Macroprudential Policy and Climate Change

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Silvia MERLER

Non-Resident Fellow – Bruegel
Head of ESG & Policy Research – Algebris Investments

BANKS AND CLIMATE RISKS

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- **Banks are gatekeepers to the transition due to their role in allocating funding across the economy.**

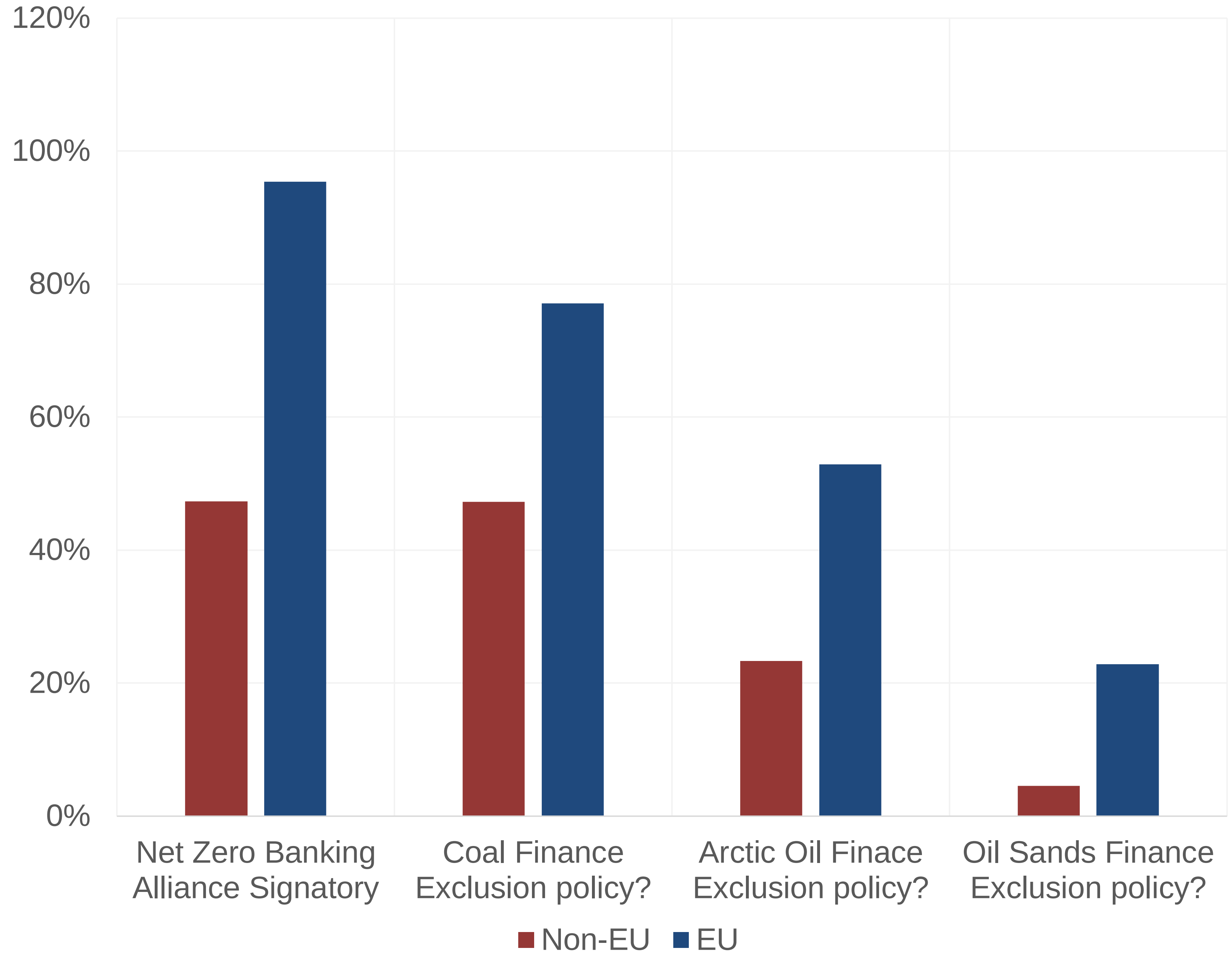
- **Bank loans to firms in high-emitting economic sectors are around 75% more emissions-intensive than shares in economic activity**, and high-emitting households typically comprise 60-80% of total mortgage borrowers in euro area countries. Banks are therefore highly exposed to climate-related risks.

- **Only about 25% of banks report financed emissions in CDP's Climate Change questionnaire.** For those that disclose, financed emissions dwarf operational ones. Banks' carbon footprint has not significantly decreased in recent years, so exposure to climate-related risks remains high.

