Zooming out: The impact of the Green Supporting Factor and its 'cousins'

Jakob Thomä, Managing Director

DATA SOURCES

Thomä et al. (2019) “Quantifying the potential impact of a green supporting factor or brown penalty on European banks and lending” *Journal of Financial Regulation and Compliance*

Thomä et al. (2019) “Sustainability Improvement Loans: A risk-based approach to changing capital requirements to favour sustainability outcomes” *2° Investing Initiative / Oxford University Smith School Joint Working Paper*

DATA SOURCES

		Green share (in %)		Brown share (in %)		
Type of instrument	Total (in billion €)	Baseline	Potential	Baseline	Potential	Risk-Weight (in %)
Loans financial corporations	1,047	0	0	0	0	20
Loans non-financial corporations (large)	2,848	0	2	5	10	100
Loans non-financial corporations (SMEs)	1,500	0	0	0	0	100
Consumer credit	654	5	5	30	30	100
Loans - house purchase	4,220	10	10	5	5	50
Other loans - household	723	0	0	0	0	100
Loans government	1,016	0	0	0	0	100
Loans non-euro area residents	2,898	0	0	0	0	100
Equity funds	1,532	0	2	5	10	300
Government debt securities	1,505	0	0	0	0	20
MFI debt securities	970	0	0	0	0	20
Debt securities - non-euro area residents	2,151	0	2	5	10	100
Total	21,064					

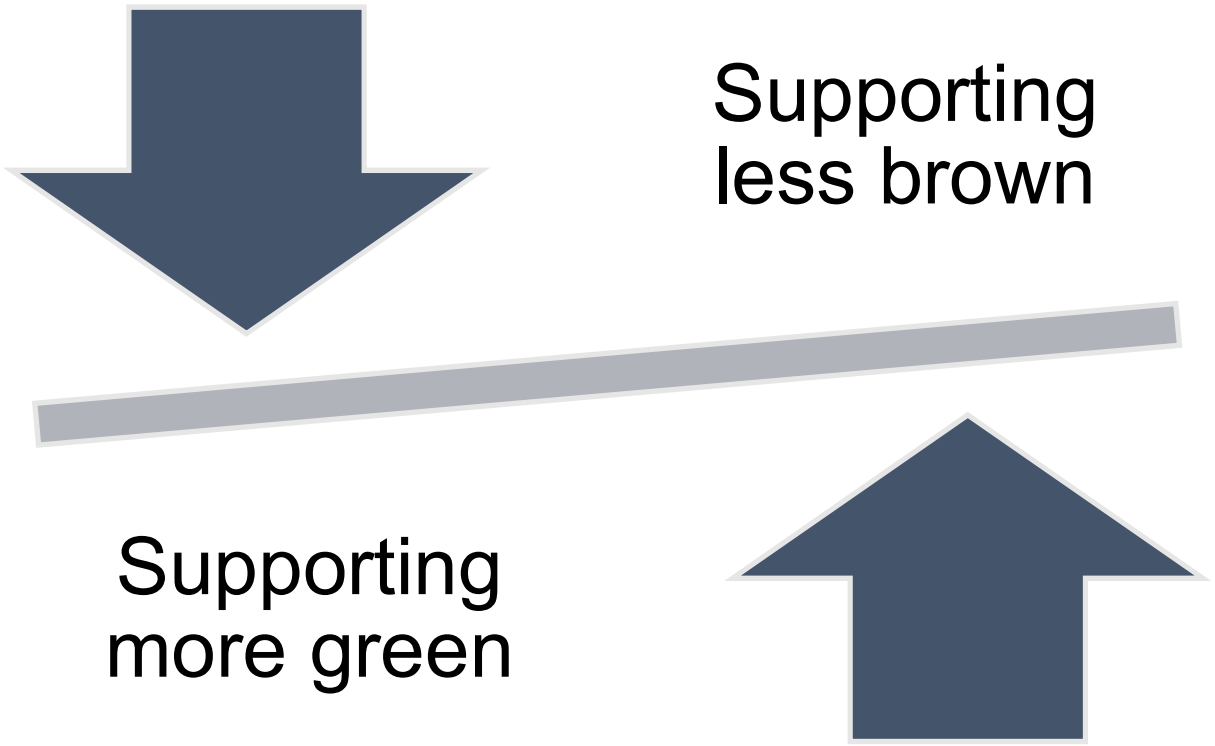
1. Combination of macro banking statistics & bottom-up green / brown share estimates

