Treasury Committee: Green Collateral Framework

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After making some progress on greening its corporate bond purchases in 2021, the MPC has stalled on operationalising its green remit. The MPC should follow the European Central Bank in greening its collateral framework, which currently favours high-carbon sectors of the economy.

The Bank of England has a mandate to support the net zero transition. In March 2021, then Chancellor Rishi Sunak updated the Monetary Policy Committee (MPC) remit to include supporting the transition to an environmentally sustainable and net zero economy. In his November 2022 remit letter, Chancellor Jeremy Hunt reaffirmed that the MPC should be supporting economic policy by "increasing long-term energy security and delivering Net Zero".

The BoE took steps to green its monetary policy operations, but progress has stalled. The MPC set out an approach to greening its Corporate Bond Purchase Scheme in November 2021, but then decided to wind the scheme down in May 2022, before it could take effect.

The collateral framework is a powerful tool that shapes the economy. The collateral framework specifies the rules via which central banks inject money into the banking system, so that banks can clear payments. A broad range of financial assets are accepted as collateral by the Bank under its eligibility criteria. As the Bank tightens monetary policy and schemes such as the short term repo facility play a greater role in injecting liquidity into the financial system, the collateral framework could have an even greater impact.

The European Central Bank (ECB) has made faster progress on greening its collateral framework. In July 2022, the ECB said it would "limit the share of assets issued by entities with a high carbon footprint that can be pledged as collateral" by the end of 2024.

The collateral framework is skewed towards high carbon assets. Since credit rating agencies do not include climate risks in their assessments, climate risks are not priced into eligibility requirements, meaning that the collateral framework structurally favours carbon intensive sectors; carbon-intensive companies issue 59% of the corporate bonds that the ECB accepts as collateral.

Greening the collateral framework is a crucial step towards securing long-term price stability and acting on the MPC's green remit. 'Haircuts' are the discounts applied by the Bank to the market value of an asset. By subjecting environmentally damaging assets to higher haircuts or excluding them from being eligible as collateral, the MPC would decrease their value across the financial system. Adding environmentally sustainable bonds would generate incentives for firms to issue green bonds, helping to fill the UK's significant green investment gap.

To act on its green remit, the Monetary Policy Committee should:

1. Commit to transparency over the sustainability of the Bank of England's current collateral holdings, by publishing data to disclose the climate and nature-related financial risk of their existing collateral holdings.
2. Support the greening of the financial system through its collateral operations, by including environmental criteria in internal assessment procedures for eligible assets. Require commercial banks to develop sustainable collateral. Over time, apply higher haircuts and exclusions to environmentally harmful assets.