From climate consciousness to climate action: leveraging the ECB's new strategy

On July 8th 2021, the ECB released its eagerly-awaited new strategy.

As ECB leaders have indicated before its publication, climate change is one of the major features of this strategy, with a roadmap dedicated to related actions. This is a turning point: putting an end to decades of blindness to environmental concerns, the central bank will strive to consider the climate threat and commits to "more systematically reflect environmental sustainability considerations in its monetary policy". Confirming ECB board members' statements, the ECB acknowledges that climate integration is required by both its primary and secondary mandates.

The conversion of the conservative ECB and its nineteen national central banks to climate consciousness is yet another sign that no financial institution can continue to ignore climate change and that all central banks have a duty to swiftly address it.

However, 31 years after the first IPCC report on climate change and six years after COP21, **the ECB is already behind schedule when it comes to addressing climate change**. The strength of its new commitment should be measured by the actions it implies and their implementation timeline.

Unfortunately, here **the bank's roadmap falls short in several instances, with major gaps and uncertainties and a slow implementation timeline**[1]. Changes to the ECB's climate roadmap are necessary to both truly fulfill its mandate and address the climate emergency.

1) Working for (and not against) EU objectives

Researchers, civil society organizations, citizens – and later ECB board member Isabel Schnabel herself – highlighted the need to align ECB operations with EU climate objectives and with the Paris Agreement.

In this regard, introducing climate criteria into both the ECB's corporate asset purchases and collateral framework has been identified as a key measure to mitigate the bank's climate impact. **While the bank plans to adjust the allocation of its corporate purchases using climate-related criteria,**[2] **it does not plan to do so for its collateral framework.**[3]

Furthermore, **the wording used by the bank for the adjustment of its purchases is worryingly imprecise and could allow it to continue supporting companies that are clearly obstructing the green transition – such as companies that develop fossil fuels.**[4] The bank does not say if its new criteria will be used to define the eligibility of the bonds, nor give a definition for "alignment with EU legislation implementing the Paris agreement". The fact that it could also rely simply on "commitments of the issuers" is highly problematic as these commitments are no substitute for real-world progress.

Apart from decarbonizing its asset purchases and collateral framework, the ECB could use its monetary tools to contribute more directly to EU objectives. **The bank could notably use its refinancing operations to support energy efficiency in Europe**[5]. Targeted long-term refinancing operations (TLTRO) have been a key feature of the expansionary phases of the ECB's monetary policy before and during the Covid-19 crisis but - while already "targeted" - have ignored the need for a green transition and recovery. Such a proactive use should follow from its secondary mandate[6] but the ECB does not consider any measure that would directly support European environmental policies.

Furthermore, as recent court cases have showed, inadequate action by public entities on climate change can violate their obligations to safeguard human rights and fundamental freedoms. **The ECB being an addressee of the European Charter of Fundamental Rights, it could soon face legal challenges for its failure to contribute to climate action at the European level and its continued support to polluting companies**.

Recommendation: immediately cut support to companies at odds with the EU GHG reduction targets and Paris Agreement and strive to support EU objectives by:

- **Aligning the collateral framework with EU climate objectives and the Paris Agreement;**
- **Adjusting corporate asset purchases using a dual exclusion and tilting approach[7], notably excluding companies at odds with the green transition – in particular companies that develop fossil fuels;[8]**
- **Using refinancing operations to contribute to EU climate objectives, for example building energy efficiency.[9]**

2) No time to "take your time"

The ECB's climate roadmap is characterized by a slow implementation timeline that disregards the fact that most EU greenhouse gases (GHG) reduction should be achieved by 2030[10] and that – as the IPCC recently stressed[11] – failure to mitigate climate change will have a catastrophic effect on our societies and economies. **The envisioned measures will be prepared in 2021 and 2022 and will not be implemented before 2023**. **For corporate asset purchases, this means that the ECB will continue to support highly polluting companies for at least a year and a half**.

