COLLATERAL DAMAGE:

Ending the ECB's support to fossil fuel companies

RECLAIM Finance

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EXECUTIVE SUMMARY

The European Central Bank (ECB) and the Eurosystem central banks that sit in its governing council play an essential role in ensuring companies have access to liquidity via lending and that inflation is kept in check. Notably, they do this by providing loans to banks in exchange for the deposit of guarantees, called collateral. But the current Eurosystem collateral framework (ESCF) used to identify which assets can be used as collateral and under which conditions drives the ECB to support fossil fuel companies. Our research shows how this support manifests, and highlights the necessity and feasibility of both excluding the assets of some fossil fuel companies from the collateral pool and applying higher discount rates (or *haircuts*) to the value of those that remain eligible.

Between July and September 2023, and November 2023 and January 2024, the Eurosystem allowed assets from 34 fossil fuel companies to be eligible for collateral. Most of the companies listed (32 of the 34) were involved in the oil and gas industry, while ten were active in the coal industry. These companies are not transitioning their energy supplies. On the contrary, most are still massively expanding their fossil fuel infrastructure and production. Indeed, assets from major oil and gas developers, including Shell, TotalEnergies, BP, Equinor, Eni and Respol, are eligible for collateral by the ECB. Even assets from Glencore, the fourth largest global thermal coal mining developer, with eight mining projects and extensions,[1] have been accepted.

Continuous support to these companies means the Eurosystem collateral framework is at odds with the ECB's own calls for an accelerated and orderly transition.[2] Furthermore, it incentivizes banks to increase or maintain support to companies in a way that is not coherent with its expectations for the management of climate-related risks.[3,4]

And, while in 2024 the ECB plans to introduce a maximum amount of "high-emitting companies" that banks can use as collateral, this is unlikely to have a significant impact on the way fossil fuel companies are treated:

- Firstly, the limit will not apply to financial corporations owned by fossil fuel companies, i.e. financial subsidiaries. Therefore, throughout the six-month period studied, the limit would not have affected Repsol, BP, Glencore or Shell, the eligible assets of which were all issued by financial subsidiaries.
- Secondly, by allowing fossil fuel company assets to remain eligible, the ECB continues to support the associated destructive and risky activities, as plain eligibility eases financing in the rest of the financial system.[5] This is all the more true given that fossil fuel assets represent only a small share of eligible assets and are unlikely to be affected by a limit on high-emitting companies. Fortunately, the relatively limited role of fossil fuel assets in the collateral framework and the abundance of other eligible assets also means fossil fuel exclusions can be introduced without affecting the efficiency of monetary policy.

Beyond eligibility, our study shows how the rules defining the way collateral assets are valued do not account for the environmental damage caused by fossil fuel company activities or for the associated financial risks. Indeed, fossil fuel assets are not systematically considered riskier than other eligible assets and can even benefit from especially low haircuts. This conclusion even holds for assets issued by companies developing new oil and gas fields, with some of the assets of Eni and TotalEnergies receiving haircuts as low as 1%.

To end its support to fossil fuel companies, the ECB should revise the Eurosystem collateral framework and introduce an exclusion of fossil fuel companies, starting with companies developing new oil and gas fields and/or coal mines. In addition, the ECB should adjust its haircuts to reflect the environmental damage and financial risks associated with fossil fuel activities for any remaining fossil fuel assets in its collateral pool.

METHODOLOGY

Timeframe of the research

The research focuses on the lists of eligible marketable assets for collateral published every working day by the European Central Bank.[6] The lists used are from two three-month periods:

1. July to September 2023, which directly follows the update of the risk control framework.[7] Analysis before then may not have reflected the current framework.
2. November 2023 to January 2024, which is the most recent period at the time of the start of this research.

Studying two different periods strengthens our results and makes them more likely to reflect general trends related to the Eurosystem collateral framework.

For the analysis on haircuts, the research focuses on January 2024, which the researchers believe to be representative of the entire sample.

Company scope of the research

The analysis defines fossil fuel companies as those listed in the 2023 Global Coal Exit List (GCEL) and the 2023 Global Oil and Gas Exit List (GOGEL) developed by the German non-governmental organization Urgewald.

The GCEL identifies companies along the thermal coal value chain. This includes coal mining companies and coal power producers, but also companies involved in coal services, such as exploration, processing, trading, transport and logistics, equipment manufacturing, coal-related maintenance and engineering services, and coal-to-liquids and coal-to-gas production. GCEL 2023 covers over 1,400 parent companies and more than 1,900 subsidiaries and joint ventures. It does not currently cover coal used for cement or steel production.[8]

The GCEL also covers any company developing new coal mines, new coal-fired power plants and new coal-related infrastructure. It additionally covers any company deriving at least 10% of its revenues from coal activities, any utility producing at least 10% of its power with coal, any company with an installed coal-fired generation capacity of at least 5 gigawatts (GW), or with an annual thermal coal mining production of at least 10 million tonnes per annum (Mtpa).

Urgewald's GOGEL is an extensive public database that provides information on companies operating in the oil and gas industry. The database presents different metrics designed to depict the size and composition of a company's oil and gas operations and its expansion activities in the upstream, midstream and gas-fired power sector. The database was compiled to assist financial institutions in the development and implementation of meaningful oil and gas divestment criteria. The companies listed in the upstream part of the GOGEL account for over 90% of annual global hydrocarbons production, over 90% of planned short-term upstream expansion, and over 90% of exploration expenditures.[9]

The GOGEL 2023 covers any upstream company that produced at least 20 million barrels of oil equivalent (mmboe) of oil and gas in 2022, or at least 2 mmboe from one out of six unconventional production methods, defined as: fracking, tar sands, coalbed methane, extra heavy oil, ultra-deep water, or arctic. It also covers upstream companies preparing to bring at least 20 mmboe of untapped oil and gas resources into production in the short term, or whose average spending in exploration between 2021 and 2023 exceeds US $10 million. As for midstream and power companies, it respectively covers companies intending to develop at least 100 kilometers (km) of pipeline or at least 1 Mtpa of liquefied natural gas (LNG) terminal capacity, and companies currently developing at least 100 megawatts (MW) of gas-fired power.

