

Please shower before entering the pool

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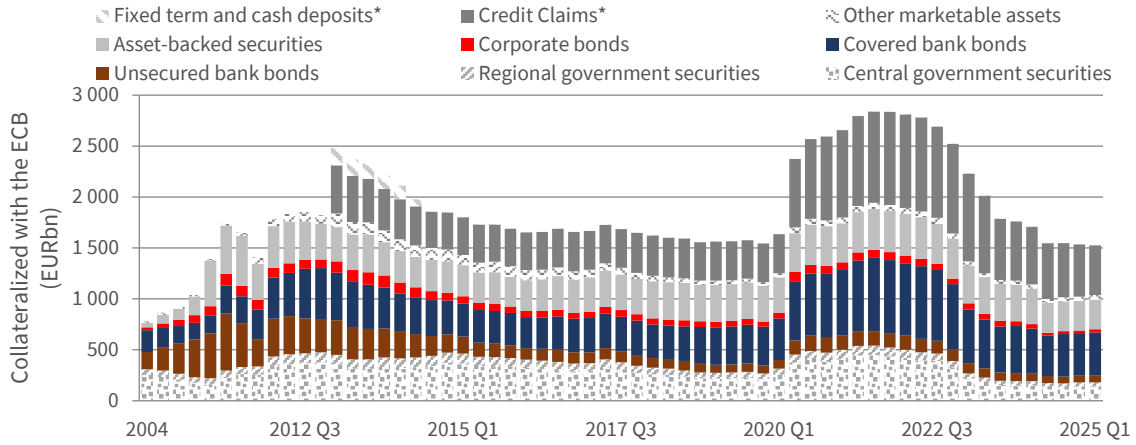
The European Central Bank (ECB) recently announced that it will apply climate risk analysis when determining eligibility and haircuts for bonds in its collateral pool.[1,2] A nominally positive statement was, however, in our view lacking ambition in terms of the scope of assets affected. AFII's analysis shows that by limiting the climate risk assessment to the corporate bond segment, only around 2% of the collateral pool is impacted (the red bars in Figure 1).[3]

We argue the analysis could be extended to also include financial bonds, specifically bank senior and covered bonds (blue and brown bars in Figure 1), increasing the coverage from 2% to 34% of used collateral. Applying AFII's The Box methodology together with the ECB's collateral data, this paper suggests adjustments to the eligibility criteria and haircut levels to better align the collateral pool with climate transition goals.

The analysis shows that the four lowest-scoring financial institutions under The Box methodology, meaning those most engaged in fossil fuel financing through their debt capital market activities, have (recently) softened net zero commitments and operate under regulatory regimes with insufficient climate transition targets. At the same time, these institutions have received the lowest haircuts of any banks in the ECB's collateral program, despite the fact that they themselves nor the covered assets are part of the Eurozone.

Our analysis concludes that removing the bonds of transition laggards like these from the collateral pool is unlikely to have any effect on financial stability, but could have a large effect in terms of driving financial institution climate transition alignment.

Figure 1. Used ECB collateral pool split by asset class and highlighting corporate and bank bonds. Source: ECB.



[1] The appendix "Why collateral matters" outlines why this technical discussion is of importance.
[2] "ECB to adapt collateral framework to address climate-related transition risks", ECB, 29 Jul 2025.
[3] See "The AFII View: ECB, necessary not at all sufficient", AFII, 30 Jul 2025; "ECB to haircut corporate bonds according to climate risk", GlobalCapital, 31 Jul 2025; "ECB to 'reduce value' of high-climate-risk assets pledged as collateral", Environmental Finance, 29 Jul 2025.

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The ECB's collateral eligibility pool and The Box

In Table 1, we analyse and rank the banking sector using our climate alignment factors and map each institution to its outstanding bonds that are eligible for the ECB collateral pool. Specifically, the table merges data from our The Box methodology[4] with the ECB's collateral eligibility list[5], as well as a few other climate alignment indicators.[6] Banks that are not in our The Box universe, generally smaller ones, do not show up in the table.