DATA SOURCES

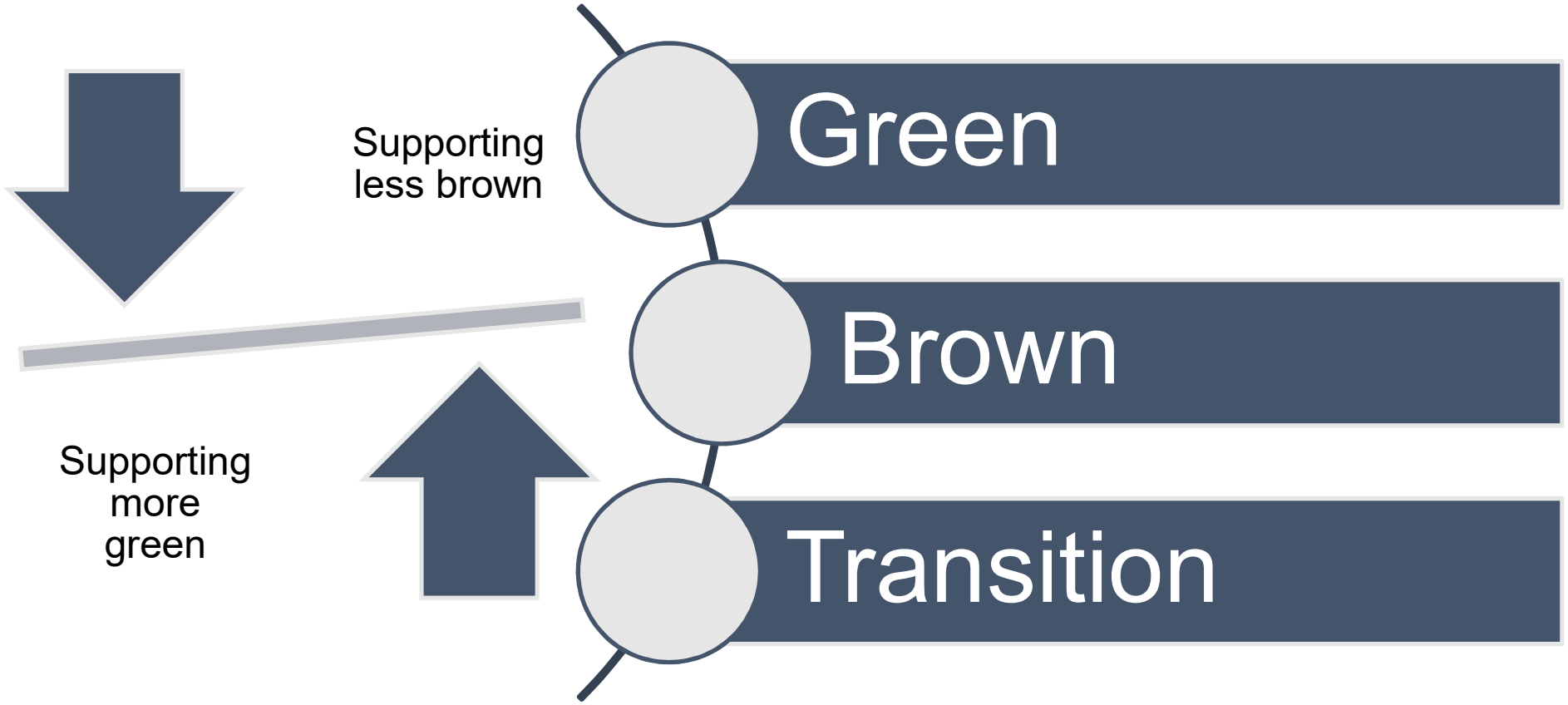
Study	Baker, M. and Wurgler, J. (2013)	BCBS (2010)	Kashyap, A. *et al.* (2010)	King, M.R. (2010)	Slovik, P. and Cournède, B. (2011)
Effect on lending rates (measured in basis points)	6-9	13	2.5-4.5	15	14.4
Modigliani and Miller assumption holds	Yes	No	Yes	No	No