Identifying the fossil fuel companies in the eligible marketable assets daily lists

On request, the NGO producing the GCEL and GOGEL, Urgewald, can provide financial identifiers such as ISINs to supplement the information in the databases. The additional information is the result of a screening conducted by Profundo and Urgewald as follows: Profundo retrieves ISIN codes for GCEL and GOGEL company issuers using Refinitiv, then Urgewald carefully reviews them to ensure they relate to the correct entity, and to filter out green bonds.

Based on the ISINs of eligible marketable assets – which are provided for every eligible asset in the daily lists – and on Urgewald's ISINs database, it is therefore possible to identify financial products related to GCEL and GOGEL companies – except for green bonds.

For its analyses, Reclaim Finance matched both databases with the lists of eligible marketable assets using ISINs and identified the share, in number, of daily eligible marketable assets that are related to fossil fuel companies.

Note that in the results presented in the following report, some eligible marketable assets' issuer names can differ from the name of the GCEL or GOGEL company matched. Indeed, Urgewald follows a specific methodology in determining which companies should be listed in the GCEL and GOGEL, but also provides details regarding the subsidiaries of such companies. Whenever a subsidiary of a GCEL or GOGEL company is matched, it is accounted for by its parent company listed in the GCEL or GOGEL. Tying a subsidiary back to its parent company is essential to identifying all financial support to fossil fuel activities.

For instance, assets issued by Var Energi ASA are grouped under Eni SpA, which is its main shareholder, while assets issued by BP Capital Markets plc are grouped under its parent company, BP plc.

Estimating the weight of fossil fuel companies in the eligible marketable assets daily lists

Eligible marketable assets enable banks to raise capital depending on the value of assets, on the one hand, and on their associated level of risk -- indicated by their haircut -- on the other hand. This study aims not only to quantify the proportion of fossil fuel company assets within eligible marketable assets daily lists, but also their proportion in value. This is to calculate how reliant the system is on raising capital from fossil fuels companies.

To do this, Reclaim Finance used Bloomberg to retrieve, when available, the amount outstanding for eligible marketable assets (in EUR). Haircuts that were provided along with the eligible marketable asset's details were then applied to the amount to correctly reflect their ability to raise capital, as follows:

Potential capital raised = (1- Haircut) x Amount oustanding

The weight of fossil fuel companies in eligible marketable assets lists each day was therefore computed as the ratio between the total potential capital raised from fossil fuel companies' assets, and the total potential capital raised from all eligible assets.

Note that during the extraction of the amount outstanding using Bloomberg, only 65.8% of all eligible assets returned a result, while 90.7% of fossil fuel companies returned a result. Given the former is at the denominator and the latter at the numerator of the ratio, this caveat in the data availability likely leads to overestimating the weight of fossil fuel companies.

INTRODUCTION

Despite calling for an accelerated and orderly green transition for the sake of financial stability,[10] the European Central Bank (ECB) continues to support companies hindering it, including fossil fuel companies. Fossil fuel companies are major drivers of the climate crisis. Companies developing new fossil fuel activities, in particular exploring and developing new oil and gas fields or coal mines, pose a significant threat to the transition and therefore to financial stability.

The ECB's current support for fossil fuel companies is apparent in the Eurosystem collateral framework (ESCF), which is the ensemble of rules applied when banks must pledge assets as guarantees, or "collateral", in exchange for central bank liquidity – should a bank be unable to repay the ECB, the central bank would seize these assets. The ESCF determines which assets are eligible as collateral and which discount, or *haircut*, must be applied to each eligible asset.

Currently, the ESCF is known to favor high-carbon companies.[11] This "carbon bias" transpires both in the eligibility criteria and the haircuts applied. In July 2022, the ECB officially recognized the need to green the ESCF and announced it would start integrating climate-related considerations into haircuts by the end of that year, and limiting the share of assets issued by certain entities by the end of 2024.[12] However, the first measure was abandoned,[13] and the analysis suggests that a limit on the share of assets is unlikely to be sufficient to cut support to the most harmful companies.

This research provides insight into the current support received by fossil fuel companies through collateral eligibility and haircuts, as well as recommendations to tackle this support. Matching the Eurosystem collateral framework's list of eligible assets with Urgewald's Global Coal Exit List (GCEL) and Global Oil and Gas Exit List (GOGEL) highlights the necessity and feasibility of updating the ESCF by excluding certain fossil fuel assets and devaluing others to account for their environmental impact and financial risk.

1. FOSSIL FUEL COMPANIES SUPPORTED BY THE ESCF

Every working day the ECB publishes the list of eligible marketable assets that can be used by banks as collateral.[14] Only a select number of assets deemed sufficiently "safe" are eligible. Being on this list sends a strong signal to the market and can ultimately make financing easier for companies.[15]

