

Newsletter



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EU ESG Stress Testing Guidelines Key Points for Financial Institutions

The **European Supervisory Authorities (EBA, ESMA and EIOPA)** have published final Joint Guidelines on the integration of Environmental, Social and Governance (ESG) risks into supervisory stress testing. The Guidelines apply from 1 January 2027 and aim to ensure consistency and proportionality across EU supervisory practices.

Although formally addressed to competent authorities, the Guidelines have practical implications for **banks, insurers and investment firms subject to EU prudential regulation**.



Scope and Objectives

The Guidelines set common standards for how ESG risks should be incorporated into supervisory stress testing and scenario analysis where such exercises are already conducted under sectoral legislation (**CRD and Solvency II**).

They do not introduce a new obligation to conduct ESG stress tests. Instead, they clarify expectations regarding: methodology, time horizons, governance, and supervisory use of results.

In the initial phase, supervisors are expected to focus primarily on **environmental and climate-related risks**, with a gradual extension to **social and governance factors** as methodologies mature.

Key Elements

Proportionality and Materiality: Supervisors must apply a risk-based and proportionate approach, starting with a materiality assessment that considers business models, portfolios, sectors and geographic exposure. Only material ESG risks should be included in stress testing exercises.



Time Horizons: The Guidelines distinguish between, **short-term stress tests** (up to 5 years), assessing capital and liquidity resilience; and **long-term scenario analysis** (at least 10 years), focusing on business model and strategic resilience.

Scenarios and Methodology: Authorities may use top-down, bottom-up or hybrid approaches, relying on recognised scientific and economic scenarios. Both quantitative and qualitative methods are acceptable, depending on **data availability** and the time **horizon involved**. Model limitations and uncertainty must be acknowledged.

Governance and Data: Competent authorities are expected to ensure adequate **ESG expertise**, data management capabilities and quality assurance processes, as well as ongoing dialogue with supervised institutions.

Supervisory Use and Timeline: ESG stress testing outcomes should, where appropriate, feed into the broader supervisory process, including **risk assessments and strategic discussions**. Any public disclosure of results must align with existing regulatory requirements.

The Guidelines apply from **1 January 2027**. Prior to this, authorities must notify whether they intend to comply. Financial institutions should:

- Review ESG risk identification and materiality processes,
- Assess alignment of existing stress testing frameworks with ESG risks,
- Identify data and modelling gaps, particularly for climate risk, and
- Ensure consistency between transition plans, strategy and risk management.



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