Too-Big-To-Strand?
Bond versus Bank Financing in the Transition to a Low-Carbon Economy

Discussion by Claudio Raddatz
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The paper’s message

• Banks (especially the largest ones) charge a lower spread than corporate bond markets for lending to fossil-fuel firms with higher stranded-asset risks
  • These firms are migrating their financing from markets to banks

• This is evidence that banks are mispricing stranded asset risk because of the implicit support they could get from the government

• This reallocation towards bank lending mitigates the capital constraints faced by fossil fuel firms (...and postpones the green transition)
Comments

- Are banks or markets mispricing the transition risks?
- Can banks help with the green transition?
Are banks or markets mispricing the risk?

• Could it be then that corporate bond investors penalize fossil fuel issuances while banks price them fairly?

• Paper takes the perspective that corporate bond buyers and banks price assets based on fundamentals (they are value investors according to Starks (2022))
  • Price differences imply that one of them is mispricing the risk
  • Since the spread gap is bigger for riskier borrowers, the paper concludes it is banks that are mispricing

• There is evidence that investors focused on promoting certain values have a willingness to pay for green/ESG securities (bonds and equities)
  • Barber et al. (2021) estimates WTP in 4.7pp of lower returns for impact funds.
The share of activist investors has been rising

- The higher spread in bond markets could reflect the increasing relevance of “values” investors?

Source: LSEG Lipper
The dynamic consistency problem of transition risks

• Transition risks that could result in stranded assets are, to a significant extent, policy-related
  • Carbon taxes, outright bans on using certain technologies, etc.

• This poses a dynamic consistency problem:
  • Would a rational policymaker pursue the policy if these risks become macro-relevant (e.g. because they threaten financial stability)?
  • This dynamic consistency problem has been recognized in the literature on systemic risk (Fahri and Tirole, 2012)

• Banks’ loading of fossil-fuel securities could endogenously reduce the transition risk.
  • If banks correctly internalize this GE mechanism but markets do not, bond markets could be the ones overestimating the risk
Could banks help with the green transition?

• The paper concludes that banks’ financing of fossil-fuel firms could postpone the green transition
• But banks also provide syndicated green loans

• Which have greatly expanded in recent years
Could banks help with the green transition?

And green loan issuers seem to improve their emissions intensity more than green bond issuers

Evolution of emissions intensity (CO2 to Income) after issuance of green debt

Cortina et al. (2024)
Conclusion

• Very nice paper with a compelling and plausible story
  • Thorough analysis of confounding explanations

• Who is wrong?
  • Hard to tell ex-ante

• The overall role of intermediaries in supporting the green transition should also consider their intermediation of green loans
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