

MARKET COMMENTARY

The BoE to start applying climate criteria to its credit purchases

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- The Bank of England has published the [details](#) of the greening framework for its corporate bond portfolio, announced earlier this year, and will start applying it next month.
- They are aiming for a 25% decrease in emissions from corporates included in the portfolio by 2025 and net-zero by 2050, both via new eligibility requirements and tilting criteria.
- Eligibility criteria and the tilting framework are smartly designed to skew investments towards energy transition champions and away from the laggards, looking at past and future carbon intensity trajectories, with also increased requirements on high carbon-intensive sectors (Energy and Utilities).
- It will only concern purchases, but divestments might also take place in the future. The BoE will also introduce increased disclosure from 2Q22 and strengthen the requirements over time.
- The immediate market impact looks limited as the BoE is no longer increasing its credit holdings; hence the new framework only applies to reinvestments, currently worth EUR500m a month.
- Nonetheless, it is an important announcement as the BoE is the first central bank to incorporate extra-financial criteria into its asset purchase programs. It will likely serve as a reference for the ECB that is due to start applying climate criteria to its credit purchases in the second half of 2022 and it will be a market mover.

A very ambitious climate policy: The central bank is targeting a 25% reduction in the weighted average carbon intensity (WACI) of the CBPS portfolio by 2025, and full alignment with net-zero by 2050. The Bank of England is also aware that another important role of this policy is to influence markets in a mutual exchange approach with other key stakeholders.

Based on rather strict eligibility requirements: The BoE is introducing import pre-requisites for companies to remain eligible for purchase, it seeks to exclude those that did not meet climate governance requirements that will take several forms:

- Firms must publish public climate disclosure in line with the UK Government's requirements, from 2022.
- Sectors with the highest carbon emissions (energy and utilities) will be required to disclose public emissions reduction targets. Over time, we expect this requirement to get increasingly stringent including possibly third-party verification.
- Issuers having any coal mining activities will become ineligible.
- Issuers using thermal coal in their activities are also ineligible unless they meet stringent criteria related to eliminating existing activity in line with science-based pathways; reducing emissions over time; and renewable energy provision.

Purchases will also be tilted towards the most virtuous players: The BOE will tilt purchases towards stronger climate performers within its corporate credit program (CBPS), and away from weaker performers, using a multifactorial scorecard incorporating:

- The level in emission intensity is calculated based on the company revenues.
- Past reductions in absolute emissions (relative to sector-specific pathways for high emitters);

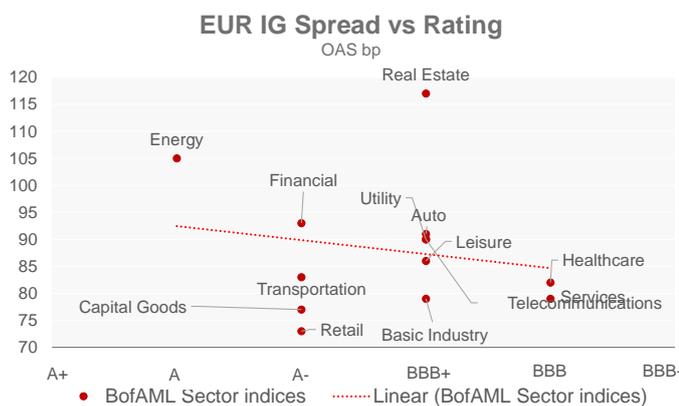
- Publication of climate disclosure.
- Publication and third-party verification of an emissions reduction target.

As for now, the calculation of firms' carbon intensities and changes in their absolute emissions will include all greenhouse gas emissions, converted into units of carbon dioxide equivalence, and reported on a Scope 1 plus Scope 2 basis (ie. not Scope 3 that might be introduced at a later stage).

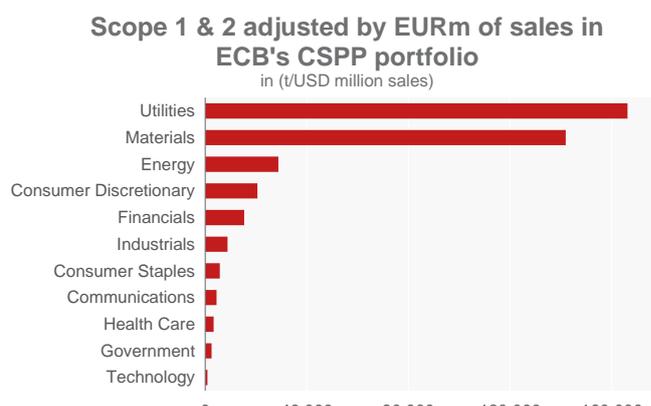
Triggers will become more and more stringent over time: The BoE is willing to ensure that the incentives they set for firms to change their behaviours remain binding as the transition progresses. Their requirements will therefore tighten over time as improvements in data quality and coverage will allow distinguishing more effectively between firms based on the ambition and credibility of their future transition plans.

The direct market impact shall be limited: The market impact will be minimal for now as the BoE is no longer increasing its credit holdings, hence the new framework only apply to reinvestments, currently worth EUR500m a month. Nonetheless, it is an important announcement as the BoE is the first central bank to incorporate extra-financial criteria into its asset purchase programs.

The ECB will likely be inspired by it and it will be a market mover: The inclusion of climate risk in CSPP purchases will only start in the second half of 2022. This will undeniably affect the ecologically dirtiest sectors/players, as the ECB is the largest credit investor in the market. It holds nearly 25% of the CSPP eligible space. We believe that the sectors most affected by the new ECB strategy will be Utilities, Energy and Materials but ultimately it will lead to further discrimination between winners and losers of the climate change journey. However, the impact also critically depends on the measurement retained. For instance, the Auto sector would score very well when looking at direct emissions only, but it is among the worst when indirect emissions are also considered. More detail can be found in our [Focal Point](#) on "ECB greening of the credit market to start in 2022".



Source: Bloomberg, BofAML indices, GIAM own calculations



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