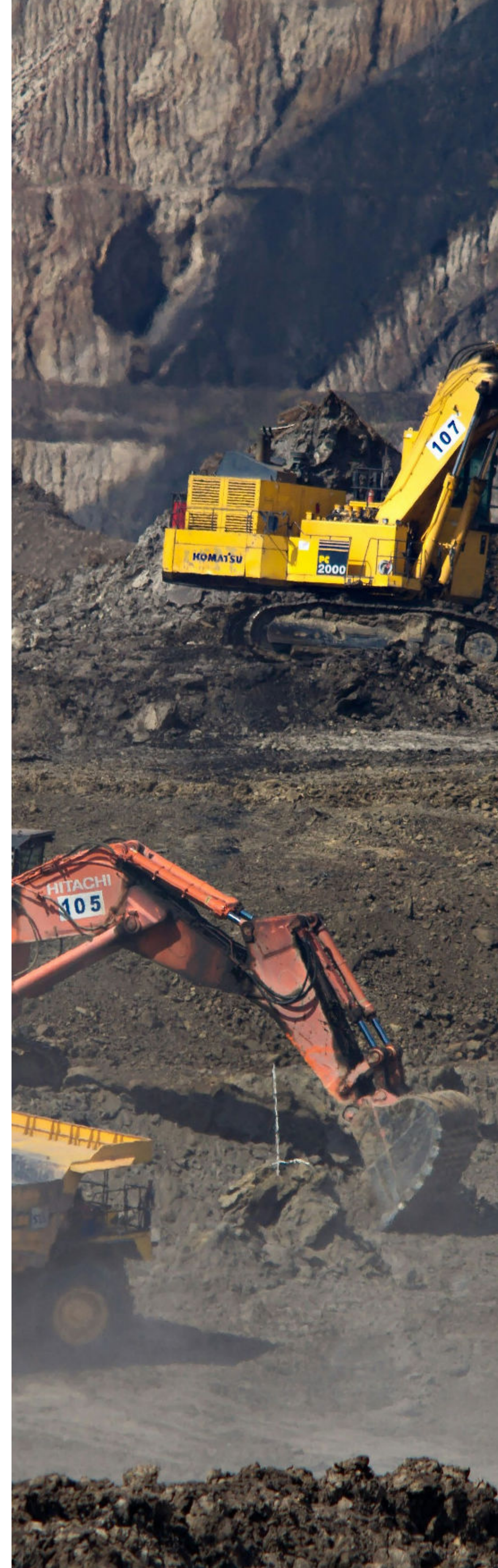
Reclaim Finance identified 34 fossil fuel companies on the list of eligible assets between July 2023 and September 2023 and between November 2023 and January 2024. Table 2 lists these companies and highlights their activities in the fossil fuel sector.[16]

The list contains ten companies heavily involved in the coal industry. The ECB notably supports Glencore, the fourth largest global thermal coal mining developer with eight mining projects and extensions with a planned total capacity of more than 63 Mtpa.[17] The Swiss company's continued efforts to develop coal mines not only contradicts the International Energy Agency's (IEA) call to phase out coal,[18] but led investors to question its strategy in 2023.[19] Glencore's mines have also been linked with environmental destruction and human rights abuses.[20]

Although the other coal companies in the list are not currently developing new thermal coal projects, none of these companies have a credible Paris-aligned coal-phase out plan - four of them don't even have a coal exit date.[21] This leads to elevated climate-related risks which should be considered in the collateral framework.

Table 1: Main activities covered by the oil and gas value chain segments

Upstream	Midstream	Downstream
Exploration	Transportation by rail, road, pipeline, and shipping	Oil refining
Drilling	Pure trading	Distribution
Production	Storage	Retail
Processing	Gas liquefaction	Use (power, heating, etc.)
	LNG regasification	Energy efficiency services



Most of the fossil fuel companies whose assets have been listed as eligible (32 out of 34) are oil and gas companies developing new projects at different levels of the industry value chain (see Table 1). Although all levels of the chain are important to consider, upstream development should be of particular interest to central bankers since keeping global heating below 1.5°C requires that the entirety of prospected fossil fuel reserves is not used.[22] As such, exploring and/or developing new oil and/or gas fields contradicts the ECB's own call for an accelerated and orderly green transition that will maintain price and financial stability.[23]

Yet, **13 of the 32 oil and gas companies found in the list of eligible assets are upstream developers. These upstream developers rank among the largest: collectively, they make up 12.9% of the industry's exploration spending in the last three years and 12.9% of all the resources under development in excess of the IEA's Net Zero Emission scenario, as per the GOGEL.[24]**

Furthermore, looking at the biggest oil and gas companies in the eligible marketable assets list, it becomes evident that none are aligned with a 1.5°C trajectory such as the IEA's Net Zero Emissions by 2050 Scenario (NZE).[25] Far from contributing to an accelerated and orderly green transition, these companies are slowing it down and continue to fuel the climate crisis by developing activities at odds with international goals and pledges.

Table 2: Companies involved in the coal and/or oil and gas industries

Company	Conduct significant oil and gas activities (i.e. is in the GOGEL)[26]	Oil and gas development	Conduct significant coal activities (i.e. is in the GCEL)[27]	Coal development
A2A SpA	Yes	Downstream power	-	-
Aker BP ASA	Yes	Upstream	-	-
ArcelorMittal SA	Yes	Downstream power	-	-
BP plc	Yes	Upstream, midstream LNG*, midstream pipeline, downstream power	-	-
CEZ a.s.	Yes	Downstream power	Yes**	-
E.ON SE	Yes	Midstream LNG	-	-
Électricité de France SA (EDF Group)	Yes	Downstream power	-	-
Enagás SA	Yes	Midstream pipeline, midstream LNG	-	-
EnBW Energie Baden-Württemberg AG	Yes	Midstream pipeline, downstream power	Yes**	-
Enel SpA	Yes	Midstream LNG, downstream power	Yes**	-
Engie SA	Yes	Midstream LNG, midstream pipeline, downstream power	-	-
Eni SpA	Yes	Upstream, midstream LNG	-	-
EP Investment Sàrl (EPH)	Yes	Downstream power	Yes**	-
Equinor ASA	Yes	Upstream, midstream LNG, midstream pipeline, downstream power	-	-
Fluxys Belgium NV	Yes	Midstream LNG, midstream pipeline	-	-
Glencore plc	Yes	Upstream	Yes	Mining
Iren SpA	Yes	Midstream LNG	-	-
MOL Nyrt	Yes	Upstream, midstream pipeline	-	-
National Grid plc	Yes	Midstream LNG	-	-
NV Nederlandse Gasunie	Yes	Midstream LNG, midstream pipeline	-	-
OMV AG	Yes	Upstream	-	-
Orlen SA	Yes	Upstream, downstream power	Yes	-
PGE Polska Grupa Energetyczna SA	Yes	Downstream power	Yes	-
Repsol SA	Yes	Upstream, midstream pipeline	-	-
RWE AG	Yes	Upstream, midstream LNG, downstream power	Yes**	-
Schlumberger Ltd	Yes	Upstream	-	-
Shell plc	Yes	Upstream, midstream LNG, midstream pipeline, downstream power	-	-
Siemens AG	Yes	Downstream power	-	-
Snam SpA	Yes	Midstream LNG, midstream pipeline	-	-
SSE plc	Yes	Downstream power	-	-
TAURON Polska Energia SA	-	-	Yes	-
TotalEnergies SE	Yes	Upstream, midstream LNG, midstream pipeline	-	-
Uniper	-	-	Yes	-
Vier Gas Holdings Sàrl	Yes	Midstream pipeline	-	-

** LNG = Liquefied natural gas*
*** Coal companies that announced a coal exit date, but lack a credible Paris-aligned coal phase-out plan. Other coal companies listed do not have a coal exit date.*

Source: Based on Reclaim Finance's matching between the ECB's data on eligible marketable assets and Urgewald's GOGEL and GCEL 2023.