2. Historical empirical analysis on capital requirement interventions

POLICY OPTIONS



POLICY OPTIONS



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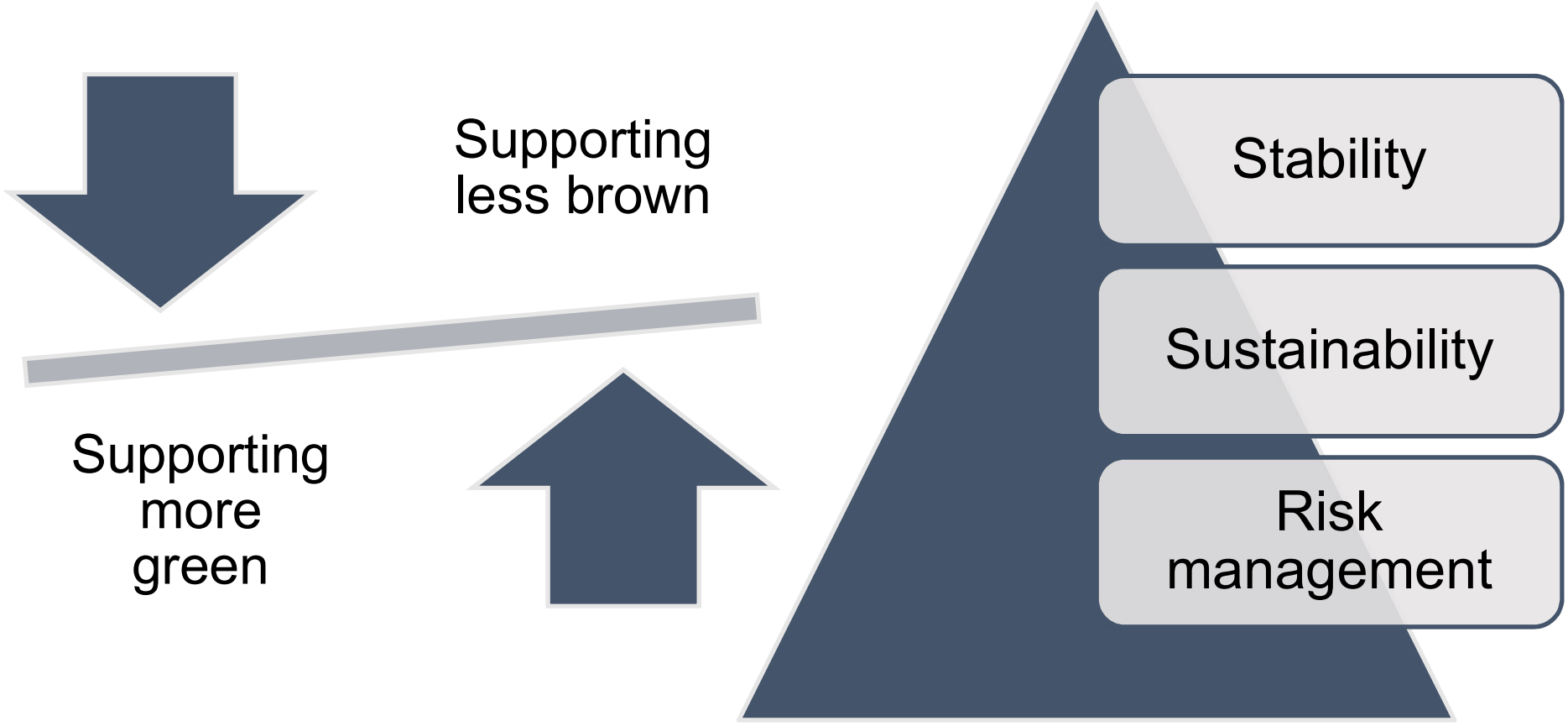
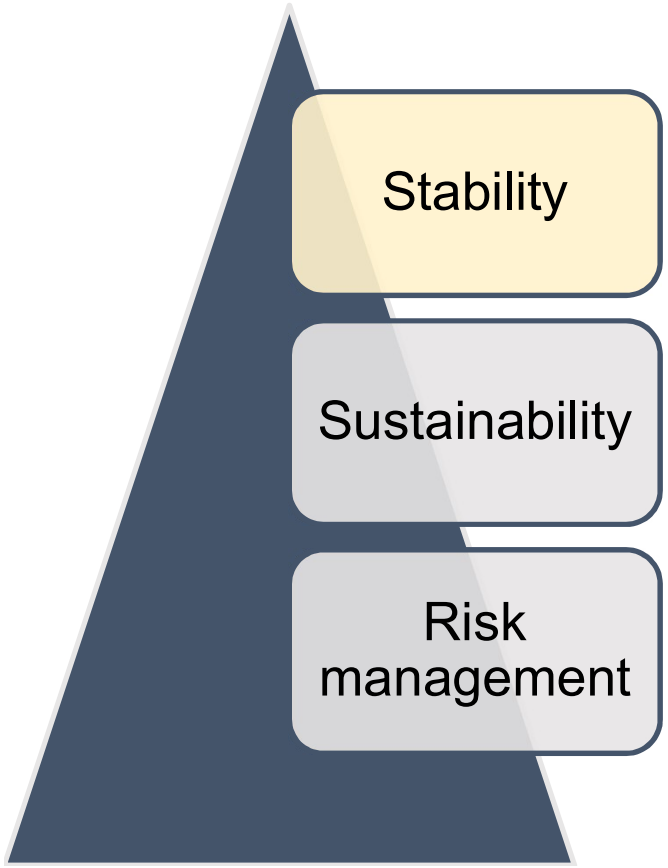
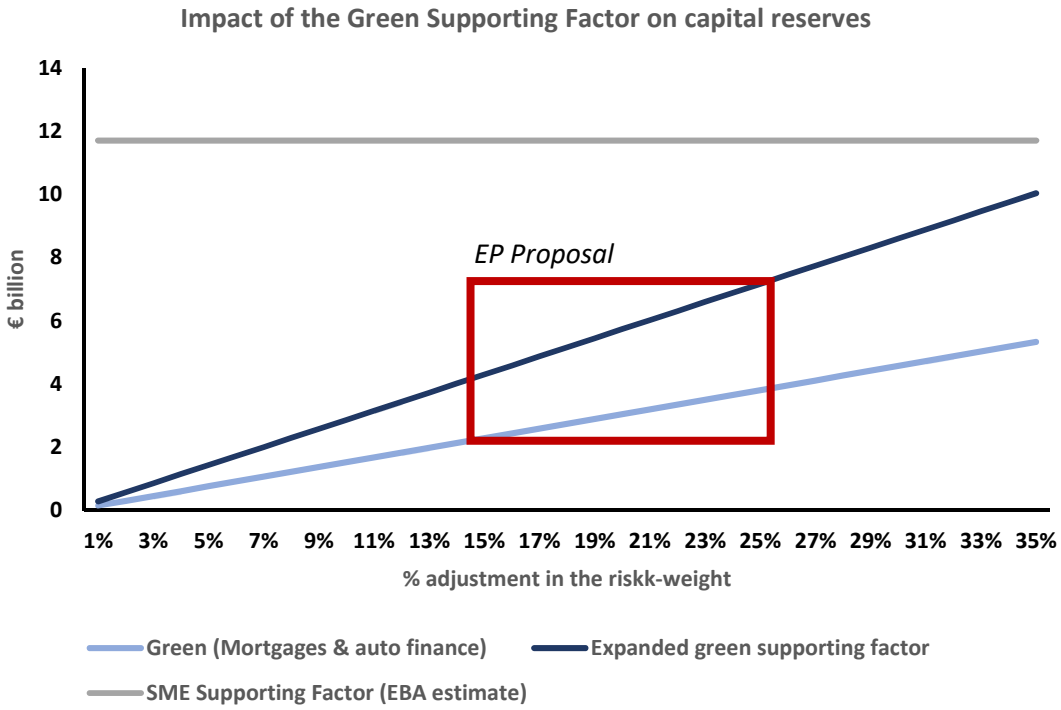


