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**‘Save the banks or save the planet?’: Governing
through strategic ambiguity in EU sustainability-
related banking regulation**

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ABSTRACT

The literature remains divided on whether sustainability-related financial governance has shifted from a narrow risk-based approach to a stronger focus on transition pathways, and whether the currently dominant approach has the potential to redirect credit away from carbon-intensive investments towards green sectors. Building on a strategic-relational approach and the concept of strategic ambiguity, as well as insights from 30 expert interviews, documentary analysis, and three public consultations, we argue that the introduction of the current sustainability-related financial policy approach in the EU was conditioned on an ambiguously framed risk narrative. By reconstructing the policy process, we suggest that while strategic ambiguity initially helped to preserve an element of credit steering, it ultimately hampered its institutionalization. Thus, we conclude that the current policy approach neither constitutes a simple continuation of existing prudential approaches nor marks a substantial divergence from them, i.e., allocative policies. While we contend that the dominant approach has shifted towards a stronger focus on transition pathways, we suggest that it represents an unbalanced mediation of stakeholders’ interests, which also limits its allocative potential.

KEYWORDS: Banking regulation, Strategic ambiguity, Sustainable Finance, Climate-related and environmental risk, Transition plans

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Introduction

Ever since the European Union (EU) launched sustainable finance policies in 2018, the process of integrating sustainability concerns into European banking regulation has been marked by two distinct goals: First, steering bank lending to support the EU's ambitious climate targets, and second, protecting the banking system from mounting climate-related risks. After years of negotiation, *prudential transition plans* have become the tool of choice in EU sustainability-related banking regulation, obliging banks to demonstrate that their transition planning is 'compatible with EU policies implementing the Paris Agreement, with concrete intermediate milestones, to enhance their long-term strategies and decision-making' (Elderson, 2021). While some observers interpreted the tool as a strategy to foster green and penalize carbon-intensive investments (CDP, 2024; Reclaim Finance, 2024; WWF, 2024), EU financial supervisors emphasized that prudential transition plans adhere to an established risk-based logic, with no intention of allocating credit (Elderson, 2022; EBA, 2024). As one banking practitioner aptly pinpointed this polarity: Should financial regulators now rather 'save the banks or save the planet?' (Interview 1).

The International Political Economy (IPE) literature remains divided on whether sustainability-related financial governance has shifted from a narrow risk-based approach towards a stronger focus on transition pathways, and whether the dominant approach has the potential to redirect credit away from carbon-intensive investments towards greener sectors. While one camp perceives a continuity of a risk-based, *prudential* governance approach that maintains favorable conditions for market-based finance and carbon-intensive assets (Baer et al., 2021; Chenet et al., 2021; Kedward et al., 2024), the other camp observes a discontinuity, namely the emergence of a novel approach that enables financial supervisors to allocate credit (van't Klooster, 2021; Di Leo, 2023; van't Klooster & Prodani, 2025). Such a shift would mark a significant departure from the highly institutionalized principle of market neutrality and move banking governance closer towards *promotional* policy objectives of credit guidance (Bezemer et al., 2018; Dikau & Volz, 2021; D'Orazio, 2023).

While this debate has considerably advanced our understanding of the different approaches that states have taken in response to the climate crisis in the realm of monetary and financial policy, we argue in contrast to these two camps that the introduction of the current sustainability-related financial policy approach in the EU neither constitutes a simple continuation of existing prudential approaches, nor marks a substantial divergence from them, i.e. allocative policies. Instead, we suggest that the EU's approach is inherently contradictory because it seeks to maintain a promotional spirit in prudential disguise. We show that while this ambiguity initially helped preserve an element of credit steering, it ultimately hampered its institutionalization. While we contend that the now dominant approach has shifted towards a stronger focus on transition pathways, we suggest that its allocative potential has been overestimated. To support our argument, we reconstruct the policy process of integrating sustainability into EU banking regulation, based on an analytical framework combining a strategic-relational approach (Jessop, 2010) with the concept of strategic ambiguity (Best, 2008), and a mixed-methods approach, including 30 interviews, documentary analysis, and an evaluation of three EU public consultations.