Setting an inadequate production target[28]

- In 2023, BP significantly decreased its oil and gas production reduction target, from a 40% reduction by 2030 to only a 25% reduction.
- BP's new target will lead to a 25% higher production level than the level required to align with the NZE.

Developing new oil and gas fields

- Reaching its 2030 production target will require the acquisition of new assets or the development of new fields, over and above BP's current short-term expansion plans.

Investing in fossil fuels over "renewable energies" [29]

- In 2022, for every dollar invested by BP in fossil fuels, less than seven cents were invested in "renewable energies".

Setting an inadequate production target[30]

- Equinor aims to keep its oil and gas production relatively steady up to 2030, at around 2,000 kilo barrel of oil equivalent (kboe) per day.
- If it meets this target, its production will be 61% higher than the level required to align with the NZE.

Developing new oil and gas fields

- Equinor has not committed to stop developing new oil and gas projects beyond those already in development, and it owns 3,203 mmboe of hydrocarbon resources that are yet to be exploited.
- From 2021 to 2023, Equinor spent on average US$1.1 billion per year on exploration, which makes it the 11th biggest investor in this activity.

Investing in fossil fuels over "renewable energies"

- For every dollar invested in "renewable energies" in 2022, Equinor invested around US $32 in oil and gas.

Setting an inadequate production target[31]

- Eni plans to increase its oil and gas production to 1,900 kboe per day by 2027, of which 40% is oil and 60% is gas, and to plateau production until 2030.
- If the Italian company achieves this target, its production will be 71% above the level required to align with the NZE.

Developing new oil and gas fields

- Eni has not committed to stop developing new oil and gas projects beyond those already under development, while the major has 3,263 mmboe of discovered hydrocarbon resources that are yet to be exploited.
- Between 2021 and 2023, Eni invested an average of US$1 billion a year in oil and gas exploration, making it the 14th largest investor in this segment of the value chain.

Investing in fossil fuels over "renewable energies"

- For every euro invested in fossil fuels in 2022, less than seven cents were invested in "renewable energies".

Setting an inadequate production target[32]

- In 2023 Repsol planned to increase its oil and gas production to 620 kboe per day by 2025 and has stated that it will maintain this level of production by 2030.
- If it meets this target, its production will be 68% higher than the level required to align with the NZE.

Developing new oil and gas fields

- Repsol has not committed to stop developing new oil and gas projects beyond those already in development, while the Spanish company owns 1,403 mmboe of discovered hydrocarbon resources that are yet to be exploited.

Investing in fossil fuels over "renewable energies"

- For every euro invested in "renewable energies" in 2022, Repsol invested more than €4 in oil and gas.

Setting an inadequate production target[33]

- Shell plans to maintain its oil production at 2022 levels until 2030, with a mix composed of 45% oil and 55% gas in 2030.
- If it meets this target, its production will be 35% higher than the level required to align with the NZE.

Developing new oil and gas fields

- Shell has not committed to stop developing new oil and gas projects beyond those already in development, while the major owns 7,544 mmboe of discovered hydrocarbon resources that are yet to be exploited.
- From 2021 to 2023, Shell spent on average US$2 billion per year on exploration, which makes it the seventh biggest investor in exploration.

Investing in fossil fuels over "renewable energies"

- For every dollar invested in fossil fuels in 2022, less than 16 cents were invested in "renewable energies".

Setting an inadequate production target[34]

- With TotalEnergies' current oil and gas production target, its production will be more than 40% higher in 2030 than the level required to align with the NZE.

Developing new oil and gas fields

- TotalEnergies has not committed to stop developing new oil and gas projects beyond those already in development, while the major owns 9,491 mmboe of discovered hydrocarbon resources that are yet to be exploited.
- From 2021 to 2023, TotalEnergies spent on average US$1 billion per year on exploration, making it the 15th biggest investor in exploration.

Investing in fossil fuels over "renewable energies"

- For every dollar invested in fossil fuels in 2022, less than 33 cents were invested in "renewable energies".

2. RESTRICTING COLLATERAL ELIGIBILITY IN A MEANINGFUL AND FEASIBLE WAY

Aware of the advantage given to companies with eligible marketable assets and that this currently benefits fossil fuel companies, the ECB announced in 2022 that it would introduce climate-related criteria in the ESCF by the end of 2024.[35] The criteria will limit the share of assets issued by high-emitting companies that can be pledged by banks. In other words, banks will not be able to use more than a certain amount of collateral issued by a certain type of company.[36] However, this limit is unlikely to tackle the Eurosystem's support to the fossil fuel sector without additional measures.

Overlooking the subsidiaries of fossil fuel companies

Firstly, the scope of the ECB's proposed measure is problematic: it will only apply to marketable[37] debt instruments issued by non-financial corporations and will only *potentially* be extended to other assets in an indeterminate future depending on data availability. Notably, this means that assets issued by financial corporations that are owned by fossil fuel companies (i.e. financial subsidiaries) will not be considered.