The first column **Net green/fossil fee ratio** indicates how much the bank has made from green vs fossil fuel-related debt capital market activities over the past year, and is AFII's preferred metric of banks' transition alignment. The column for **NZBA status/departure** shows membership of the Net Zero Banking Alliance, which acts as a quasi-binary indicator of a bank's strategic commitment to climate alignment. The **MSCI Sovereign Implied Temperature Rise (ITR)** numbers indicate the temperature alignment of a bank's home country, based on the country's decarbonisation targets and track record. As banks are highly regulated and usually heavily intertwined with their domestic markets, this indicator proxies the expected amount of climate transition support a bank is likely to get from the system in which it operates. This is especially important in understanding covered bonds, where the regulatory framework is key for ECB collateral eligibility.

The **ECB collateral eligibility columns** provide data on the bank bonds that are in the program. 'Weighted' numbers show weighted averages based on the nominals of the eligible bonds.

Table 1. ECB eligible collateral pool, bonds issued by banks covered by AFII's The Box analysis. Table column explanations in the text. Source: AFII, NZBA, MSCI ESG Research, ECB, Bloomberg. As of 11 Aug 2025.

	Climate transition alignment			ECB collateral pool eligibility				
Bank	Net green/fossil fee ratio	NZBA status/departure	Country MSCI ITR (C°)	Number of bonds	Nominal eligible (mn)	Average haircut	Weighted haircut	Weighted maturity (yrs)
Swedbank	35.5%	Member	1.6°	41	12.5	7.2%	6.2%	2.9
SEB	24.0%	Member	1.6°	13	13.7	7.1%	5.5%	2.0
Danske	20.1%	Member	2.0°	26	15.6	6.6%	6.4%	2.8
Nordea	18.4%	Member	1.7°	49	26.8	5.8%	4.4%	3.0
ABN Amro	16.5%	Member	2.1°	87	76.1	8.3%	5.9%	6.5
Credit Agricole	11.5%	Member	1.9°	149	68.6	12.5%	12.6%	4.4
Natixis	9.4%	Member	1.9°	8	1.3	7.1%	4.4%	3.1
NatWest	9.4%	Member	1.8°	8	1.1	12.1%	9.8%	2.2
BBVA	9.0%	Member	2.1°	21	19.6	10.7%	7.0%	3.4
SocGen	8.9%	Member	1.9°	37	18.1	14.5%	12.0%	2.9
Rabobank	7.7%	Member	2.1°	81	84.7	11.4%	3.6%	4.6
BNP	7.1%	Member	1.9°	10	18.8	2.2%	2.4%	4.0
DNB	6.6%	**Not member**	1.8°	63	17.1	5.2%	2.8%	4.6
ING	6.4%	Member	2.1°	47	63.5	3.9%	2.8%	4.2
Lloyds	6.3%	Member	1.8°	9	3.6	3.7%	2.0%	2.7
Intesa	5.9%	Member	2.2°	243	112.9	14.5%	7.7%	4.4
Commerzbank	5.6%	Member	2.0°	123	48.5	7.7%	3.9%	4.2
UniCredit	3.8%	Member	2.2°	86	34.0	16.6%	8.2%	3.6
HSBC	3.0%	**Jul 2025**	1.8°	31	3.3	12.9%	11.4%	3.4
Santander	2.3%	Member	2.1°	163	79.4	12.1%	6.2%	4.2
Deutsche Bank	2.3%	Member	2.0°	353	46.0	10.8%	6.6%	2.5
Morgan Stanley	**-1.5%**	**Dec 2024**	**2.9°**	5	0.1	14.8%	14.6%	8.0
Barclays	**-3.0%**	**Aug 2025**	1.8°	24	4.8	8.3%	7.7%	0.5
Citigroup	**-3.0%**	**Dec 2024**	**2.9°**	1	0.0	10.0%	10.0%	1.9
Bank of Montreal	**-3.7%**	**Jan 2025**	**3.3°**	6	8.9	2.3%	1.5%	1.6
Royal Bank of Canada	**-5.5%**	**Jan 2025**	**3.3°**	24	20.6	3.6%	2.0%	2.9
Bank of Nova Scotia	**-8.1%**	**Jan 2025**	**3.3°**	11	12.4	3.7%	2.1%	3.2
TD Bank	**-8.9%**	**Jan 2025**	**3.3°**	17	23.9	2.5%	1.9%	2.6

[4] Please refer to The Box subsection of the AFII's homepage for overview and latest data from the methodology.

