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‘There is no Planet B’ but for Banks ‘There are countries B to Z’: Domestic  
Climate Policy and Cross-Border Lending

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A discussion

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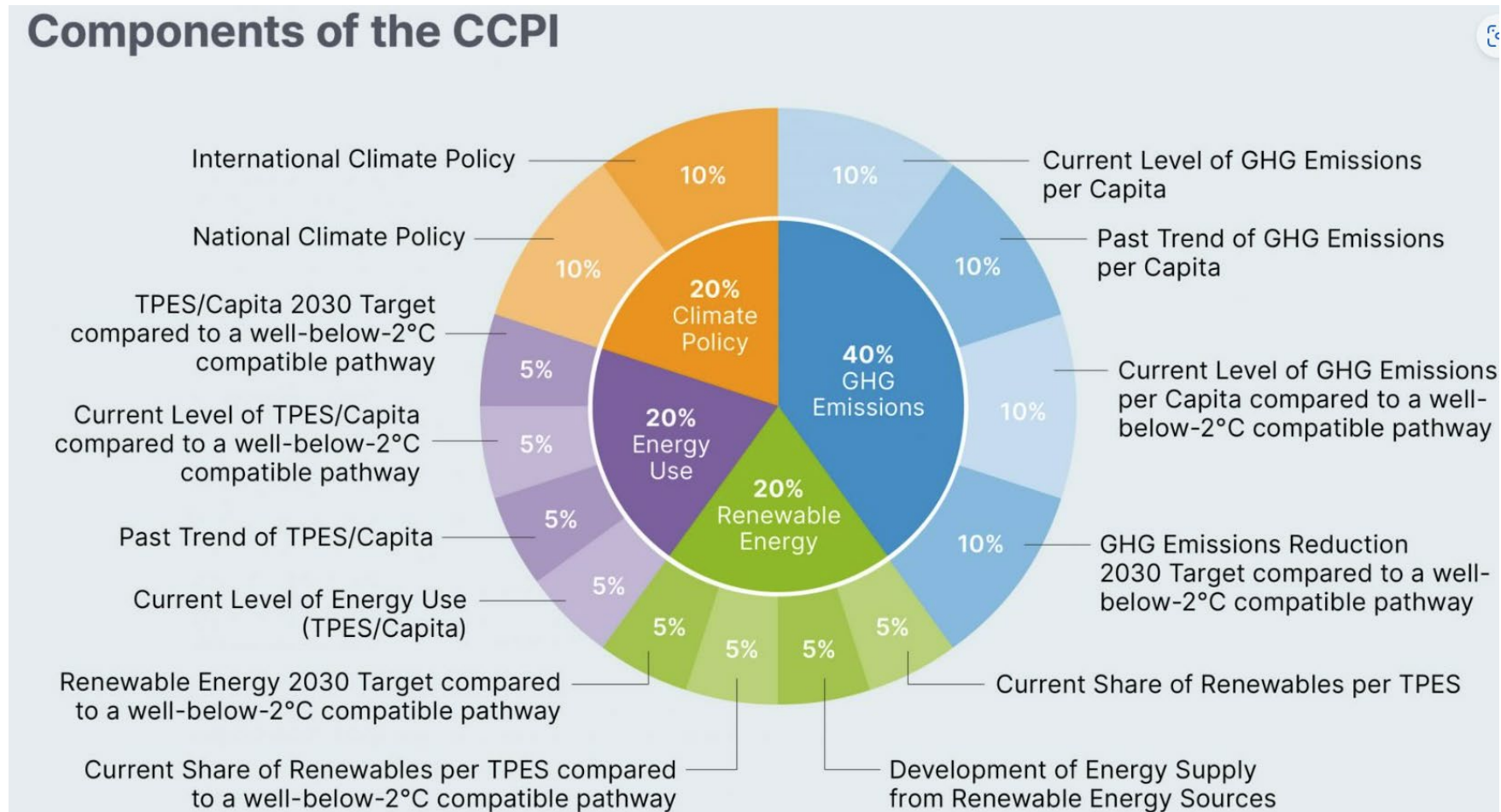
# The Paper

- Hypothesis: Banks will increase their cross-border lending in response to the higher stringency of climate policies in home country in order to reduce their exposure to climate policies ('Race to the bottom').
- Mechanism: Stricter climate policies in home country make domestic lending less appealing. Cross-border lending helps banks to avoid this.
- Cross-border lending: Share of a lender in cross-border syndicated loans (2007-2017, 32 countries for lender banks and 40 countries for borrower firms)
- Climate policy stringency: Climate Change Performance Index (CCPI), Green Party share in the parliament (14 European countries)
- Finds evidence in support of the hypothesis.

# Comments

- A very nice paper, with novel contribution to the literature on the link between finance and climate policy.
- Comments on measures of climate policies, cross-border lending, and the economic mechanism linking the two.

# CCPI as a measure of climate policy stringency



Source: German Watch Climate Change Performance Index Methodology.

Note: GHG = Greenhouse Gases, TPES = Total Primary Energy Supply.

# CCPI as a measure of climate policy stringency

- Might want to use the climate policy sub-index instead of CCPI.
- The level of CCPI (or policy sub-index) could be interpreted as the standard of climate policy. Results imply that banks in countries with a higher standard of climate policy do more cross-border lending.
- But what happens if lender & borrower countries simultaneously tighten climate policies? We would not expect banks in both countries to increase lending to each other.
- The hypothesis implies that cross-border lending should be driven by the relative stringency in climate policy between lender and borrower country. This might be better captured by the difference in climate policy sub-indices of the two countries.

# Lender share in syndicated lending as measure of cross-border lending

- Measure of cross-border lending: loan share of the lender in syndicated lending increases by 10 pp when its home country's CCPI increases by 24 points.
- It's not clear how to take into account the possibility of several countries tightening climate policies simultaneously.
- Might be worth looking at how the \$ amount of syndicated loans is impacted by relative change in CCPI (or CCPI policy sub-index).
- Check if the share of foreign lending in banks' loan portfolio is impacted; and whether in aggregate, net foreign lending increases in response to higher domestic CCPI.

# Economic mechanism

- Evidence that the higher level of CCPI is associated with higher NPL ratio and lower net profits. But this is likely to be driven by the existing stock of loans rather than new lending.
- So this evidence doesn't necessarily imply that a higher domestic CCPI makes new domestic lending less attractive relative to new lending abroad.
- Higher CCPI could imply lower climate transition risk for new domestic lending, even if it reduces profitability of the existing domestic lending (e.g. due to asset stranding).
- If the story is that new lending is constrained by stranded assets on banks' balance sheets, then it is not obvious that it should encourage more cross-border lending relative to domestic lending.

# Some suggestions

- Results differ from existing evidence that investors demand compensation for their exposure to carbon emission risk (Bolton & Kacperczyk 2021).
- So worth exploring this further, e.g. by looking at how changes in country-level climate policy are priced in the syndicated loan market.
- Hypothesis would imply that borrowers with tight climate policy countries would face a high funding cost, particularly high emission borrowers.



# Conclusions

- A very interesting paper, with some intriguing results.
- Lots of implications for international coordination of climate policies, incl. the need to consider potential channels for leakages.
- Financial regulators might need to consider how to prevent banks from exposing themselves to higher climate risks abroad.