Institutionalising Green Finance without Sacrificing Financial Stability

"There is not a plan B, because there is not a planet B"

Ban-ki Moon

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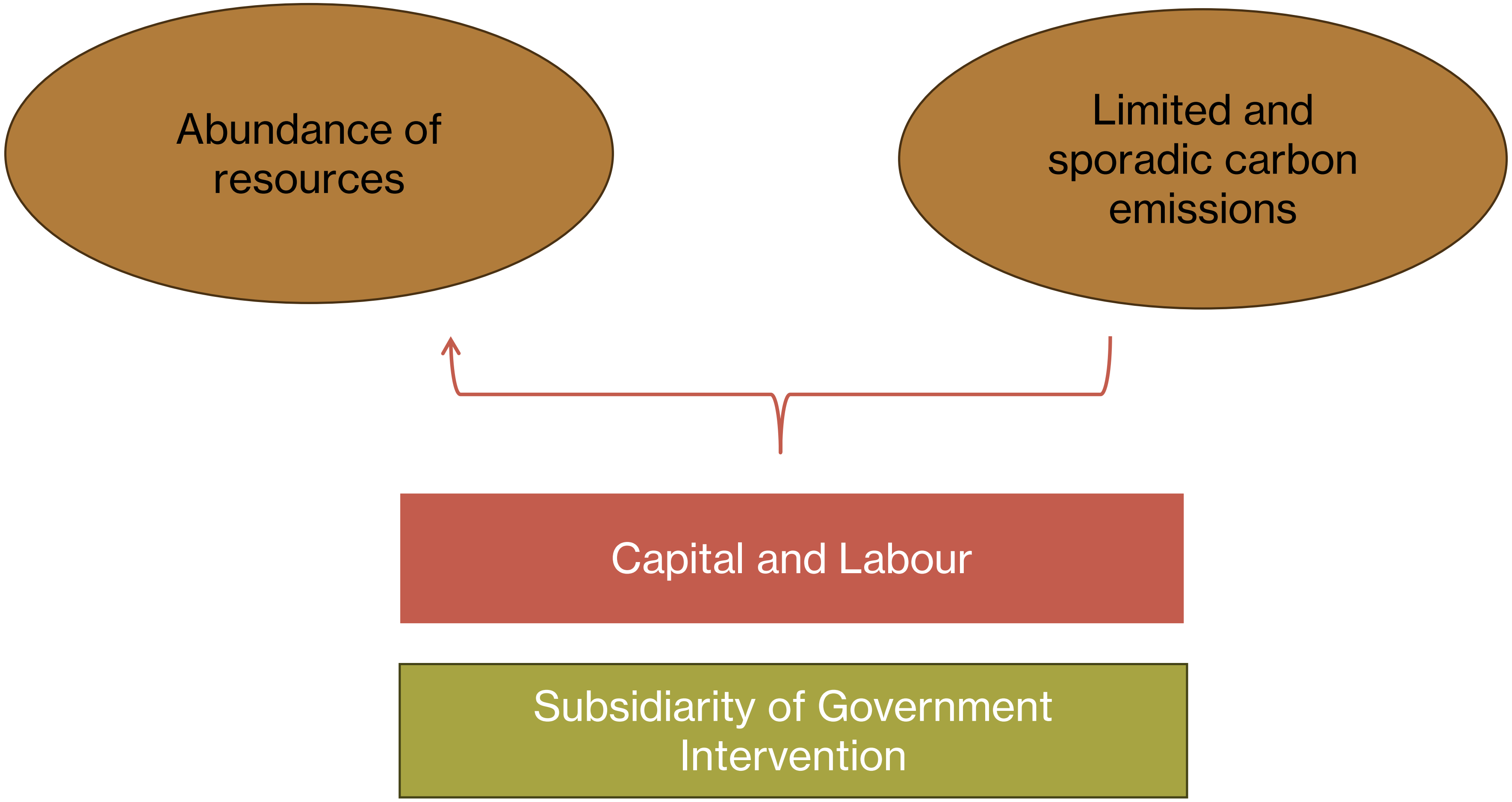
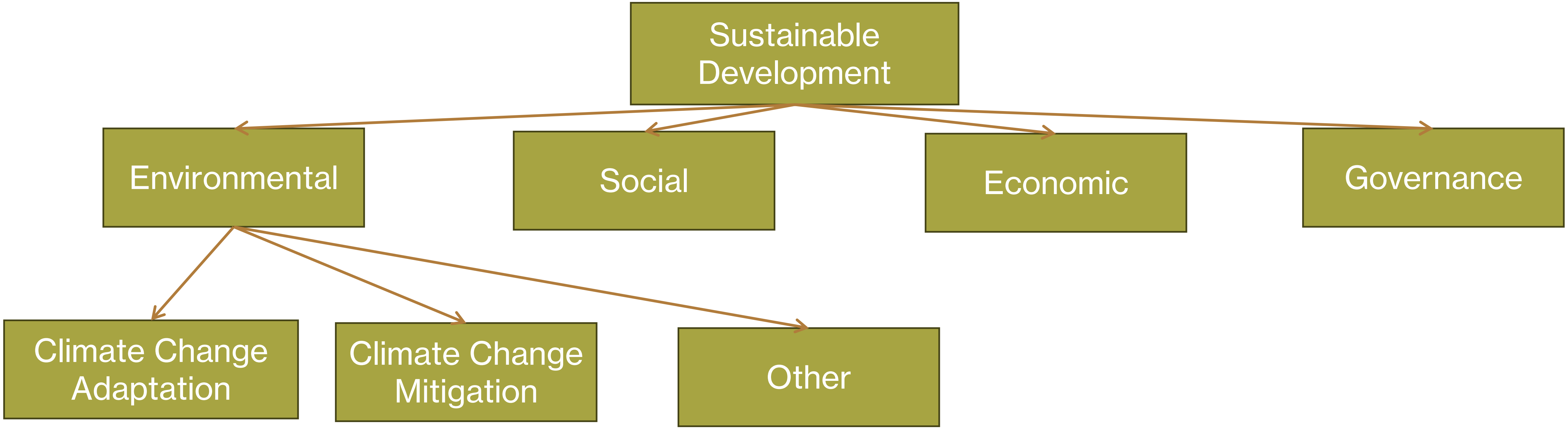
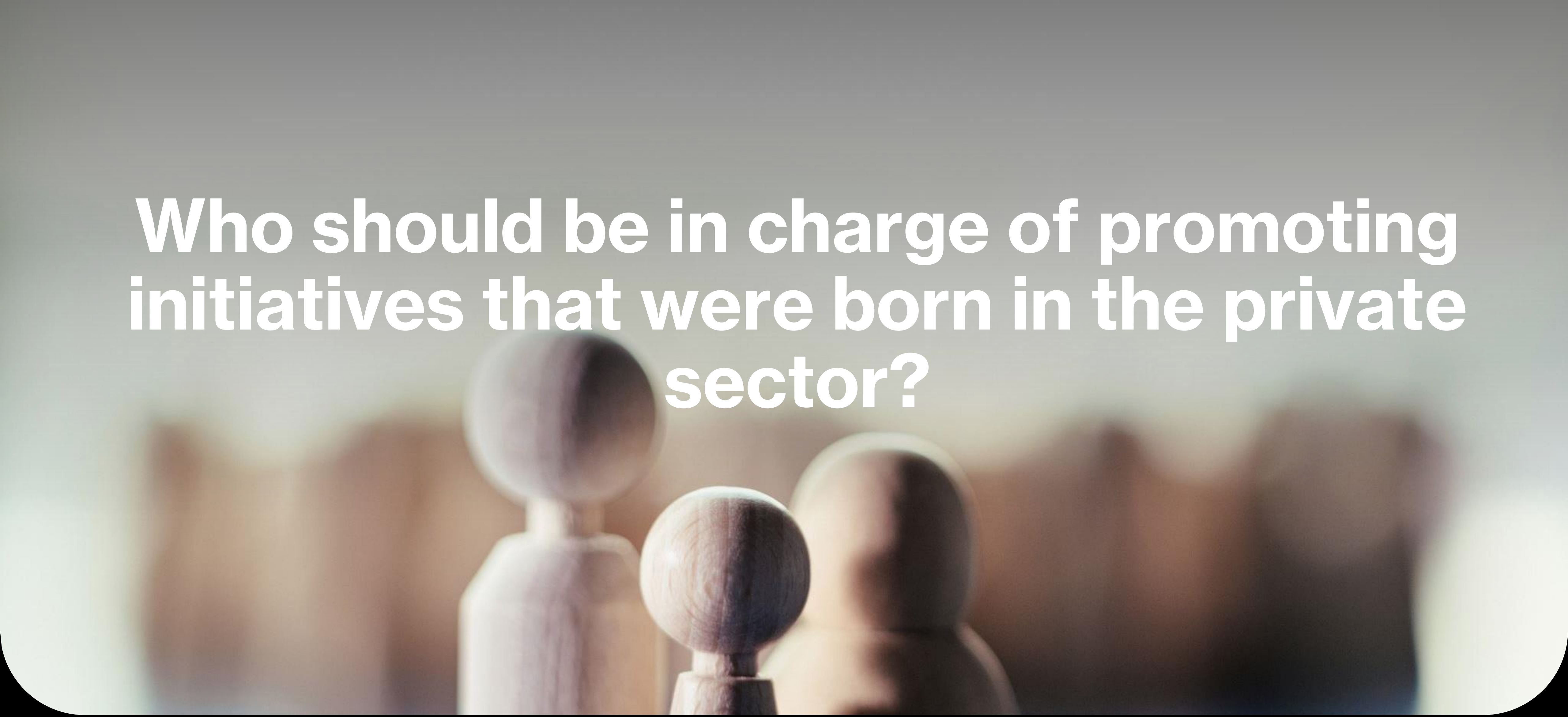
TRADITIONAL SYSTEM OF ECONOMIC THEORIES AND MODELING