- ESRB finds that banks' vulnerability towards combined transition and credit risk via their loan portfolios could triple in the event of a pronounced shock.

NET ZERO INITIATIVES: from signalling to policies

As % of total (regional) market capitalization:



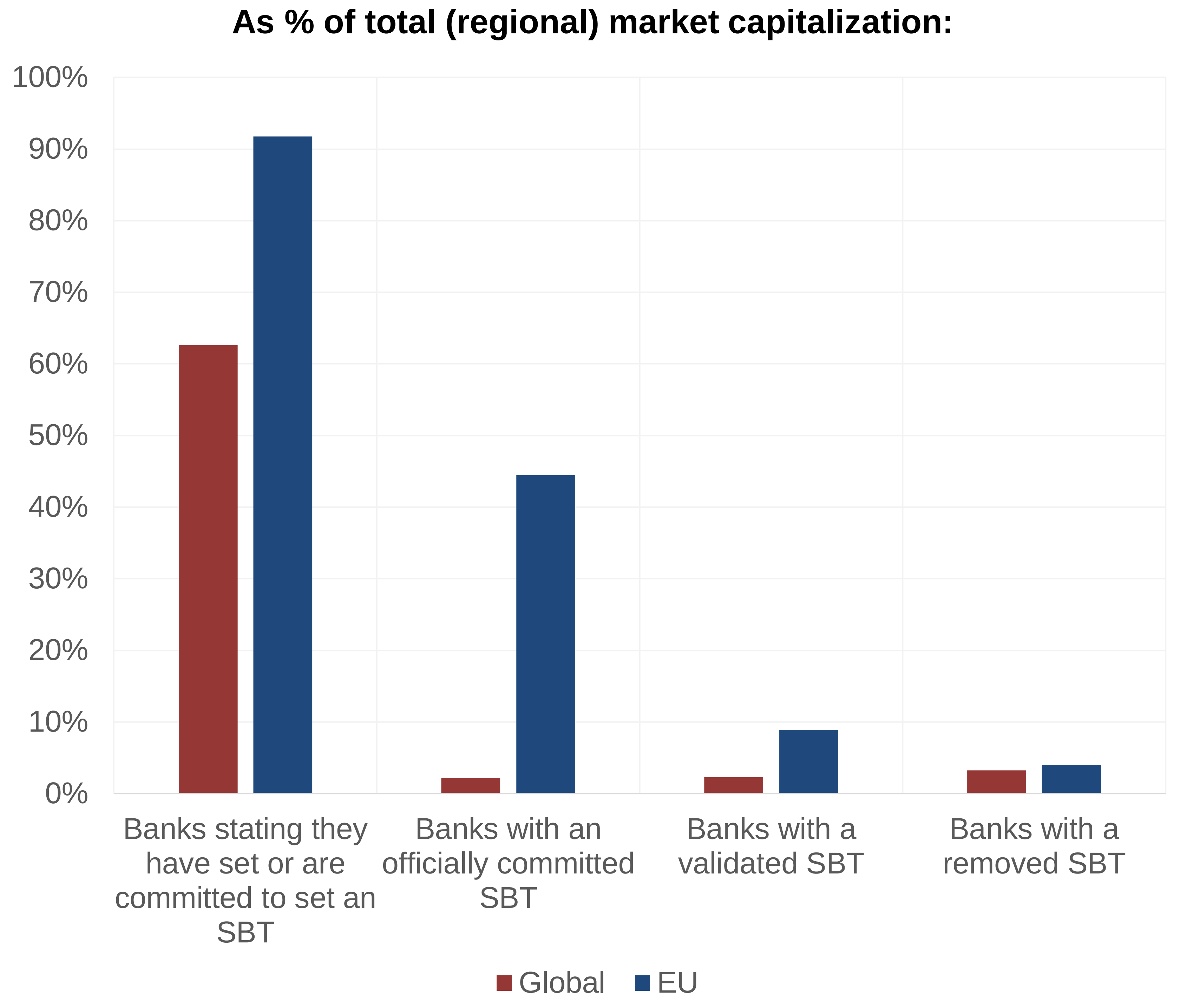
Source: Own calculations based on data from Bloomberg LP; NZAB; NGOs

SAMPLE: 129 banks representing ca. USD 6 trillion in market capitalisation (iShares Global financials +)

Membership in Net-Zero sector initiatives is very high in Europe (95% of mkt cap) but implementation of financing exclusions on high-impact energy sectors is lower. Coal financing exclusions are widespread, other less so.

Membeship rates to Net-Zero initiatives drop outside of the EU, and so does implementation of lending practices.

NET ZERO TARGETS: do banks walk the talk?