This is critical since, between July and September 2023 and November 2023 and January 2024, **all eligible assets from Repsol, BP, Glencore and Shell were issued by their financial subsidiaries. If this practice continues, these companies will not be affected by the ECB's new limit applied in 2024.**

Ultimately, the measure does not take into consideration that fossil fuel companies are regularly financed through financial subsidiaries. Not including these entities in the scope of the measure ignores the fact that financial corporations such as BP Capital Markets plc or Eni Finance International SA play a significant role in enabling the financing of fossil fuel activities at the level of the BP and Eni groups. In short, this loophole would allow fossil fuel companies to continue benefitting from the collateral framework through their subsidiaries.

Missing the eligibility bonus

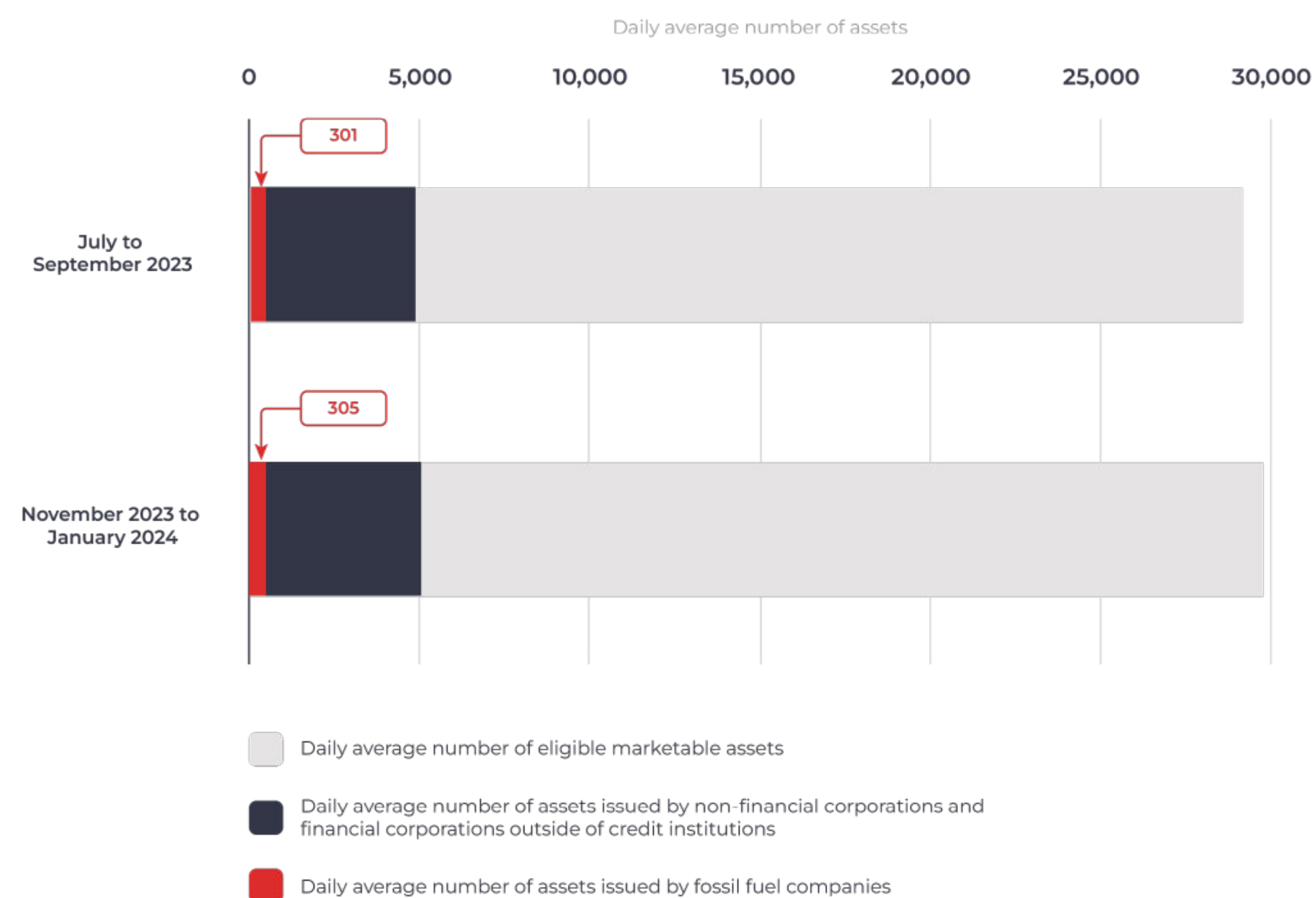
Moreover, imposing a cap on the share of high-emitting companies is unlikely to tackle the eligibility advantage whereby a company which issues assets that can be pledged as collateral can get easier access to financing.[38] **The loss of eligibility, however, would have an actual significant impact on companies: their assets would be less useful to banks (compared to eligible assets) and would lose their status as "safe enough" assets for the ESCF.**

Exclusion instead would guarantee that fossil fuel companies no longer benefit from the advantages of being included in the collateral framework. They would not be part of the highly selective lists of eligible marketable assets, which mostly contains government securities.[39]

Struggling to find a meaningful threshold

The impact of a limit imposed by the ECB on a type of company will depend on whether the threshold it chooses is adequate. In other words, it would need to be lower than the type of company's current representation in the eligible marketable assets lists. However, given that most eligible assets are issued by governments, assets from fossil fuel companies presently represent a small share of collateral.[40] For example, limiting banks to 10% of their total pool of collateral from fossil fuel companies when fossil fuel assets currently only represent 1% of eligible assets is therefore unlikely to have an effect. Changing the practices of banks regarding use of collateral in fact would require the ECB to set a particularly low threshold.

