

Open letter to the European Central Bank's Governing Council

Dear Governing Council Members,

8 September 2022

As the ECB is facing high inflation, driven in large part by the Euro Area's reliance on fossil fuels, and in the context of the worsening climate crisis, exemplified by recent record-breaking heatwaves across Europe, measures to mitigate climate-related risks and help accelerate the green transition are of utmost importance.

As highlighted in the ECB's roadmap of climate change related actions, decarbonising corporate bond holdings is a prerequisite to ensuring the compatibility between the ECB operations and climate goals, tackling climate-related risks and helping the EU to wind down its fossil fuel dependency. As announced in July, the Eurosystem will begin in October to tilt its corporate bond holdings towards issuers with better climate performance. However, the exact criteria that the ECB will use to do so remain unspecified, and how they are applied is crucial in determining whether the approach is consistent with a Paris Agreement aligned path.

A robust approach to greening the corporate bond holdings must, as a minimum, deliver on four key aspects:

- 1) Introduce exclusions of the most climate-harmful assets, specifically assets from companies involved in the coal sector or in the development of new fossil fuel exploration and production projects¹, by eliminating them from the current portfolio and future eligibility².
- 2) Prioritise climate neutrality over market neutrality in the approach to decarbonising bond holdings. The proposed tilting approach can only be credible if it leads directly to the correction of the carbon bias in asset purchase programmes. This can only be achieved through a rapid and visible change in the sectoral weightings³, accompanied by a measurable reduction in the carbon footprint that is in line with the Paris Agreement.
- 3) Require that companies' targets and actual performance are aligned both with net zero emissions by 2050 and with 55% absolute emissions reduction below 1990 levels by 2030, in line with the EU's Climate Law⁴ and include all emission scopes (1 - 3) in the calibration of climate performance of issuers. Emission reduction targets should be backed with science-based plans that are quantifiable, outline annual emission reductions aligned with the 1.5C target, and implementation can be regularly verified by the ECB.
- 4) Make climate-related disclosures a mandatory requirement of eligibility for corporate purchase programmes immediately. Initially the ECB should specify the required disclosure standards, which should include both the current climate impacts by reporting on Scopes 1-3 emissions, and credible transition plans. These standards can then be later aligned with the Corporate Sustainability Reporting Directive (CSRD) requirements once these are in force.

By excluding the most harmful assets and those not covered by sufficient climate disclosures, the tilting approach could be appropriately calibrated for the remaining eligible assets, thus strengthening issuers' incentives to meet those minimum requirements while mitigating the Eurosystem's exposure to climate-related risks. To strengthen the signalling effects, the ECB should be transparent about which issuers and assets were no longer eligible due to their inadequate climate performance. To further reinforce these impacts and accelerate the alignment of its entire corporate portfolio, the ECB should not confine those measures to re-investments alone, but include asset sales ahead of maturity as well.

Importantly, the ECB should strive for a more inclusive approach inviting external voices, echoing the approach of the Bank of England involving civil society and other stakeholders through open consultations when developing its policies, including before the policy changes outlined in its announcement dated 4 July 2022 are finalised and enter into force. We welcomed positive engagement with the ECB Climate Change Centre and Member of the Executive Board Frank Elderson, and are keen to continue working with you in driving an ambitious climate agenda forward.

With best wishes,

Signatories

- | | | |
|-------------------------|---|-------------------------------|
| 1 FairFin, Belgium | 6 Reclaim Finance | 10 WWF European Policy Office |
| 2 Green Liberty, Latvia | 7 Veblen Institute for Economic Reforms | 11 Koala Kollektiv |
| 3 Greenpeace Germany | 8 Bürgerbewegung Finanzwende | 12 New Economics Foundation |
| 4 SumOfUs | 9 Sustainable Finance Lab | |
| 5 Positive Money Europe | | |

-
1. As the International Energy Agency underlined in its Net Zero scenario, new fossil fuel production projects are not aligned with keeping global warming at 1.5°C or lower (See: <https://reclaimfinance.org/site/en/2022/01/19/weo-2021-three-principles/>). This conclusion stems from the fact that consuming currently exploited fossil fuel reserves would largely exhaust the remaining carbon budget for 1.5°C of warming and almost exhaust the budget for 2°C of warming (See : <https://iopscience.iop.org/article/10.1088/1748-9326/ac6228>). The scientific need to end fossil fuel expansion is also supported at the international level by UN Secretary General Antonio Guterres.
 2. The ECB should follow the example of the Bank of England (BoE), which incorporated thermal coal exclusions in its approach to greening the CBPS, while addressing its gaps and incorporating exclusions of all fossil fuel assets (See <https://neweconomics.org/2022/04/climate-roadmap>). However, the ECB should also note that the BoE's approach was largely insufficient to reach its climate targets, notably because it failed to exclude other very high-emitters (See: <https://reclaimfinance.org/site/en/2022/02/07/bank-of-england-lets-big-polluters-slip-through-the-net/>).
 3. Dafermos, Y. Gabor, D., Nikolaidi, M. and van Lerven, F. (2022) An Environmental Mandate, now what? Alternatives for Greening the Bank of England's Corporate Bond Purchases. <https://eprints.soas.ac.uk/36190/>
 4. European Commission. (2022). European Climate Law. https://ec.europa.eu/clima/eu-action/european-green-deal/european-climate-law_en
 5. See for example the BoE's consultation on greening its corporate QE: Bank of England. (2021). Options for greening the Bank of England's Corporate Bond Purchase Scheme. <https://www.bankofengland.co.uk/paper/2021/options-for-greening-the-bank-of-englands-corporate-bond-purchase-scheme>