiality-based approach

A proportional approach is promoted, taking into account the **nature**, **size** and **complexity** of the supervised entities, and based on the **materiality of ESG risks** for each entity. This means that the intensity and structure of stress tests must be appropriate to the actual relevance of the risks for each institution, avoiding excessive burdens where not justified.



Initial focus on environmental risk (E), with future extension to social risks (S) and governance risks (G)

In the first phase, the Guidelines focus on the integration of environmental risks, particularly those related to climate change (physical and transition risks). However, the intention is to gradually extend the scope to social and governance risks as methodologies and data availability evolve.



Principles and Methodological Considerations

Stress Test: Time Horizon and Design

Stress Test: Methodological Approaches and
Granularity

Stress Test: Balance Sheet, Proportionality, and Model
Robustness



Principles and Methodological Considerations 1/3

Stress Test: Time Horizon and Design

Authorities must clearly define which portfolios, sectors, geographical areas, and activities are to be included in the stress tests. A **balanced** and **pragmatic approach** is essential, taking into account the maturity of available data and models. For **cross-border financial groups**, all relevant entities must be included.



The time horizon of the stress test should align with the purpose of the exercise:

- **Short to medium term (≤ 5 years):** to assess financial resilience to adverse shocks.
- **Long term (≥ 10 years):** to assess the strategic resilience and long-term sustainability of the business model.



Scenario definition is a crucial component of ESG stress tests, as it determines the consistency and significance of the impacts assessed. The ESAs' guidelines provide a detailed framework to support authorities in selecting and designing scenarios according to the objectives of the exercise.

Scenarios should be based on recognized scientific sources and take into account sectoral and regional trajectories. Authorities are encouraged to include:

- **Compound risks** (e.g., ESG + macroeconomic shocks)
- **Second-round effects** (indirect and amplified consequences of ESG shocks)
- **Multiple alternative scenarios** for long-term stress testing
- **Adaptation of scenarios** to different risk profiles or to enhance comparability

Principles and Methodological Considerations 2/3

Stress Test: Methodological Approaches and Granularity



Top-down

- Stress scenarios and impact assessments are developed centrally by supervisory authorities.
- Ensures **methodological consistency**, **comparability** across entities, and **reduced burden** on institutions.
- Authorities retain full control over the process, assumptions, and data sources.
- Particularly suitable when granular data at institution level is limited.



Bottom-up

- Financial institutions independently estimate the impact of ESG stress scenarios on their own portfolios.
- Allows for **higher granularity**, capturing **institution-specific risks** and detailed exposures.
- Encourages **internal risk assessment capabilities** and strengthens ownership of ESG analysis.
- More resource-intensive and may lead to inconsistencies without coordination.



Hybrid

- Combines the **consistency of top-down** with the **granularity of bottom-up** approaches.
- Authorities may define the overarching framework and scenarios, while entities provide detailed input and projections.
- Flexible approach adapted to **data availability**, **modeling capacity**, and **risk typologies**.
- Useful for capturing complex risks (e.g., underwriting, transition) while maintaining oversight.

The level of **granularity** refers to the degree of detail used in assessing ESG risks. A higher level of granularity allows for **more accurate and targeted analyses**.

KEY DIMENSIONS OF GRANULARITY



Portfolio level
(loans, bonds, equities, real estate)

Sectoral level
(energy, agriculture)

Geographical level (region or risk zone)

Counterparty level (obligor or customer group)

Risk category level (Physical risks, Transition risks, Social and governance risks)

Principles and Methodological Considerations 3/3

Stress Test: Balance Sheet, Proportionality, and Model Robustness



Balance Sheet Assumptions

ESG stress tests should begin with a **static balance sheet** to ensure comparability. For **longer-term scenarios**, a **constrained dynamic approach** may be used to reflect credible transition plans, including asset reallocations and risk mitigation actions, if justified and documented.



Entity Selection and Targeting

Authorities should define a **representative sample** of institutions with adequate **sectoral and geographical coverage**. They may also conduct **targeted tests** on subsets of entities exposed to specific ESG risks or vulnerabilities.



Proportionality

Stress test design should be **proportionate** to the size, complexity, and data capacity of each institution. Simplified approaches may apply to smaller entities, balancing **robustness and feasibility** in modelling and reporting.