Source: Own calculations based on data from Bloomberg LP; SBTI

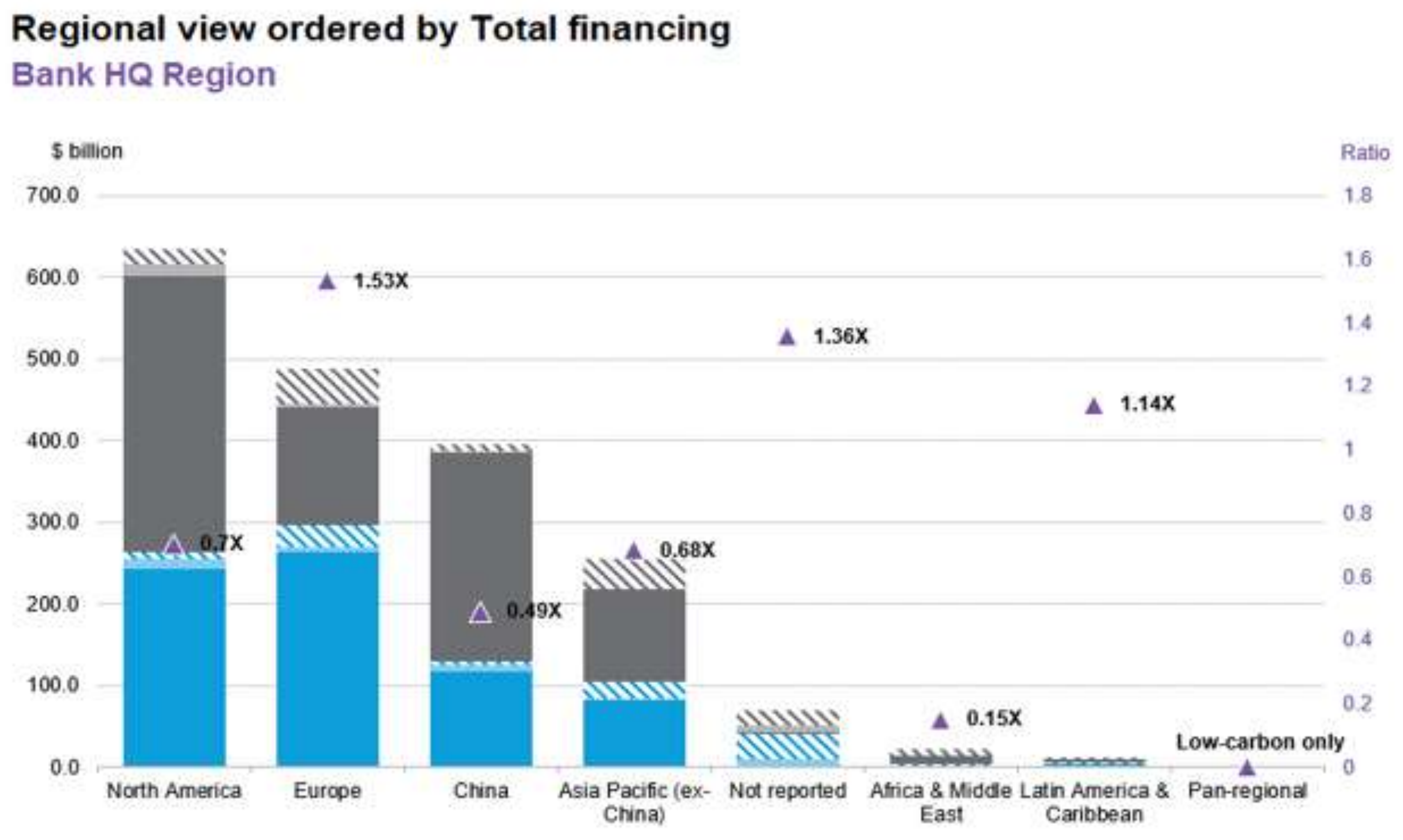
SAMPLE: 129 banks representing ca. USD 6 trillion in market capitalisation (iShares Global financials +)

In the EU sample, more than 90% of the banks explicitly state that they either have set or are committed to set a Science Based Target (SBT) for emission reduction.

But only 44% have formal commitments approved by the SBT Initiatives, and only 2% have validated SBTs.

The gap between talk and action is larger outside the EU.

