



TOPICS:

Market Risk

SOURCE:

[International Swaps and Derivatives Association](#)

ISDA: Climate Risk Scenario Analysis for the Trading Book Phase 4 - NGFS Short-Term Scenarios

- The document sets out ISDA's latest work **to operationalise climate risk scenario analysis for banks' trading books**, building on prior phases and aligning with emerging supervisory expectations. Its primary objective is **to translate** the Network of Central Banks and Supervisors for Greening the Financial System (**NGFS**) **short-term climate scenarios into usable market risk shocks across major asset classes**.
- The paper responds to a key regulatory gap: most existing climate scenarios operate over multi-decade horizons, whereas **trading book risk management requires short-term (three-to-five-year, and ultimately one-year) stress calibration**. ISDA reviews the NGFS short-term scenarios, highlighting their policy credibility and broad macro-financial coverage, while also identifying limitations relevant to trading activities. These include reliance on stylised policy assumptions, limited modelling of market microstructure and investor behaviour, conservative treatment of physical risk tail events, and data constraints such as regional aggregation and annual reporting frequency.
- **Two NGFS scenarios** are selected for detailed application: Sudden Wake-Up Call (SWUC), representing abrupt transition risk driven by delayed but aggressive policy tightening and Disasters and Policy Stagnation (DAPS), representing acute physical risk through sequential extreme weather events. ISDA develops a methodology to front-load multi-year NGFS outputs into 12-month shocks consistent with trading book liquidity horizons, covering equities, credit spreads, rates, inflation breakevens, foreign exchange and commodities.
- The **resulting shocks** indicate pronounced losses for carbon-intensive sectors under the transition scenario, widespread credit spread widening and upward pressure on yield curves driven by inflation and policy rate responses. Physical risk impacts are more heterogeneous, with emerging markets showing greater vulnerability. The paper also benchmarks NGFS scenarios against recent supervisory stress tests, concluding that NGFS paths are relatively mild and back-loaded, requiring adjustment to be decision-useful for trading books.