POLICY OPTIONS

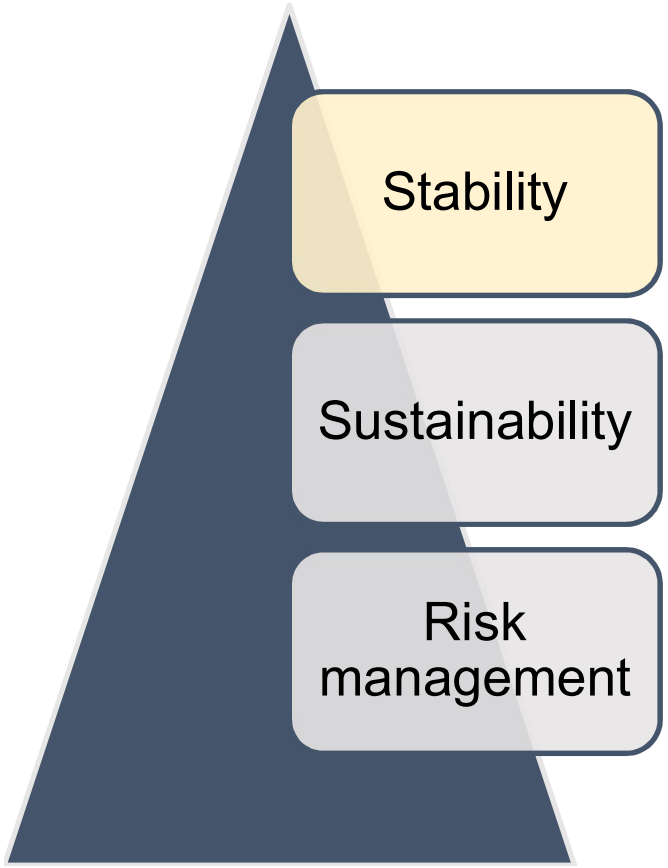
- Green Supporting Factor
- Brown Penalty
- Sustainable Improvement Factor