Model Limitations

ESG models have **inherent uncertainties**. To ensure credibility, results should be supported by **benchmarking, expert judgment, and cross-validation** with alternative methods.

03

Organizational and Governance Configuration

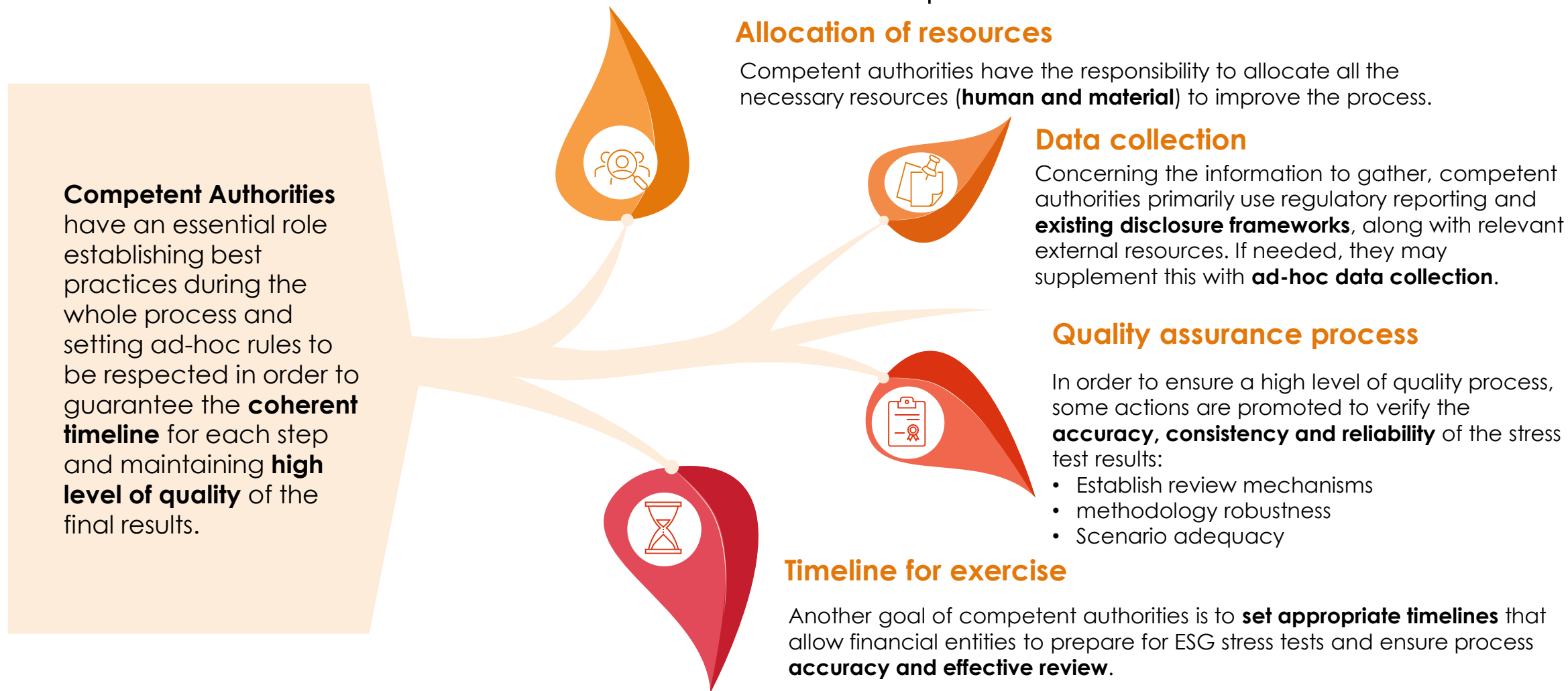
Resource Allocation and Data Infrastructure: Main Aspects

Governance Process and Engagement with Financial Entities: Key Points



Organizational and Governance Configuration 1/2

Resource Allocation and Data Infrastructure: Main Aspects



Organizational and Governance Configuration 2/2

Governance Process and Engagement with Financial Entities: Key Points

During the whole process, a crucial aspect is **the promotion of a solid dialogue** between competent authorities and financial entities in order to make the process more efficient, smooth and transparent. Ongoing engagement will strengthen the credibility of the process and help financial institutions to better on integrating ESG risks into their risk management frameworks.