[5] See "Eligible Marketable Assets", ECB, accessed 11 Aug 2025.

[6] The list does not include "credit claims" in the collateral program that is likely a large source of collateral cash for banks. Credit claims would add another 32% of the total collateral pool.

Data analysis and key takeaways

The table is ordered by the net fee column. For understanding banks' alignment with ECB climate goals, readers should focus on the tail end. This shows those institutions operating counter to the central bank's aim with the collateral pool.

We overlay a distinct cut-off at the 0% net fee threshold, thereby defining a 'bottom tier' of banks that make more fees from running fossil fuel deals than from green deals. These seven banks, MS, BARC, CITI, BMO, RBC, BNS and TD are notably all non-Eurozone and have all left the Net Zero Banking Alliance. BARC did so fairly recently compared to the North American institutions.[7]

Furthermore, all but one of the bottom tier institutions operate under the regulatory regimes of high-emitting countries, based on their implied temperature ratings (ITRs). BARC again is the exception, with a home country implied temperature rise of 1.8°C. Perhaps notable here is the 3.3°C ITR for Canada, substantially higher than the 2.9°C for the US. This is due to the former's large-scale plans to continue non-conventional oil and gas production.

Turning to the ECB collateral metrics, we see that MS and CITI are miniscule in terms of the amount of paper outstanding that has collateral eligibility, with EUR100mn and EUR0.1mn, respectively. For the purposes of this exercise, they are more or less irrelevant.[8]

This leaves us with BMO, RBC, BNS, and TD. Collectively, the quantum of bonds that are collateral pool eligible comes to more than EUR65bn. This is a substantial amount in the context of the collateral pool itself, but is slight from a banking stability viewpoint. Regarding the first point, the total size of *used* corporate bond collateral affected by the ECB's high-profile statement is around EUR30bn, just a fraction of the total amount of eligible bonds from the Canadian bank issuers. On the second point, Canadian bank bonds represent just 0.33% of the total eligible collateral pool, suggesting their exclusion poses minimal risk to financial stability within the Eurozone.

Furthermore, these four institutions also enjoy some of the lowest-weighted haircuts of those banks in The Box, with haircuts ranging between 1.5-2.1%. The average weighted haircut is 6.1% for all listed institutions. This seems counterintuitive in a framework that should be applying larger haircuts when there is more climate transition risk at hand.

To summarise:

- **Four banks currently in the ECB collateral program can be readily identified and separated out as having poor climate transition alignment.**
- **These banks today face among the lowest haircuts of all institutions.**
- **The amount of eligible paper issued by these banks dwarfs the amount covered by the ECB's corporate bond collateral program.**
- **Still, it is unlikely that the removal of these banks' bonds would undermine the financial stability purposes of the collateral program.**

[7] As a discussion of NZBA membership as an indicator, see "An examination of net-zero commitments by the world's largest banks", ECB Occasional Paper Series No 334., 2023.

[8] The main structural difference among the North American banks for purposes of the ECB's collateral is that Canada has a regulatory covered bond framework, allowing Canadian banks to issue real-estate backed bonds that are ECB collateral eligible.

Conclusion/recommendation

In our view, the weak climate transition metrics of the lowest-performing banks in the ECB's current collateral pool —BMO, RBC, BNS, and TD — together with their current 'best-in-class' haircut treatment, call into question the effectiveness of the ECB's application of climate risk metrics in its collateral framework. We further note that this analysis does not incorporate asset- or activity-based exclusions commonly used in the private sector, such as those related to thermal coal or oil sands. Including such exclusions would likely strengthen some of our conclusions.[9]

Given the clarity of the indicators we use, it would seem trivial for the ECB to adjust its programme and expand climate risk analysis beyond the current 2% of collateral to our suggested 34%. The simplest follow-on measure would be to adjust haircuts, similar to what has been suggested for corporate bonds. Alternatively, the ECB could consider applying a binary (in)eligibility criterion. Such measures would serve to prepare banks for the application of comparable climate-related adjustments to credit claims, potentially extending climate risk coverage to an additional 32% of the collateral pool.

