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Special issue on green and ethical finance

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Editorial

Special issue on green and ethical finance

This special issue includes several papers that focus on green and ethical finance. The climate change challenge has raised important questions about the financial sector's role in realizing a carbon-neutral global economy. The global financial crisis also brought critical ethical and governance questions for financial sector actors to the forefront. Such developments have together increased attention to environmental, social and governance (ESG) issues among financial sector practitioners, regulators, and investors. Recently, there has been an increasing focus of finance researchers on issues related to ESG and climate change, reflected also in the increasing number of submissions and published papers in the Journal of Banking and Finance related to these topics.

This special issue collects several papers that touch on different topics related to ESG and climate change. Some of these papers were presented at a research conference on green and ethical finance on 16-17 September 2020, jointly organized by Asian Development Bank Institute (ADBI), the Journal of Banking & Finance, and the Singapore Management University's Sim Kee Boon Institute for Financial Economics. In this preface, we briefly summarize the five papers included in this special issue.

Do banks price carbon emissions?

Climate change poses new risks for financial intermediaries and an important question is to which extent these risks are being priced properly. Combining syndicated loan data with carbon intensity data (CO2 emissions relative to revenue) of borrowers across a wide range of industries, Torsten Ehlers, Frank Packer and Kathrin de Greiff find a significant "carbon premium", but only since the Paris agreement in 2015. Banks charge a carbon premium both within industry sectors, as well as across industry sectors, i.e., beyond sectors subject to stranded assets or with typically high carbon emissions. However, the price of risk appears to be relatively low given the material risks faced by some borrowers, with only carbon emissions directly caused by the firm priced, and not the overall carbon footprint including indirect emissions. Interestingly, "green" banks do not appear to price carbon risks differently from other banks.

When do firms care about ESG?

What turns firms' attention to ESG scores? Mark Shackleton, Jiali Yan, and Yaqiong Yao show that worse stock market performance increases firms' efforts on environmental and social (ES) activities, using a panel vector autoregression to control for endogeneity. Specifically, firms are more likely to improve their product and diversity performance and enhance their ES strengths rather than reduce ES concerns after poor stock market performance. This finding that poor stock market performance precedes enhanced ES performance is present (i) in firms with more financial slack, (ii) in firms with higher customer awareness, (iii) during the post-financial crisis period, and (iv) when a firm's shareholder activism on ES issues is intense. So, there seems important pressure from markets, customers and investors on firms to shift their attention beyond pure profit maximization.

What role do retail investors play?

Do retail investors really incorporate social considerations into their investment decisions? Philipp Kollenda analyzes 70,000 transactions by retail impact investors on a peer-to-peer lending platform that intermediates loans to firms in low-income countries and gauges the relative importance of financial returns vis-à-vis social consideration for retail investors. Financial returns significantly influence investors' decisions, while expected social impact has no or limited influence on investors' funding decisions. The results suggest that peer-to-peer lending platforms should function as gatekeepers of social impact and cannot outsource the evaluation of social impact to retail impact investors.

Do sustainable consumers prefer socially responsible investments?

Ann-Christine Brunen and Oliver Laubach gauge whether people behave consistently when it comes to sustainability, using a financially incentivized choice to study the non-investment-related sustainable behavior of the clients of three German robo advisors and relate it to their investment decisions with a digital wealth manager that offers both conventional and sustainable investments. They find that households with more sustainable consumption patterns are also more likely to choose a portfolio following a sustainable investment strategy. However, they also find that self-reported sustainable consumer behavior not backed up by pertinent actions is not significantly related to sustainable investment choices.

Do depositors care about ESG?

Mikael Homanen[1] gauges whether depositors react to negative non-financial and climate related information about their financial

[1] To avoid any conflict of interest, this paper was under the editorial responsibility of co-managing editor Carol Alexander and not Thorsten Beck.

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institutions, studying the case of the highly controversial Dakota Access Pipeline. Using branch level data for the United States, he shows that banks that financed the Pipeline experienced significant decreases in deposit growth following social protest. These effects were greater in localities with higher support for the protests, higher environmental and social awareness and closer proximity to the pipeline. Data suggests that locally oriented banks were among the main beneficiaries of this depositor movement. These results suggest that non-financial preferences of households can influence their financial investment decisions.

These five papers show the importance of climate change and ESG concerns for firms, financial institutions and households, but also that there are limits to the extent to which these risks are properly priced. More research will be needed to underpin the critical function that the financial sector has in supporting the economic transition and resource re-allocation made necessary by climate change.

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