GOALS

- **Providing clear and comprehensive guidance** on regulatory expectations, methodologies, and deliverables to ensure that financial entities are well-informed and aligned with supervisory objectives.
- **Facilitating structured engagement at key stages of the process**, such as during the design, implementation, and evaluation phases, to promote transparency and mutual understanding.
- **Ensuring that financial institutions have ample opportunities to clarify methodological aspects**, raise concerns and seek feedback, thereby fostering a collaborative environment that enhances the quality and credibility of the overall process.

04

Integration into Supervisory Process and Data Disclosure

Enhancing Coordination and Supervisory Integration
Transparency, Review and Continuous Improvement



Integration into Supervisory Process and Data Disclosure

Enhancing Coordination and Supervisory Integration Transparency, Review and Continuous Improvement



Enhancing coordination and supervisory integration

- Authorities should collaborate across countries to **ensure a consistent approach** to ESG stress testing for international financial groups.
- This involves **working with other regulators** to align methods, exchange best practices, and prevent inconsistent regulation.
- Broader coordination at a system level should also be encouraged to ensure ESG stress tests reflect financial stability concerns and potential cross-sector impacts.
- Once performed the methodology, ESG stress tests results should be included into the supervisory process in order to inform **risk assessments, capital adequacy reviews and strategic discussions with financial entities**.



Transparency, review and continuous improvement

- **Public disclosure** is another crucial aspect to be handled from Competent authorities; the results of the publications have to be transparent and have to guarantee a correct interpretation of the result in order not to generate market distortions.
- As a general rule, the level of disclosure is affected by the quality of the whole methodology and data applied, **the higher the data quality the greater will be the level of disclosure**.
- Once the stress test framework is operative, Competent Authorities have the responsibility to handle the **review and monitoring process** with the aim to improve and refine any aspect of the stress test system.
- A best practice concerns the **update of this framework**, it is essential to incorporate:
 1. tips emerged from previous exercises
 2. new regulatory aspects
 3. new advanced techniques in order to refine methodological aspects.

05

Conclusion and Next Steps

Final Reflections and Future Outlook



Conclusion and Next Steps

Final Reflections and Future Outlook

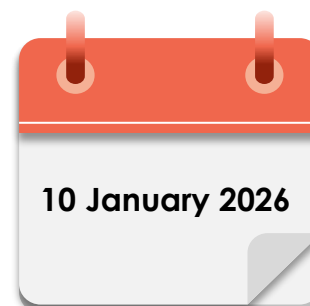
Current framework under **the European Supervisory Authorities** (ESAs) do not offer clear instructions on how national regulators should carry out ESG-related stress tests or scenario analyses to evaluate the resilience of financial institutions. As a result, different authorities may adopt different methods, leading to inconsistencies in how these tests are defined, structured, and integrated into supervisory frameworks.



- **The proposed guidelines** aim to address these gaps, ensuring that both regulators and financial institutions are adequately equipped to handle potential ESG risks.
- **In conclusion**, ESG risks can have a crucial impact on the analyzed framework, hence is essential to deeply understand their relevance and being able to consistently incorporate ESG risks into the supervisory process.



The ESAs have launched a **three-month consultation on the draft Joint Guidelines**. They will be reviewed during the third and fourth quarters of 2025. The final version is expected to be defined by the end of 2025.



Currently, the publication is scheduled by the **Joint Committee** on 10 January 2026.

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Company Profile

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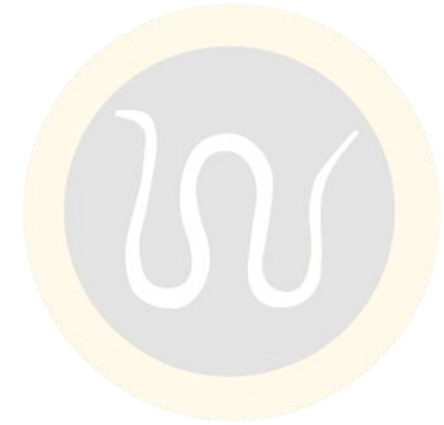
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