”Glossy Green” Banks: The Disconnect Between Environmental Disclosures and Lending Activities

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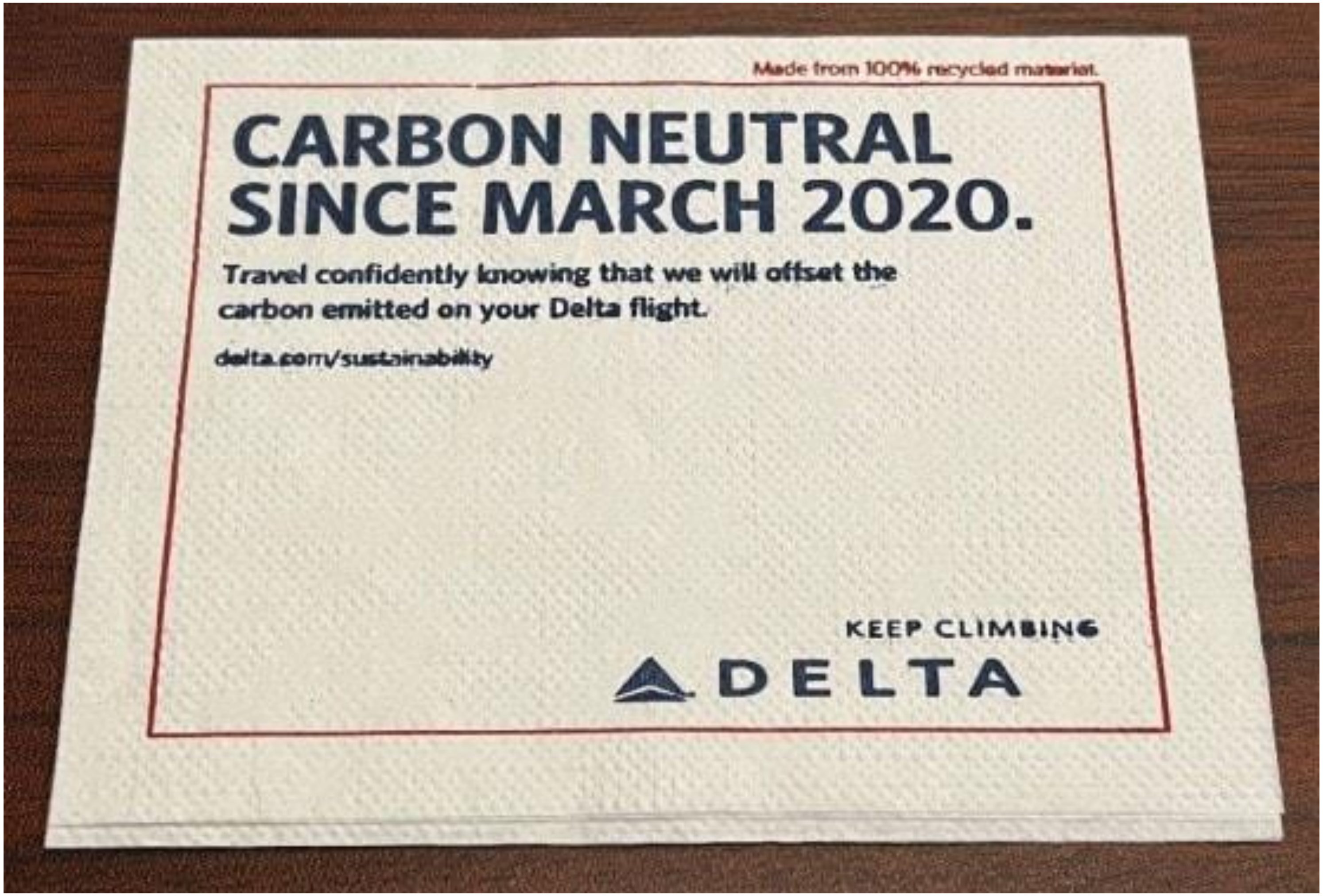
Greenwashing: A Hard-to-Escape Reality