While the ECB's climate roadmap focuses on climate risk integration, these measures will not have concrete effects before 2023-2024. An important climate risk measure – integration into its own ratings – is also yet to be confirmed by the ECB.[12]

Furthermore, climate risk integration relies on new metrics and climate risk measurements that are uncertain and will always remain incomplete. These metrics require progress at the EU and company level. Climate risks are also characterized by a radical uncertainty that makes it hardly impossible to accurately evaluate and model and warrants a precautionary approach that centers climate mitigation as a means to mitigate the related risks. The Network of Central Banks and Supervisors for Greening the Financial System (NGFS)[13] and ECB's Executive Board member Frank Elderson[14] emphasized that **central banks should act now based on the information already available**, instead of waiting for hypothetical financial metrics. For climate risks, this notably **requires targeting highly risky activities leading to "stranded assets - such as fossil fuel exploration and production.**[15]

The ECB's pledge to start disclosing climate-related information on its corporate sector purchase program (CSPP) in 2023 is emblematic of the bank's "take your time" approach. This information would have been especially relevant to the strategy review process and is already published by the Bank of England.[16]

Recommendation: act now based on the information available to mitigate climate-related risks, take precautionary measures before detailed solutions are put in place and address the climate emergency by:

- **Accelerating the overall implementation timeline;**
- **Immediately excluding fossil fuel companies that do not align with the Paris Agreement[17] – notably companies developing fossil fuel projects[4] - from corporate asset purchases while waiting for the ECB's decarbonization approach to be ready;**
- **Adopting and championing a precautionary approach to climate risks and adapting all operations as soon as possible to reflect the asset stranding risk;**
- **Confirming the integration of climate risk metrics into the ECB's own ratings.**

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[1] The details of the ECB's new climate approach are analyzed in Reclaim Finance's press release published on July 8th. 350.org's press release provides information on the general mobilization around the ECB's strategy review.

[2] The ECB pledged to adjust the allocation of corporate bond purchases to incorporate climate change criteria, notably "the alignment of issuers with EU legislation implementing the Paris agreement" or "commitments of the issuers to such goals". It will develop a proposal by mid-2022 and implement it by 2023. See the ECB's press release.

[3] The necessity of greening the ECB's collateral framework has notably been highlighted in a report by Yannis Dafermos et al, "Greening the Eurosystem collateral framework". The report finds that carbon-intensive companies issue 59% of the corporate bonds that the ECB accepts as collateral. It highlights that the average haircut in non-carbon intensive sectors (13.93%) is demonstrably higher than carbon-intensive sectors, including fossil fuel companies (13.33%), energy-intensive companies (11.03%), non-renewable utilities (13.36%) and companies that engage in carbon intensive transportation (10.27%).

[4] Developing new fossil fuel projects is clearly incompatible with the transition, as the consumption of currently exploited reserves would push us far beyond 2°C warming. The UN production gap report underlined the need to reduce global fossil fuel production by 6% a year from 2020 to 2030. The IEA itself underline that no new investments should be made in fossil fuel reserves.

[5] The use of "green" targeted long term refinancing operations (TLTRO) has been proposed by several civil society organizations including Positive Money Europe. The ECB could notably start with a pilot program for housing energy

efficiency. The Bank of Japan recently announced the equivalent of a green TLTRO program, with zero-interest loans to lenders that finance climate change projects.

[6] ECB board member Franck Elderson clearly emphasized the ECB's secondary mandate was not optional.
[7] Such an approach has notably been adopted by the Bank of England. The report Decarbonizing is easy by Yannis Dafermos et al also lays out a proposal for tilting ECB's purchases.

[8] Reports from Reclaim Finance identify the ECB's support to fossil fuel companies through corporate asset purchases, notably support to companies developing new gas projects.

[9] Positive Money Europe proposes the use of "green" TLTRO to accelerate building renovation in Europe.

[10] The EU agreed on a 55% GHG reduction cut by 2030. The reduction should be higher according to climate science.

[11] A leaked version of the coming IPCC report warns about the drastic effects of global warming.

[12] The ECB only pledged to consider developing minimum standards for the incorporation of these risks into its own ratings.

[13] See the NGFS' report.

[14] See Frank Elderson's speech.

[15] See the report by Reclaim Finance and al, *Fossil fuel: the new subprimes? How funding the climate crisis can lead to a financial crisis* and Finance Watch's report *Breaking the climate finance doom loop*.

[16] See Bank of England's climate disclosure.

[17] Any fossil fuel company that develops fossil fuel projects is not aligned with the Paris Agreement. Furthermore, companies that are massively involved in the most polluting fossil fuels or that adopt no plans to progressively phase out their fossil fuel production are not aligned. Companies with high exposure to coal can notably be identified thanks to the Global Coal Exit List.