LENDING: greening loanbooks



Source: Bloomberg BNEF

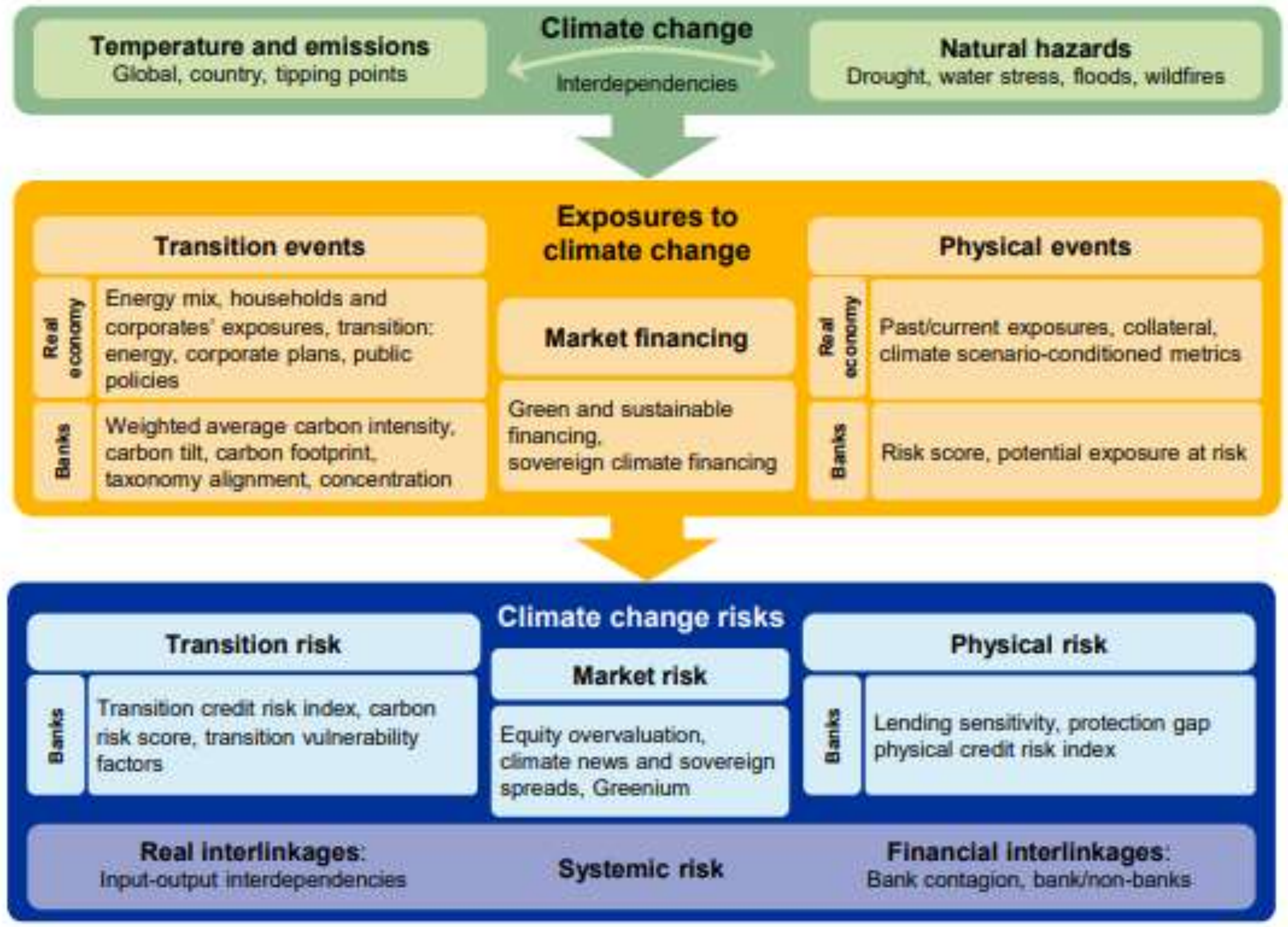
In 2021 banks globally financed 80% as much low-carbon energy supply as fossil supply. For European banks, the figure was higher (153%). Research shows that this proportion will need to rise to 4x or above.

The Green Asset Ratio will offer a more detailed view into the broader sustainability of banks' loan books – a welcome addition to disclosure.

Yet the pace of loan book greening seems slow.

The ESRB framework

Figure 1
Surveillance framework for climate-related financial stability risks



Source: ECB/ESRB Project Team.

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What is the goal?

- **Managing climate-related risks is not necessarily the same as reducing emissions:** in a risk management perspective, it can be optimal for the prudential authority to increase capital requirements on loans that are more likely to be affected by climate change even if this results in lower green lending.
- **Green is not necessarily risk-free:** in an incentive-shifting perspective, it can be optimal to tilt capital requirements in a way that would not be optimal from a prudential perspective (e.g. Brown Penalizing Factor or Green Supporting Factor).
- Strong rationale for macroprudential overlays (eg. systemic buffers, concentration charges) but coordination of macro and micro prudential is essential to maintain level playing field.

Thank you!

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