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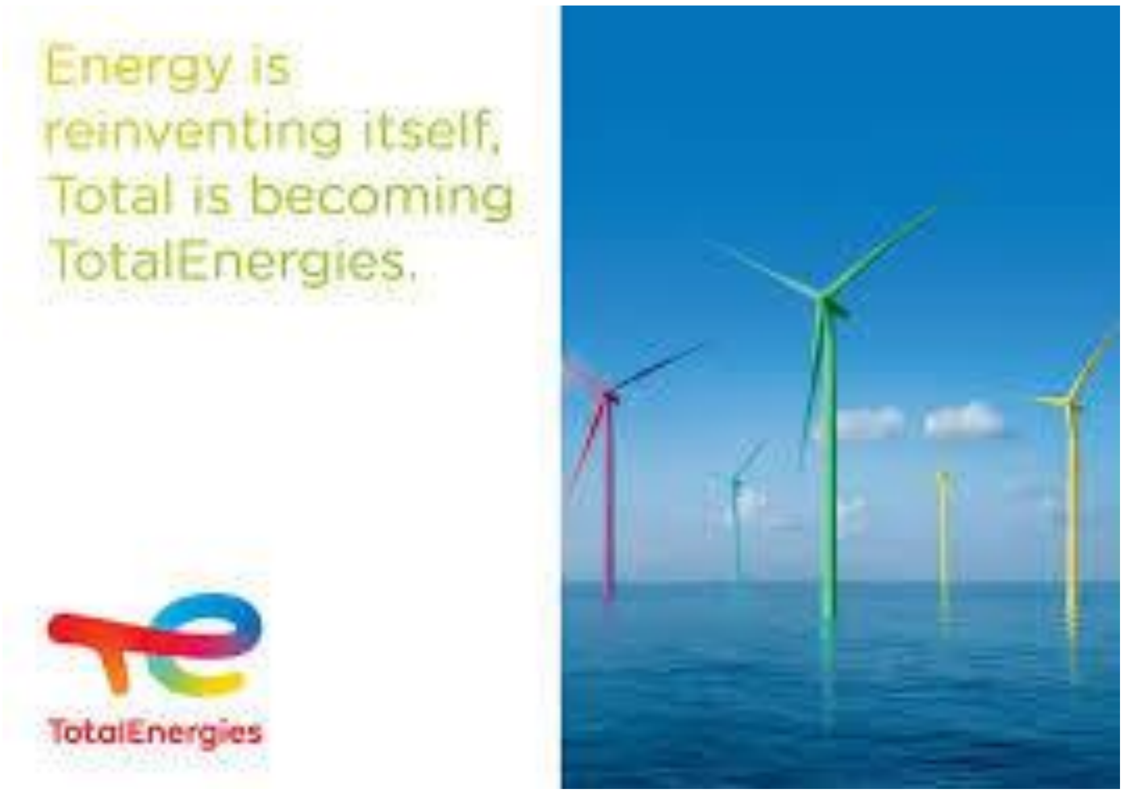


What are the costs of Corporate Greenwashing?

- **Delay / replace** actual impactful actions towards sustainability from firms (or their clients)

- Build **mistrust** towards business / finance

- Can be **wasteful** on its own (e.g. public advertising on screens)

- **Can even hide <u>worsening</u> behaviors**

$\Rightarrow$ **Is greenwashing particularly bad in finance?**

It is… if Finance Can Save the World!

- **Economic rationale:** most human activities require capital, so incorporating externalities in the capital allocation system can have a large impact on the scale and scope of these activities

- **Legitimacy:** many end investors, e.g. households, sincerely care about mitigating climate change and biodiversity loss, and not only about financial returns

- **Main proposed tools:**

1. **<u>Divestment / Exit Policies / "ESG"-driven portfolio allocation</u>**
2. Impact Finance
3. Voluntary Carbon / biodiversity offsets

Framework for impact of financial institutions policies
(Green and Vallee, 2023)

Policy Impact	=	Policy Compliance	x	Limited Substitution	x	Capital Dependence

- **Policy Compliance**
  - Do the financial institutions actually ration credit to targeted firms?

  <u>=> THIS PAPER</u>

- **Limited Substitution**
  - Is it difficult for exposed firms to find alternative sources of capital?

- **Capital Dependence**
  - Is outcome of interest affected by rationed or higher cost of capital?

This Paper

What:

- Banks that increase their *emphasis on sustainability* for their lending policies extend **more new loans to brown firms** / less to “green” firms
- These patterns are more pronounced for loans to **small borrowers**
- These facts are unlikely to be driven by banks engaging in transition lending, but instead support **greenwashing**

How:

- *Emphasis on sustainability* is measured through an **aggregation of the ChatGPT assessment of each paragraph** of the bank annual and sustainability reports
- *Brown/green loans are* measured through **credit registry data, based on industry or firm emission intensity**

Contribution to Literature

Scope of sustainability policies matter for banks to actually follow through on them:

- Precisely targeted policies seem to be followed with actions (Green and Vallee (2023), Haushalter et al (2023))
- Broader commitments appear less effective (Kacperczyk and Peydro (2022), Sastry, Verner and Marquez Ibanez (2024))

⇒ Disclosures might be the **broadest / less precisely defined object**

⇒ Why shall stakeholders care about disclosure / communications that are **not associated with commitments**?