Of course, the initial corporate bond coverage announced recently may be viewed as a first step toward broader coverage across asset classes.[10] We believe that methodologies such as those presented in this paper could accelerate this expansion. The corporate bond rules are set to take effect in the second half of 2026, and one can hope that coverage of the financial sector could begin concurrently or soon thereafter.

Appendix: Why collateral matters

The ECB's collateral pool currently amounts to around EUR1.5trn (see Figure 1) and is likely one of the largest bond portfolios in the global financial system. Eligible bonds are effectively 'cash-like' as the ECB has committed to exchange them for cash, no or few questions asked. The mechanism through which the ECB manages risk in this pool is the haircut — a percentage deduction applied to the bond's market value to determine the amount of cash provided. If a bank posts €100 of an eligible bond to the ECB, and the haircut is 2%, then the bank gets €100-2%=€98 in cash back.

The core purpose of a collateral program is to compress liquidity premia, which directly translates into lowering cost-of-capital over the long term. Normally, investors require a liquidity premium to compensate for the uncomfortable position that a bond they own might not be sellable at a certain point in time. For example, an asset manager running a fund may face outflows one day, at which point they would appreciate having bonds they can liquidate immediately to source the necessary cash. This is especially important in tail-risk scenarios such as the Covid crisis, the Great Financial Crisis, and February 2016. On such occasions, the willingness to pay a higher price for highly liquid bonds effectively lowers their yield or credit spread. The haircut applied to these bonds determines the amount of cash that can be raised through collateralization; the lower the haircut, the greater the value placed on bonds eligible for use as collateral.

What is in it for the central bank? The ECB has used the collateral program to inject liquidity into the Eurozone banking system at various crisis points. When European banks are in trouble, such as during the Euro sovereign crisis of 2010-15, they have difficulties raising cash the usual ways

[9] For an example of such suggested exclusions, see "The Montreal-West Virginia-Frankfurt price stability paradox", AFII, 6 May 2024.

[10] We advocated for climate transition analysis for the Eligible Marketable Assets list, specifically SSA paper, as early as in 2020 in "The ECB and Alberta's oil production tax holiday".

through markets. At these times, tthe ECB has allowed them to post certain securities as collateral in exchange for cash, in order to avoid an escalating illiquidity situation.

Are there drawbacks to large-scale collateral programs? Few argue against the central bank's role as lender-of-last-resort. However, **there are some drawbacks** if the programs are extended beyond their 'Minsky Moment' contexts.

First, the central bank effectively takes on liquidity risk on behalf of the public purse. This may have moral hazard effects, since rather than evaluating assets on the basis of their independent credit risk profile, banks will seek assets that comply with the central bank's collateral eligibility criteria, and/or construct such assets themselves. Indeed, it is rational for them to seek the highest risk assets that they can get conditional on the eligibility and haircut levels that the central bank provides.

Second, the liquidity premium is removed from private investors, such as pensions funds. Say a pension fund has a 10% allocation into covered bonds, and that the collateralizable nature of covered bonds compress their spread by 3bps per annum. That may sound like very little, but as these AAA-rated securities trade at a spread of perhaps 20-30bps, it actually removes 10-15% of the excess return potential for the investor. The natural response then is for the investor to move some of that allocation into other bonds that are more illiquid. As a result, funds start allocating into even more illiquid investments as they know the central bank is provisioning liquidity at the top of the capital structure.

Lastly, collateral programs, despite having such large AUMs, are generally not regulated. Forget SFDR, Article 8, and other control mechanisms on the risk-taking or climate impact of private investors. It simply does not apply when the regulator herself is running portfolios. Some asset managers and owners may see this as unfair, which may dampen their enthusiasm for the regulatory policy.

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