CIFF CHILDREN'S INVESTMENT FUND FOUNDATION

London, 28 February 2020

Christine Lagarde
President
European Central Bank
Sonnemannstrasse 22
60314 Frankfurt am Main
Germany

Dear President Lagarde,

European banks should be made to publicly disclose their coal loan exposures and significantly increase the applied risk-weightings of these coal loans

The climate emergency threatens the prosperity and security of all of us. Central banks and financial supervisors must take immediate action to address climate change and particularly the growing financial, human and environmental damage being caused by coal.

We write as trustees of the Children's Investment Fund Foundation (CIFF), one of the largest funders of civil society groups working on climate change-related issues in the world with current assets of $6bn. We have an active climate portfolio of $500m, of which a third is in Europe, and have significant partnerships with several European governments.

We applaud you for including climate change in the review of the European Central Bank's (ECB) monetary policy strategy, and for highlighting it as a "mission critical" priority. We agree, the review is an important platform for the ECB to actively regulate the financial risks associated with climate change.

In 2020, the European Banking Authority will conduct its next EU-wide stress tests on the European banking sector based on scenarios developed in cooperation with the European Systemic Risk Board (ESRB), the ECB and the European Commission (EC). We believe that climate risk assessment is an important part of setting an appropriate regulatory capital framework for European banks. This is particularly the case for coal power financing, given **coal is the single largest source of greenhouse gas emissions globally and these risks are not adequately reflected in the risk analysis and designated risk-weightings of banks and central banks.**

Carbon Tracker estimates that over 40% of global coal power is already uneconomic[1]. In this context, European banks' global coal power financing is highly likely to become non-performing and the assets stranded due to low plant utilisation, as zero-marginal cost renewables grow rapidly, along with tightening regulations on air pollution and carbon emissions globally. Please see attached a presentation on why coal loans are highly likely to become, and should therefore be, accounted for as high-risk loans which are equity risk in nature.

Over the last three years alone, global financial institutions have channelled $745bn in new lending and underwriting to companies developing coal plants[2], and European banks remain counterparties for financing of their existing and new projects. BankTrack estimates that five European banks (BNP Paribas, Credit Agricole, Deutsche Bank, ING Group and UniCredit) provided over $26bn of new finance to international coal plant

[1] See https://www.carbontracker.org/42-of-global-coal-power-plants-run-at-a-loss-finds-world-first-study/
[2] See https://coalexit.org/sites/default/files/download_public/COP25_PR3.pdf

developers[3]. These numbers likely understate the scale of the problem: the stock of coal loans built up by European banks over time is likely to dwarf the annual flow of new lending. Yet European banks are failing to disclose their exposure to coal, leaving central bank regulators and investors in the dark.

A new report by the New Economics Foundation – Banking on Coal[4] highlights that central banks and financial supervisors have a critical role to play in addressing these coal-related financial risks, in particular by:

- Excluding coal-exposed assets from central bank collateral frameworks and asset purchases;
- Accounting for coal risks in setting microprudential capital requirements;
- Introducing macroprudential capital buffers for coal exposures; and
- Ensuring that the risks of coal asset stranding are properly reflected in stringent stress tests.

We agree with these recommendations. In our view, the risks associated with coal financing are very high, and the broader exposure to the coal financing issuer is also increased. In addition, banks' forward-looking models introduced with IFRS 9 must properly account for the high and increasing probability of coal loan default.

We therefore call upon the European bank regulators to:

1. **Review and publicly disclose the appropriate risk-weighting of coal financing to recognise the high risk for European banks and their stakeholders inherent in funding coal power globally;**
2. **Require European banks to publicly disclose their exposures to coal assets and financing, and the risk-weightings associated with these exposures, so that the market is able to properly assess risk and compliance with the communicated ESG policy.**
3. **Exclude banks which have coal lending from central bank asset purchases and collateral frameworks, because of their elevated risk.**

The Basel Committee approach to standardised risk weights relating to claims on corporates tend to range from 20% (AAA-AA rated loans) to 150% for assets below BB-, and 250% for equity and non-performing loans.

In our view, regulators should require European banks to:

1. Provision against existing coal-related exposures and recognise a **risk-weighting of 250%** of their net book value, given the high risk of default of the underlying business. Coal loans are highly likely to become non-performing and hence should be treated as high risk and equity in nature in their risk assessment and the capital weightings assigned by banks and central bank regulators.
2. Increase the risk-weighting on the other borrowing and exposures of the parent company promoting coal power projects, to factor in the climate-related risk caused by their business.

The implication of using a 250% risk-weighting is to make new and existing coal loans uneconomic for a bank. These provisions and increased risk-weightings are necessary notwithstanding whether a bank currently designates such financing as performing assets. Central banks cannot allow banks to hide these loans and the totally unrealistic risk-weightings (likely closer to 50%) being used.

Disclosing the amount and percentage of carbon-related assets relative to total assets is also one of the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD). Such disclosures should be mandatory.

[3] See https://www.banktrack.org
[4] See https://neweconomics.org/2020/02/banking-on-coal

Rating agencies have a key role to play but they cannot properly rate bank debt without loan book disclosure, and while this disclosure is only made to rating agencies privately, it severely limits the ability of investors to assess the risks themselves.

Central banks and financial supervisors are a critical catalyst in directing capital flows and safeguarding the resilience of the financial system. All stakeholders need to understand bank exposures to assets and financing linked to companies with high climate-related risk, particularly coal risk. **We urge European bank regulators to require banks to publicly disclose such exposures, as a matter of urgency.** It will be important for such action to be coordinated with other central banks, financial supervisors and rating agencies. In the event no action is taken, we would expect a public explanation as to why this is the case, given the increased risk to the banking sector.

Yours faithfully,

Graeme Sweeney
Chairman CIFF

Chris Hohn
CIFF Trustee

Copies to: ECB Governing Council Members; Andrea Enria, Chair European Central Bank Supervisory Board; José Manuel Campa, Chairperson European Banking Authority; Irene Tinagli, Chair ECON Committee – EU Parliament; Valdis Dombrovskis, Executive Vice-President – EU Commission; Paul Taylor, CEO Fitch Ratings; Doug Peterson, CEO S&P Global; Ray McDaniel, CEO Moody's Corp; Frank Elderson, Chair Network for Greening the Financial System.