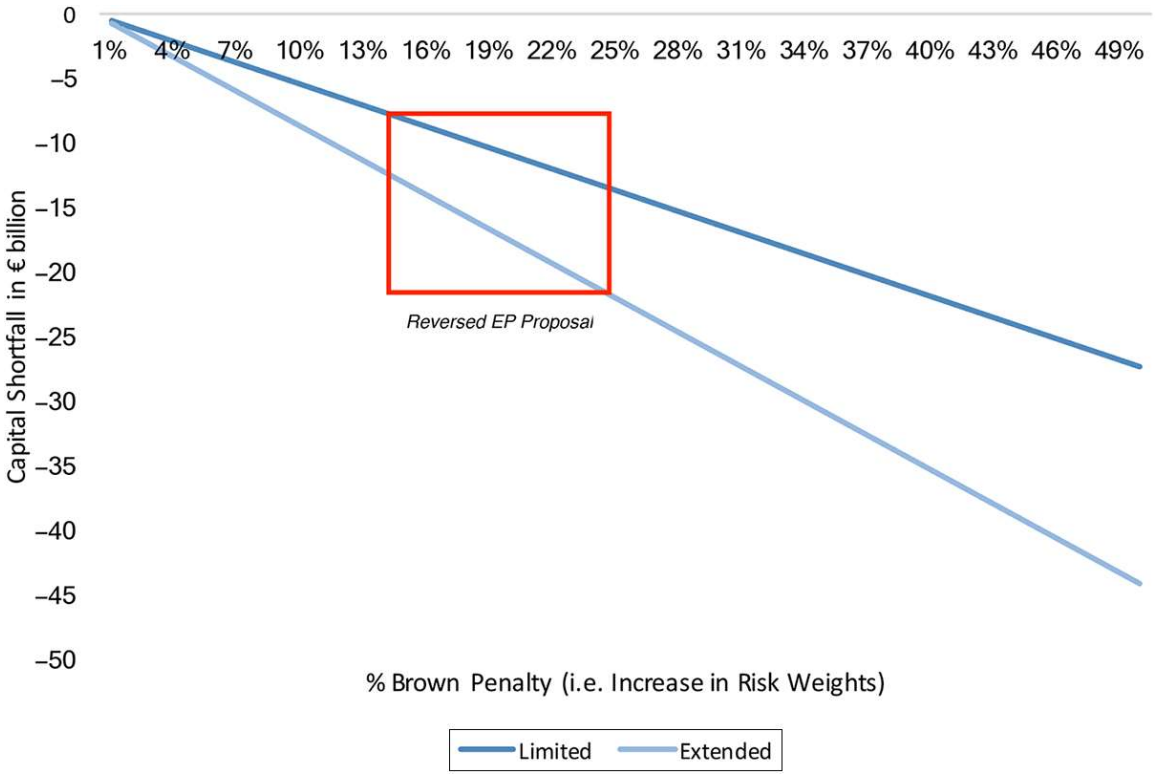
IMPACT OF GSF ON COST OF CAPITAL





IMPACT OF GSF ON FINANCIAL STABILITY





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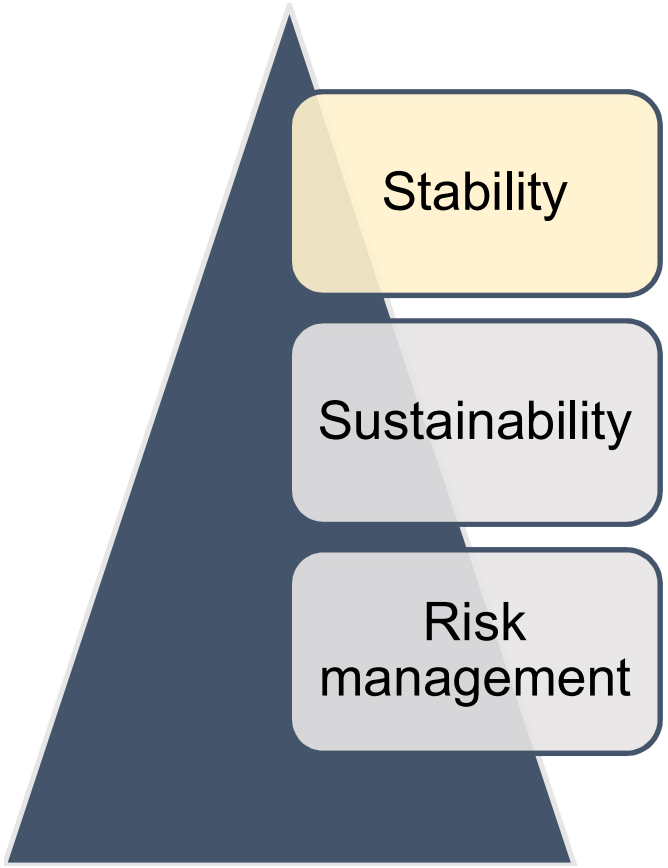