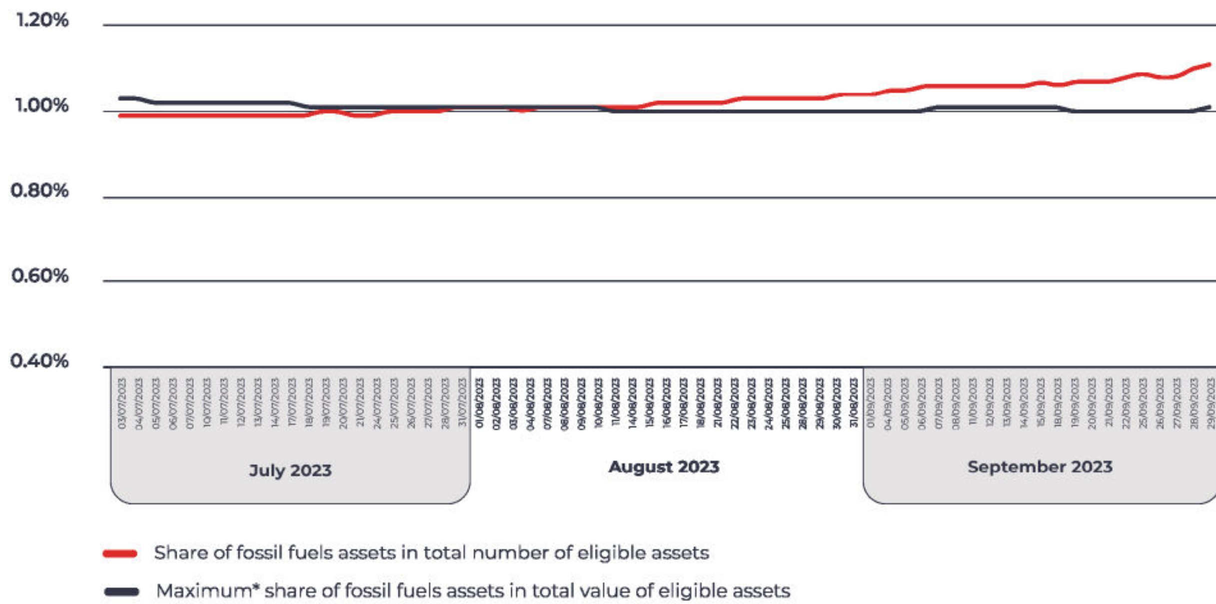
Figure 1: Average number of eligible fossil fuel assets in the eligible universe between July and September 2023 and between November 2023 and January 2024



Source: Based on the ECB's data on eligible marketable assets, Urgewald's GOGEL and GCEL 2023 and Profundo.

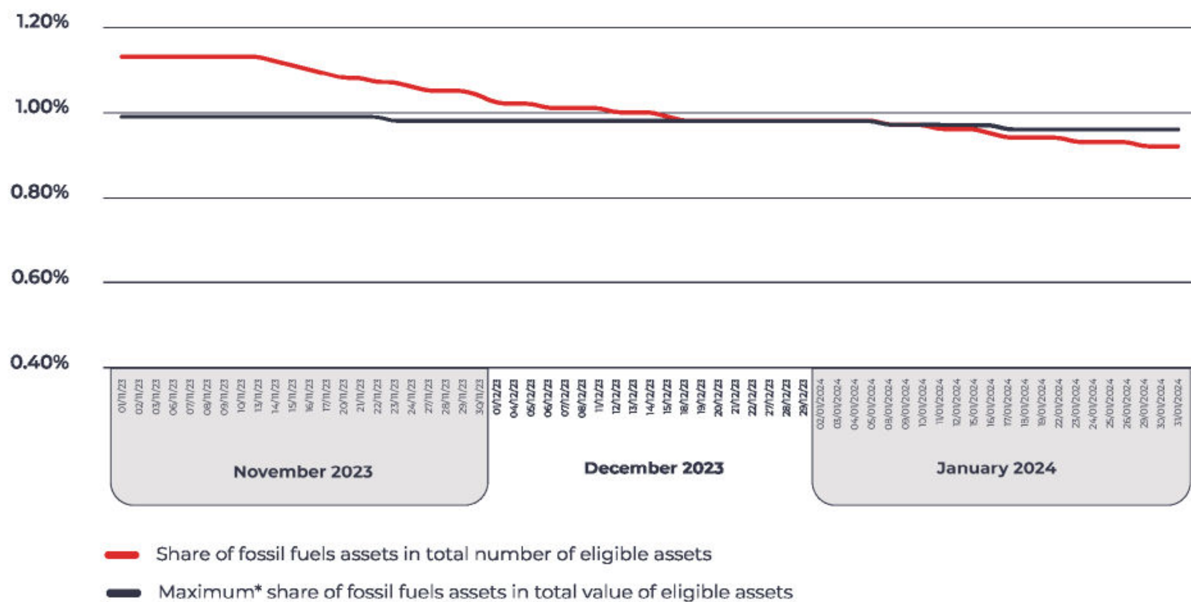
Note: On average, between July and September 2023, the ECB listed around 29,290 marketable assets everyday that could be used as collateral, but only 4,977 (17%) were issued by either a non-financial corporation or financial corporation outside of credit institution, and, amongst those, 301 (6%) were issued by a fossil fuel company. Between November 2023 and January 2024, these numbers were 29,872, 5,016 (17%) and 305 (6%) respectively.

Figure 2a: Daily share of fossil fuel assets in total universe of eligible assets (from July to September 2023)



Source: Based on the ECB's data on eligible marketable assets, Urgewald's GOGEL and GCEL 2023, Profundo and Bloomberg.

Figure 2b: Daily share of fossil fuel assets in total universe of eligible assets (from November 2023 to January 2024)



Source: Based on the ECB's data on eligible marketable assets, Urgewald's GOGEL and GCEL 2023, Profundo and Bloomberg.

** As explained in the methodology, some of the values of eligible assets could not be retrieved (values for approximately 66% of all eligible assets were available). Given most values from fossil assets were retrieved (more than 90%), the share (in value) presented in the graphs is likely an overestimation of the weight of fossil fuel companies. The values used to calculate the weight of fossil fuel assets take into account the haircut as to reflect their value as collateral (the value banks could use for their credit operations with central banks), rather than their market value.*

To illustrate this, our analysis shows that between July and September 2023 and November 2023 and January 2024, assets issued by fossil fuel companies represented around 1% of the eligible universe, and around 6% of assets issued by corporations – both non-financial and financial outside of credit institutions (see Figure 1).

