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Discussion

Banks and environmental sustainability: Some financial stability reflections

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Info

- Any views expressed are solely those of author(s) and so cannot be taken to represent those of the Bank of England or to state Bank of England policy.

Summary

- Between research and policy
- High-level description of how the transition to a low carbon economy could impact banks
- Analysis of the exposure of banks to high environmental risk sectors via their loan book
- Policy proposals to preserve financial stability

Scenarios

- Smooth transition: banks are broadly fine
- Abrupt transition, three channels impact banks:
 - GDP growth
 - Direct exposure to stranded assets
 - Second round effects via indirect exposures

- Scenarios are not quantitative. Weyzig et al (2014) finds that a slower transition has a higher impact than a bubble shock.

Direct exposure

- Coverage: US, EU, Japan, China, and Switzerland (end of 2014)
- Total exposures are estimated for each geographical area (and by lending instrument):
 - US: \$505bn
 - EU: \$700bn
 - Japan: \$300bn
 - China: \$70bn
 - Switzerland: \$59bn
- **Caveat: Total exposures are extrapolated from the exposures of the top 10 banks.**

Policy actions

- Short term:
 - Framework to overcome the shortcomings of the current classification
 - Supervisory reporting
 - Medium term:
 - Carbon stress test
 - Environmental aspects in regulation
- There is no real quantitative basis for the recommended policy actions.



Similar studies

- Weyzig et al (2014):
 - Only EU, end of 2012
 - Loans, bonds, and equities
 - Banks, pension funds, and insurance companies
 - Three scenarios that lead to estimated losses
 - No material risk of systemic risk
- Battiston et al (2016):
 - Mostly equities
 - EU and US, end of 2014
 - Banks, governments, non-financial, funds, etc.
 - Focus on second round effect: potential systemic risk

Suggestions

- Compare the analysis of exposures with other available studies.
- Explain the role of exposures, are they upper bounds to losses in the worst case scenario?
- More work: have quantitative scenarios and (even coarse) estimates for losses.
- Make the recommended policy action more streamlined and possibly more quantitative.