GREEN FINANCE VS SUSTAINABLE FINANCE
EUROPEAN COMMISSION REPORT, OCTOBER 2017



- Green Finance: branch of finance that focuses exclusively on the Enviromental area;
- Sustainable Finance: branch of finance that seeks to synthesize and create a connection between all the above-mentioned four areas of application.



Who should be in charge of promoting initiatives that were born in the private sector?

In 2019, the Network for Greening the Financial System presented its first comprehensive report: “A call for action – Climate change as a source of financial risk”. At its core are six recommendations for action chiefly aimed at central banks, supervisors and legislators:

- climate-related risks into financial stability monitoring and micro-supervision
- Integrating sustainability factors into own portfolio management
- Bridging data gaps
- Building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing
- Achieving robust and internationally consistent climate and environment-related disclosure
- Supporting the development of a taxonomy of economic activities

SEE: NGFS WEBSITE

THE NEEDED PROMOTION OF ESG INVESTMENTS

European Green Deal: the EU will become climate-neutral by 2050 (European Commission, 2019). The EU estimates that approximately €350 billion of additional investment is required in the energy system alone each year up to 2030 in order to meet the 55% emission reduction target (European Commission, 2021b).

To finance the Green Deal, the EU Commission has announced that a total of €1 trillion will be invested in the green transformation of the European economy. The funds will be generated, inter alia, under the 2021-2027 Multiannual Financial Framework (MFF) and Next Generation EU fund with a total volume of €750 billion. Although this is a large sum, **a huge gap of at least €2.5 trillion remains to be financed predominantly by the private sector**.

- 6th assessment report by the Intergovernmental Panel on Climate Change (IPCC, 9 August 2021): another wake-up call.

CENTRAL BANKS

- Regulatory power. E.g. guidelines making disclosure of environmental risks mandatory for financial institutions;

- The inclusion of ESG criteria in supervisory frameworks. E.g. risk assessment tool for the evaluation of sustainability with respect to financial assets;

- Purchase of green bonds as part of asset purchase programs;

- Offer tax incentives/lower collateral requirements for green bonds;

- Set reserve requirements for commercial banks. E.g.: preferential reserve ratios for green assets;

- Influencing borrowing costs across the economy through interest.

However…

- Banks are “profit-maximizing institutions”. There are potential risks of inefficiencies associated with subsidizing green technology through central bank generated “greeniums” that are not market-ready;

- Institutional and Comparative advantage;

- Principle of subsidiarity, to be balanced with the principle of proportionality;

- Legitimacy and thus trust.

THANKS FOR YOUR ATTENTION!

For any questions and/or suggestions, please feel free to reach me (also) at ctreglia@luiss.it