



# PRA Update on the Climate Change Stress Test

## Revised approach and disclosure of an indicative list of scenario variables

The PRA published an update on the upcoming Climate Biennial Exploratory Scenario (“CBES”), which will be launched in June 2021. The publication outlines:

1. some revisions to the approach following their initial discussion paper released in 2019
2. an indicative list of variables that will be provided by the PRA

### General updates

- The PRA **confirmed the three climate scenarios**, which have been disclosed in original discussion paper: early policy action; late policy action and no policy action.
- For this exercise, the regulator has decided to **exclude traded risk from the scope of the CBES**. As climate risk scenarios have long duration, their applications on trading book exposures have **limited relevance** because of their **dynamic nature**.
- The diminishing scope from leaving out the traded risk exposures should help **banks to focus on assessing credit risk** on their banking book assets and **insurances** on capturing **impact on their assets and liabilities**.
- With regards to **litigation risk**, the PRA will **explore** this risk by proposing a **quantitative approach for general insurers** focused on exposure assessment and a set of **qualitative questions for banks**.
- The balance sheet cut-off date for the CBES has also been set to the **end of 2020**.

### Tiered counterparty-level analysis

- Based on the discussion paper released in 2019, participants were expected to take a **bottom-up approach** and perform a **counterparty-level assessment** for at least **80%** of their **exposure to corporates**.
- Following the feedback from the participants on the discussion paper, the PRA has disclosed a more **proportionate approach** for the counterparty-level analysis by introducing **minimum expectations on the coverage** required.
- The regulator also introduced a more **flexible tiered approach** and recognize that their initial expectations is too resource-intensive to meet the stress test deadline.
- A **qualitative questionnaire** will be required, where the **number and the proportion of corporate exposures** that could be analysed at a detailed counterparty-level should be **included**.

### Indicative list of variables

- The PRA reaffirmed that stress test participants are required to perform **financial analysis** to their counterparty exposures based on **physical** and **transition risk** variables as key inputs.
- The regulator emphasizes that **macroeconomic modelling will not be sufficient**, and the macroeconomic variables published by the PRA are not expecting to drive material impacts.
- The indicative **list of variables** for the CBES is available in the **appendix** of the PRA’s update document and comprises c.50 macroeconomic variables, c.30 transition variables and 20 physical variables.
- **Not all the variables** that the participants needs for modelling will be published by the PRA and they expect participating firms to **undertake scenario expansion**.

### Implications and next steps

- Participating firms should **review the indicative list of variables** that have been published by the PRA and **provide feedback** on identifying variables that are essential for modelling.
- Although this is **not a requirement** for the upcoming CBES, the PRA would like to introduce the measurement of the participants **portfolio alignment** to a specific climate target.
- The regulator advise the participating firms while conducting their counterparty-level analysis to **assess their counterparties activities** and estimating their **contribution to climate change**.





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