CLIMATE TRANSACTION METRICS, FRAMEWORKS AND MARKET PRODUCTS

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SUMMARY

- Climate transition framworks used to assess climate transition risks and opportunities and payways to net zero
- Variety of approaches across the globe (let a thousand flowers bloom)
- Central banks/regulators can use frameworks for:
  - Reserve management
  - Assess efficiency of monetary policy transmission
  - Assess financial stability risks

OVERVIEW OF MY COMMENTS

- How to assess?
- Who assesses?
- What are the consequences?
- What role for central banks and regulators?
- What incentives for central banks and regulators?

HOW TO ASSESS?

- What is the objective?
  - Low correlation between ESG and carbon-intensity
- Uncertainty about data – backward vs. forward-looking
  - High degree of uncertainty – consider different scenarios
  - Micro- and macro-risks – whatever a company commits to can be useless if no one else does anything
- Which framework?
  - Standardisation needed? Or competition?
  - How reliable? Dynamic?
  - Need for transparency
- Assess activity or issuer?
  - Avoid greenwashing – NIMBY effects

WHO ASSESSES?

- ESG Ratings - what is the benchmark
  - Compare to credit ratings – default probability (with a big confidence interval)
  - Sustainability ratings – shifting benchmark
- Conflict of interest – rating and consulting
- Who monitors the rating agencies?
  - Transparency and market discipline sufficient?
- Duty to rotate rating agencies?

WHAT ARE THE CONSEQUENCES?

- Shareholder engagement critical to influence corporate behaviour
- Creditors? Banks?
- Do markets price in transition risk?
- Long chain from corporations to fund/bank to investor/depositor?

DO BANKS HAVE THE RIGHT INCENTIVES TO SHIFT?

- Beyene et al. (2021)
- Bonds of fossil fuel firms are issued at a higher yield relative to their non-fossil fuel counterparts while no such relative discount can be detected for syndicated bank loans of the same fossil fuel firms
- Fossil fuel firms substitute from corporate bonds to syndicated bank loans in response to changing climate policy exposure
- Why are banks reluctant to support green transition:
  - Entry of innovative and green firms in polluting industries risks devaluating legacy positions held with incumbent clients; the more homogeneous and concentrated the banking system is in a given industry, the fewer new innovative firms will be granted loanable funds (Degryse et al., 2021)

ADOPTING REGULATION TO A NEW OBJECTIVE?

- Green capital requirements? Penalising brown and supporting factors can address prudential risks, but are less effective in addressing externalities (Oehmke and Opp, 2021)
- Concern: Tinbergen rule – one policy objective per instrument
- Better rules: taxation, carbon pricing (to force internalisation of climate risks/externalities)
- Important: climate risk stress testing for prudential purposes

WHAT ROLE FOR CENTRAL BANKS AND REGULATORS?

- Central banks as market participant – reserve management
- Monetary policy transmission – central banks have to adjust structure of economy to maintain efficient transmission process
- Bank supervision – minimise risk of bank failures
  - Focus on both physical and transition risks
  - ‘Green’ swan as problem
- Go beyond their price/financial stability mandates?

WHAT INCENTIVES FOR CENTRAL BANKS AND REGULATORS?

- From ‘not-on-my-watch’ to ‘tragedy of horizon’ (Carney)
- Trade-off between climate and financial stabiliy (imagine green boom-bust cycle)
- Do central banks take actions of other policy areas as given or do they Contribute to Coordination to Combat Climate Change?

THANK YOU

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