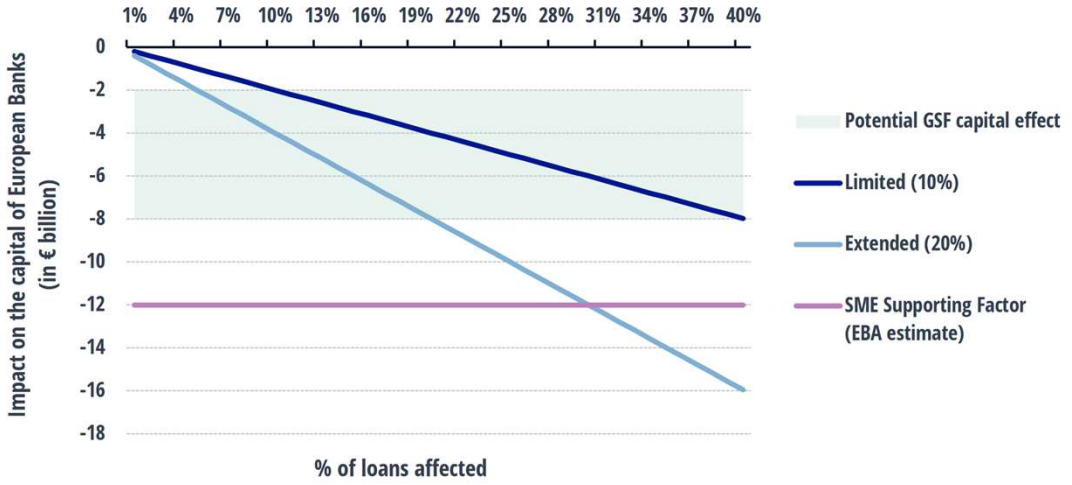
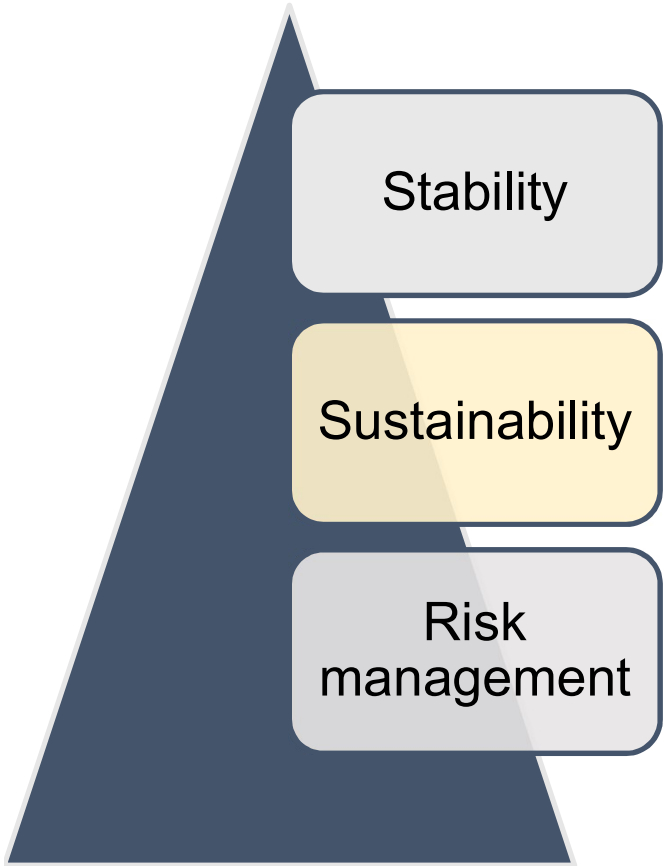
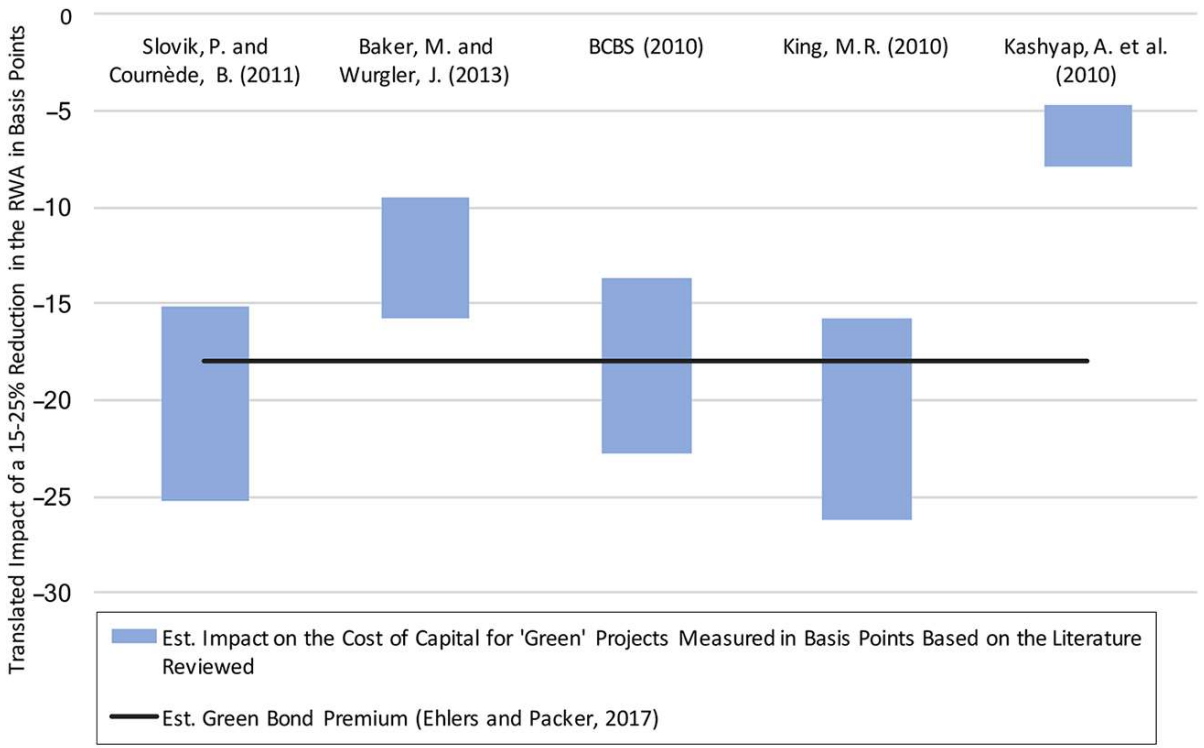


Figure 3. Impact of limited and extended SI capital adjustments on the capital of European banks (Source: Authors, based on ECB, EBA, Thomä et al. 2018, and own calculations)