This trend is further confirmed when considering the value of eligible assets (see Figures 2a and 2b). The total value of assets issued by fossil fuel companies and their subsidiaries represented approximately 1% of the total value (post haircut) of eligible marketable assets.[41]

Despite the significant advantages that fossil fuel companies benefit from by being considered eligible, their assets currently make up only a small portion of all eligible marketable assets. If the use of collateral by banks mirrors even partly the eligible universe, the ECB's limit would have to be very low to be of any consequence. **The exact threshold required is difficult to predict, while the effect on the financing of fossil fuel companies is even less evident – since their assets would still be eligible and used by banks as collateral, even if to a lesser extent. Exclusion would circumvent both issues and would therefore be a better option to green the ESCF.**

Fearing exclusion for no reason

On the one hand, the fact that fossil fuel companies represent such a small portion of the total eligible universe means that an inadequate limit could have no effect on the acceptance of fossil fuel assets. On the other hand, it illustrates the feasibility of implementing fossil fuel exclusions in the collateral framework. Indeed, one of the key elements that the ECB focuses on is the need to "ensure that ample collateral remains available, allowing monetary policy to continue to be implemented".[42] Consequently, central bankers might fear that banning fossil fuel assets from the collateral pool could reduce the efficiency of monetary policy.

However, **the results of our analysis show the abundance of eligible marketable assets issued by non-fossil fuel companies. Some fossil fuel assets could therefore be excluded and easily replaced by other assets without having a negative effect on the transmission of monetary policy.**

3. PUTTING HAIRCUTS BACK ON THE TABLE

While the principle of adjusting haircuts was dropped by the ECB in December 2022,[43] less than six months after the measure was first announced,[44] as a tool it would complement exclusion and help tackle the support going to fossil fuel companies.

Table 3: Haircuts applied to assets of oil and gas upstream developers in January 2024

Company	Range of haircuts
Aker BP ASA	15%
BP plc	7.5-21%
Eni SpA	1-17.7%
Equinor ASA	2-23.6%
Glencore plc	18.5-26.5%
MOL Nyrt	13%
OMV AG	1-7.5%
Orlen SA	4.5-23%
Repsol SA	11.5-26.5%
RWE AG	9.5-14%
Schlumberger Ltd	7.5-16%
Shell plc	7.5-33.6%
TotalEnergies SE	1-21%

Source: Based on the ECB's data on eligible marketable assets, Urgewald's GOGEL and GCEL 2023 and Profundo.

Setting haircuts on fossil fuel assets

A haircut is a discount rate applied on the value of an eligible asset which depends on how risky the asset is deemed to be – safer assets have lower haircuts and riskier assets have higher haircuts. The ECB eventually argued that it was not necessary to adjust these based on climate considerations because the current haircut calculations provided enough protection from a financial risk perspective.[45]

However, this approach does not account for the climate impact of issuers and their contribution to medium- and long-term price and financial instability due to the climate crisis. In **January 2024, for example, assets issued by oil and gas upstream developers (companies exploring and/or developing new production fields) had widely variable haircuts reaching surprisingly low levels in some cases – as low as 1% for both Eni and TotalEnergies, and 2% for Equinor** (see Table 3).

Comparing these haircut levels to those generally applied to assets does not suggest that higher haircuts are systematically applied to assets issued by upstream oil and gas developers (Figures 3a and 3c). Furthermore, beyond oil and gas upstream developers, the haircuts set for assets issued by fossil fuel companies appear largely inconsistent – with very high and very low levels depending on the assets – and on average are only moderately above the haircut levels generally applied to all eligible assets (Figure 3b).

In other words, the distribution of haircuts in January 2024 does not suggest that haircuts applied to fossil fuel assets are systematically higher than those for other eligible assets. This illustrates that **the ECB does not currently consider fossil fuel assets systematically riskier than other eligible assets, even in the case of companies exploring and/or developing new oil and gas fields.** Indeed, the contribution of these companies to the climate crisis and long-term financial instability are seemingly overlooked by the ESCF.

Failing to consider the risks inherent to fossil fuel companies

The fact that the ECB haircut levels do not reflect the heavy involvement of some companies in the fossil fuel sector shows that the central bank is overlooking the environmental impact of their activities as well as the risks inherent to the industry.

Indeed, despite major limitations in climate scenario and stress testing,[46,47] **preliminary exercises conducted by banking supervisors all identified fossil fuel activities as higher risk.** This is notably the case of the stress tests conducted by the ECB, the French Prudential Supervision and Resolution Authority (ACPR) and other European regulators and supervisors.[48,49,50,51] Recent scenario analysis conducted by the Department of Insurance of California further underlined the fact that the plans of oil and gas companies in US West Coast insurers' portfolios are not aligned with policies implemented in 2021 implies "exposure to transition risk even in the absence of any additional collective climate action", and that coal and oil and gas have the highest probability of default in delayed/disorderly transition scenarios.[52]

Beyond the results of stress tests and quantitative analysis, fossil fuel assets are notably exposed to a "stranding risk".[53,54,55] This is especially the case for assets tied to new production projects, since these are not needed in a scenario that limits global heating to 1.5°C, and they would take decades to recover their investment cost. **Indeed, new fossil fuel production assets have a high chance of being closed before amortization or of requiring a faster closure of pre-existing assets, and are thus a major source of risk as identified by the IEA.[56,57,58]**

This supports a renewed call for the ECB to adjust haircut levels based on climate-related considerations. Fossil fuel assets should be considered riskier than their counterparts in the Eurosystem collateral framework and be given haircuts that reflect this.

