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

  - 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.