IMPACT OF GSF ON SUSTAINABILITY





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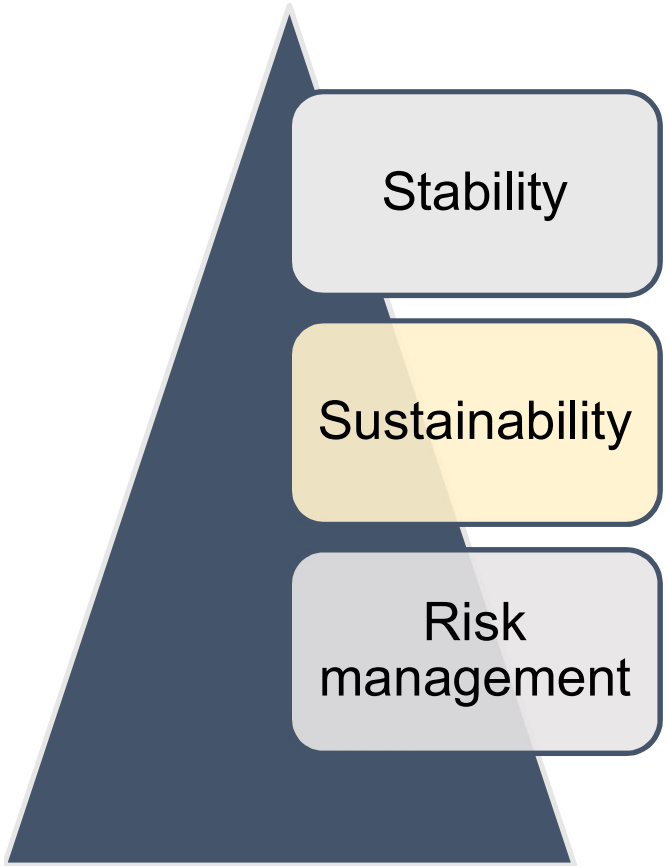

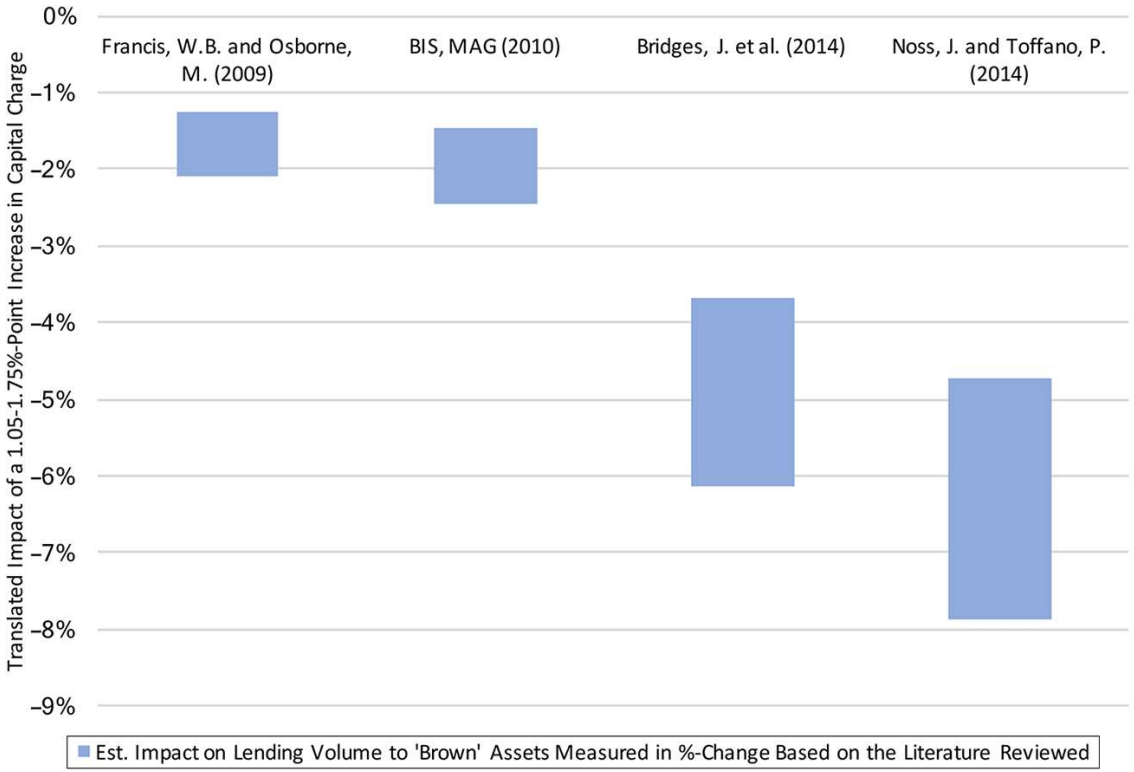

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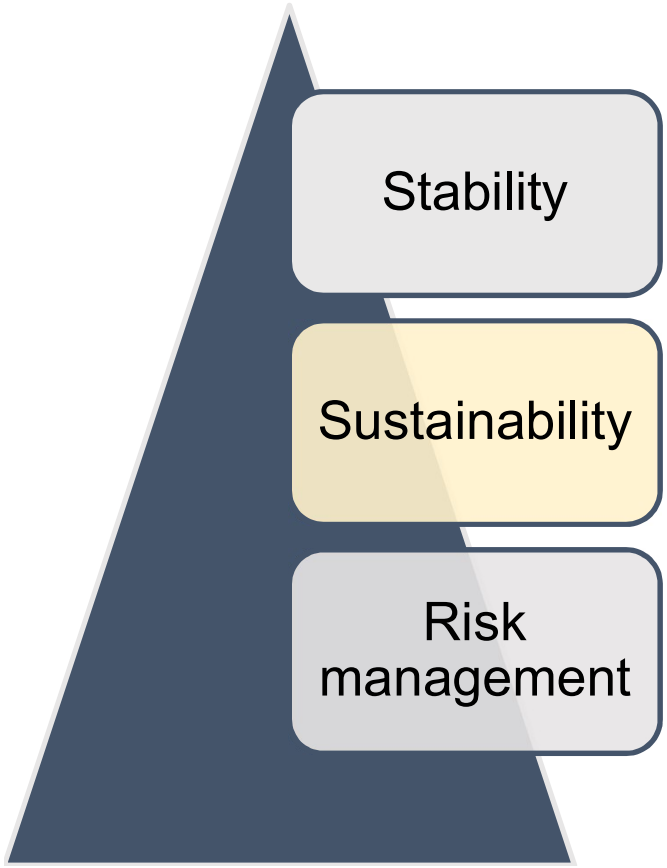