Figure 3a: Haircut distribution of all eligible marketable assets (January 2024)

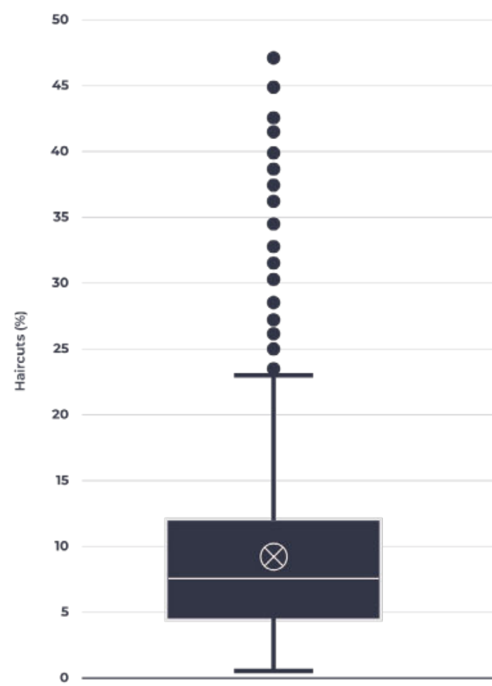


Figure 3b: Haircut distribution of fossil fuel assets (January 2024)

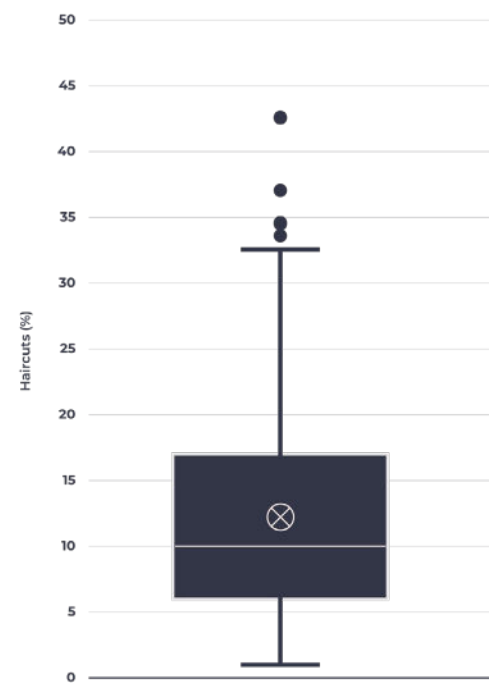
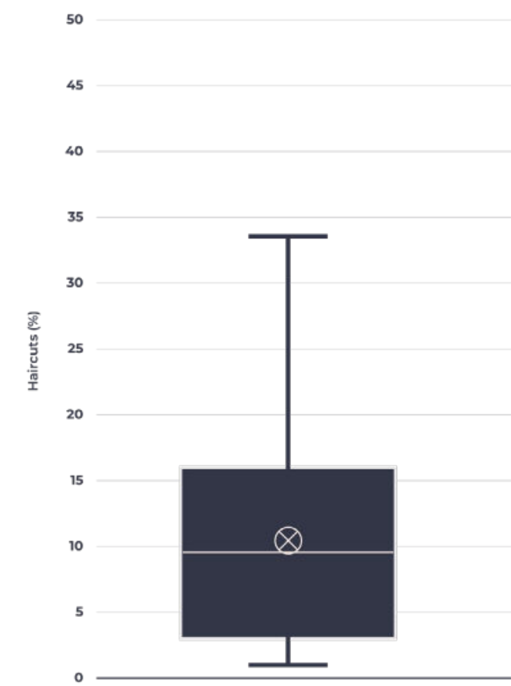


Figure 3c: Haircut distribution of assets from oil and gas upstream developers (January 2024)



Source: Based on the ECB's data on eligible marketable assets, Urgewald's GOGEL and GCEL 2023 and Profundo.

Note: These graphs show the distribution of haircuts for each category of eligible assets. The box represents 50% of the values. The horizontal line in the box is the median, whereas the x is the mean. Points above and beyond the whiskers are outliers.

CONCLUSION

The ECB must take strong action to stop its contribution to the ease with which fossil fuel companies can finance their destructive activities. As it currently stands, the Eurosystem collateral framework persistently overlooks climate considerations, granting eligibility and low haircuts to assets issued by fossil fuel companies.

Between July and September 2023, and November 2023 and January 2024, the ECB supported more than 30 fossil fuel companies. This analysis shows that several are engaged in activities that worsen the climate crisis and are contrary to an accelerated transition, such as developing new oil and gas fields or coal mines.

Furthermore, the ECB's plan to impose a limit on high-emitting companies is unlikely to have any concrete impact on fossil fuel companies: instead it is likely both that they will continue to benefit from the advantage of being eligible for collateral and that they will be able to use their financial subsidiaries to circumvent the limit. Exclusion would be more effective at ending the ECB's support to fossil fuel companies and would not affect its transmission mechanism due to the abundance of eligible assets unrelated to fossil fuel companies.

Moreover, the fact that fossil fuel companies do not systematically suffer higher haircuts than their counterparts reveals the inadequacy of the Eurosystem collateral framework. The ECB seems to completely overlook the risks associated with fossil fuel companies, including those investing in new production projects. The ineffectiveness of both eligibility and haircut rules calls for urgent changes to the ESCF.

First, the ECB should take the opportunity of its current review to begin excluding from its list of eligible marketable assets those issued by companies developing new fossil fuel fields. Second, the ECB should reconsider its December 2022 decision not to adjust haircuts based on climate considerations, and instead ensure remaining assets from fossil fuel companies no longer benefit from low haircuts.

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37. Non-marketable assets do not have observable market value. For instance, non-financial corporations can issue marketable assets that do not have a rating from an external credit assessment institution for the issue, issuer or guarantor. The ECB accepts certain types of non-marketable collateral, mostly loans to non-financial corporates and public sector entities. These assets are not included in the public list of eligible assets and, as such, are outside of the scope of this report.
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COLLATERAL DAMAGE: Ending the ECB's support to fossil fuel companies

Reclaim Finance is an NGO affiliated with Friends of the Earth France. It was founded in 2020 and is 100% dedicated to issues linking finance with social and climate justice. In the context of the climate emergency and biodiversity losses, one of Reclaim Finance's priorities is to accelerate the decarbonization of financial flows. Reclaim Finance exposes the climate impacts of financial players, denounces the most harmful practices and puts its expertise at the service of public authorities and financial stakeholders who desire to bend existing practices to ecological imperatives.

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