We identify three periods in this policy process: The first period was marked by a strong dichotomy between promotional and prudential policy discourses. EU policymakers faced difficulties in crafting a coalition in support of the rudimentary promotional policy of a green supporting factor (GSF). In the second period, the ECB became more proactive in shaping

sustainability-related financial policies, which – by *ambiguously* framing prudential transition plans as a tool for banks’ path towards Paris-alignment – contributed to privileging the prudential discourse. We demonstrate that this new approach not only responded to a call by civil society to steer credit away from carbon-intensive sectors but also incorporated financial industry demands for greater leeway to decarbonize its portfolios. The analysis of the third phase reveals how the ECB faced difficulties in defending its ambiguously framed proposal of prudential transition plans against its own and the EU’s more general prudential architecture. Instead, the risk-framing left ample room for other actors in EU financial supervision to challenge potentially allocative elements.

Our findings make three contributions to the literature. First, in following a call for paying greater attention to ‘structural pressures and entanglements with the private sector that shape central bank policies’ (Kedward et al., 2024: 1596), we suggest an analytical framework that takes structural factors seriously while also considering actors’ strategies. By integrating work on the relevance of strategic ambiguity in financial governance (Best, 2008; van’t Klooster, 2021) into a strategic-relational approach (Jessop, 2010), we can show *how* and *why* actors affected, or failed to affect, change through and in response to highly sedimented political discourses in EU banking regulation. Second, while we confirm findings of an element of discontinuity with a narrow risk-based approach (van’t Klooster & Prodani, 2025), reconstructing the policy process allows us to qualify whose interests are represented in the predominant approach, and how this limits the potential for credit allocation. Third, and in contrast to contributions that have mainly focused on central banks (Deyris, 2023; Quorning, 2023; Siderius, 2023; Aguila & Wullweber, 2025) or private-sector-led decarbonization (Fichtner et al., 2025), our contribution accounts for the multiplicity of political actors in the EU who leave a considerable mark on its green financial and monetary governance.

The remainder of this paper is structured as follows. The second section introduces the discussion of (dis-)continuities in banking regulation and supervision in the face of climate change in the IPE literature, based upon which we develop a typology of promotional and prudential policy approaches. The third section presents the analytical framework for scrutinizing power struggles in political processes by integrating the concept of strategic ambiguity (Best, 2008) into a strategic-relational approach (Jessop, 2010). The fourth section is divided into three periods. The first period (2017-2021) saw a strong dichotomy between the promotional and the prudential approach. In the second period (2021-2023), the prudential discourse superseded the promotional one through the proposal of prudential transition plans. In the third period (2023-2025), the ambiguity inherent in this proposal contributed towards strengthening its risk-based interpretation. The penultimate section discusses the paper’s results regarding the ambivalent role of strategic ambiguity in policy processes, while the last section critically assesses the claim of allocative potential.

(Dis-)continuities in banking regulation and supervision in the face of climate change

The Basel Accords, adopted by the Basel Committee for Banking Supervision (BCBS), form the core set of international rules for banking regulation and serve as a global minimum standard with ensuing national implementation. Basel Pillar 1 sets minimum capital requirements by applying risk weights to banks’ existing stock of capital, determining how much money they can lend to counterparties. Pillar 2 adds additional capital requirements related to banks’ specific risks in the supervisory review process. Pillar 3 requires banks to disclose

information on the respective risk categories to enhance transparency and market decisions. The most recent BCBS Accord – Basel III – was negotiated in 2010 to correct several shortcomings of Basel II, which is widely understood to have exacerbated rather than prevented crisis tendencies in the run-up to the Global Financial Crisis (GFC) (Baker, 2013). The prevailing problem analysis of Basel II rules is that financial regulation and supervision had focused too much on the stability of individual financial actors (*microprudential* perspective) and lacked an understanding of how financial systems tend to produce systemic risks, financial bubbles, and liquidity spirals (*macroprudential* perspective) (De Larosière Group, 2009). In the EU, the political and economic consequences of the crisis contributed to reforms that centralized the supervision of large banks at the ECB, that streamlined microprudential regulation and supervision at the level of the European Supervisory Authorities (ESAs), including the European Banking Authority (EBA), and that introduced the macroprudential European Systemic Risk Board (ESRB) (ECB, 2024a; European Parliament, 2025). Considering these institutional changes, the IPE literature remains divided on whether banking regulation essentially perpetuates the pre-GFC market-oriented type of governance (Helleiner, 2014), or whether financial supervisors increasingly impose their own risk definitions on the financial industry (Baker, 2013; Coombs, 2022; Thiemann, 2024).