Measure of Sustainability Emphasis

- Who is the **recipient** of this communication: investors or customers? It would help to clarify the underlying **theory of greenwashing** (lowering cost of capital? Avoid activism?), which would speak to the right measure to use
- LLM-based measure could be holistic and assess whether the communication appears as sincere, or can easily be spotted as cheap talk => ***would call for more nuanced prompts***
- Needs to make clearer what the current measurement brings vs. simpler/more transparent methods such as counting keywords
- Relative vs. absolute quantity of green talk?
- Would be helpful to illustrate and describe the **heterogeneity** of sustainability emphasis **in the time-series (as identification is based on it)**

Econometric Specifications

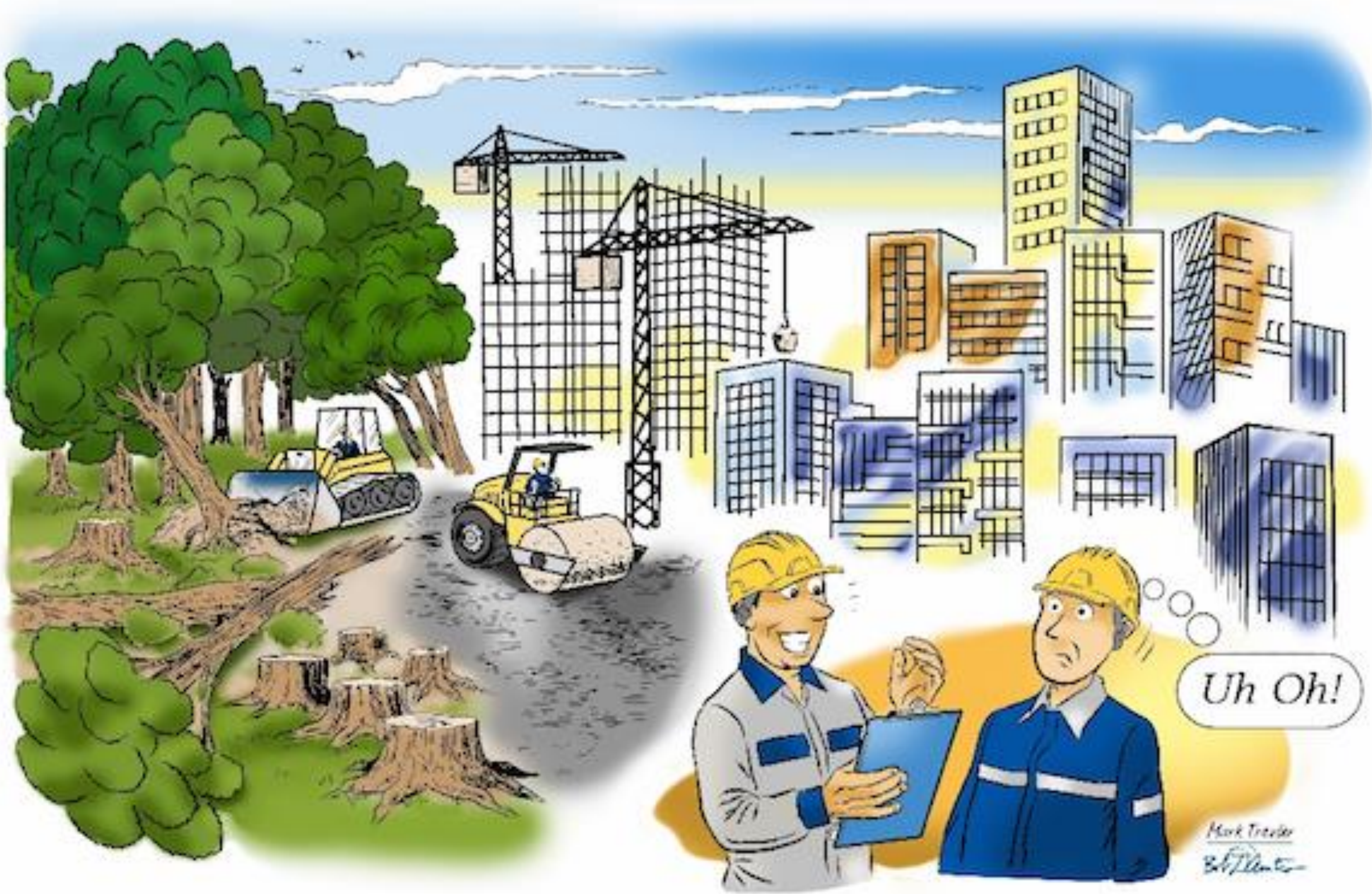
- Do you want to make a **cross-sectional or time-series point**? Specification suggests the latter, but would be useful to clarify why ***changes*** are more important than ***levels*** for greenwashing

- Not trivial to interpret the results in a specification with **bank fixed effects** and explanatory variable is bank is in the top quintile of environmental reporter in that year (relative measure)

- Do we expect an *absolute* reduction in lending to brown firms for banks reporting more on the environment than they used to, or one *relative* to other banks? Current specifications look at relative effect

- I would start with **simpler specifications**, maybe using sample splits

What is “Green” Lending?



Don’t worry about sustainability. They’re all LEED buildings!

Minor Comments

- **Tighten your cites**: e.g. Green and Vallee (2023) DO NOT show that banks that become members of initiatives extend more syndicated loans to greener borrowers at lower prices

- **Include placeholders** for tables and figures to facilitate reader's back and forth

Conclusion

- Nice paper! Clearly a lot of work

- I would focus on:

1. clarifying conceptually the motive for greenwashing
2. make the empirical analysis flowing from this framework and as easy to digest as possible

- I look forward to reading the next version!