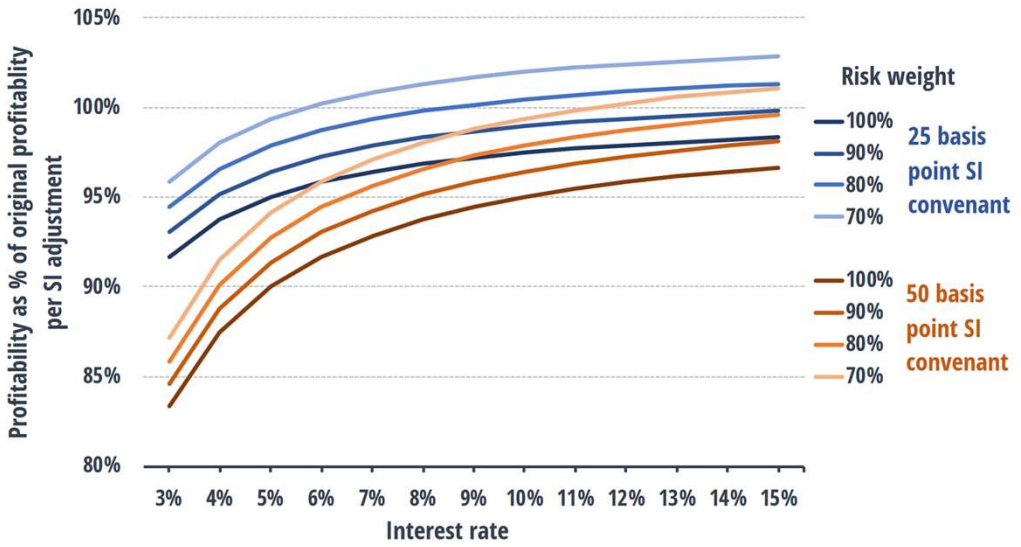
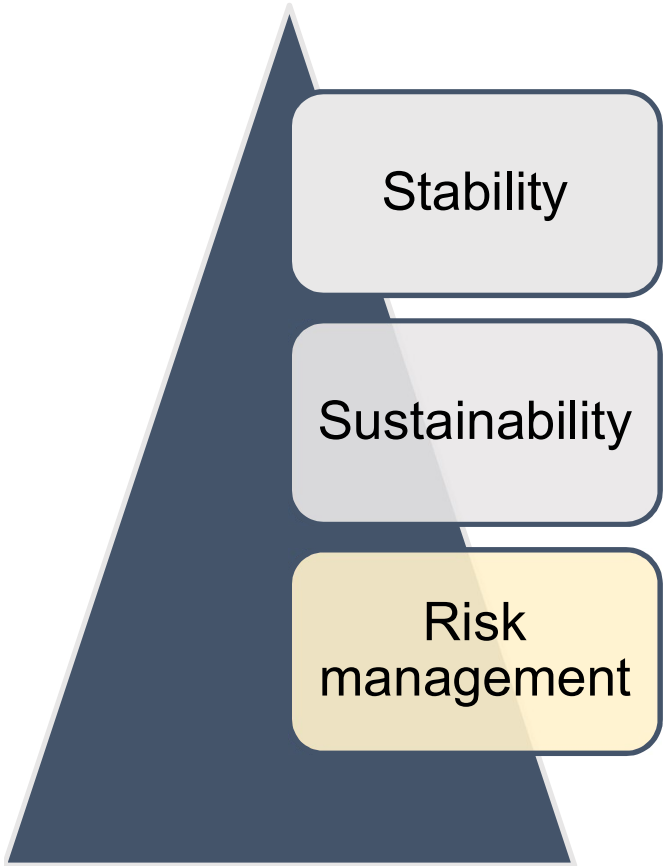


Figure 2. Impact of a SI capital adjustment on profitability at different interest rates, assuming a 25-basis point SI covenant (Source: Authors)

IMPACT OF GSF ON RISK MANAGEMENT



- **We know** that backward-looking analysis of green / brown differentials don't make sense and risk being misleading.
- **We know** that forward-looking analysis of green / brown analysis is technically possible, but politically difficult for the ESAs to conduct, given the need to make assumptions about future performance.

3 options:

1. Make a **political** decision.
2. Support **management** rather than environmental perforamnce.
3. Focus on **concentration** risk.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