With a recognition of climate-related risks as *financial risks* (Carney, 2015) and the rise of green central banking practices in the EU and elsewhere (Deyris, 2023; Quorning, 2023; Siderius, 2023; Aguila & Wullweber, 2024), the IPE literature has devoted growing attention to the analysis of sustainability-related monetary and financial governance. According to an established definition, climate-related and environmental risks (henceforth climate-related risks) can accrue to real and financial economy assets through physical risks, when sudden and long-term effects of climate change materialize, through transition risks, when policies, technological change, or consumer preferences shift, or through litigation risks, when firms are sued for climate-related corporate misconduct (Carney, 2015; Campiglio et al., 2022). In the institutional context, a differentiation between double and single materiality, and outside-in and inside-out risks, has become common: While single materiality encapsulates how the financial sector is affected by climate-related risks (outside-in risks), double materiality adds the notion of how it impacts the environment and its counterparties, such as the productive economy (inside-out risks) (Hummel & Jobst, 2024).

Various contributions have demonstrated how financial and monetary policies can be *greened* in theory and how different states already incentivize or penalize financial assets based on their sustainability characteristics (Dikau & Ryan-Collins, 2017; Dikau & Volz, 2021, 2023; D’Orazio, 2023). To safeguard financial stability in the face of climate-related risks, financial supervisors can employ policies such as adjustments to capital and liquidity requirements, stress tests, and risk disclosure (D’Orazio & Popoyan, 2019). Monetary policy, in turn, is concerned with how climate change affects price stability. It can attempt to correct ‘market failures’ (Schnabel, 2021) and factor in climate-related risks by, for example, excluding carbon-intensive assets from central banks’ collateral frameworks or from asset purchase programs, which is referred to as a ‘tilting’ approach (Aguila & Wullweber, 2024).

Crucial to this paper, this strand of literature has given rise to a new analytical distinction between a sustainability-related promotional and prudential approach: Policies follow a *promotional motive* when they aim to ‘mitigate climate change by steering credit allocation towards low-carbon activities’ and a *prudential motive* when they seek to ‘ensure the stability of the financial system in the face of climate-related risks’ (Baer et al., 2021: 3). Building on

this distinction, Di Leo (2023: 672) observes the emergence of a ‘thermostatic mode of policy innovation’ in the UK that allows its central bank to switch between a prudential and a promotional stance. Van’t Klooster (2021: 782) finds that current EU monetary and financial policy resembles a ‘reintroduction of credit guidance [...] part of a paradigm shift, which leaves behind key market liberal assumptions’. Thus, these authors highlight an element of discontinuity in financial market governance, which contributions concerned with macroprudential policies had similarly pointed out (Baker, 2013; Coombs, 2022; Thiemann, 2024).

However, other authors contend that such a strong focus on discontinuities comes at the cost of an analysis of ‘structural pressures and entanglements with the private sector that shape central bank policies’ (Kedward et al., 2024: 1596). Accordingly, recent central bank interventions such as asset purchasing programs and adaptations to the collateral framework should not be mistaken for promotional policies resembling historical forms of credit guidance under fiscal dominance (e.g. Bezemer et al., 2018; Monnet, 2018). Instead, public *derisking* policies create specific conditions for a market-based financial system under monetary dominance, into which some sustainability features have been integrated. The predominant approach, they argue, can best be characterized as ‘carrots without sticks’ (Kedward et al., 2024: 1603): While some large central banks have started fostering green market-based finance practices, all of them, with the intention to do so, have until now failed in penalizing carbon-intensive assets. Baer et al. (2021) observe a similar trend, reflected in a *promotional gap* arising from EU policymakers’ reliance on market mechanisms and an ever-increasing role of technocratic institutions in banking supervision, which obstructs policies of credit allocation.

While these arguments provide a relevant critique of what qualifies as a promotional policy, they tend to overlook the fact that prudential policies often entail a much broader conception of risk (van’t Klooster & Prodani, 2025). The authors suggest terming *deferential riskification* what others have called ‘risk-based’, i.e., supervisory practices based on banks’ and rating agencies’ backward-looking risk assessments. In contrast, a climate-related *alignment-focused approach* imposes supervisors’ broader risk definitions and expectations on financial industry credit allocation and risk management. Furthermore, they argue that the ongoing shift from the former to the latter approach renders prudential regulation ‘potentially highly allocative’ due to forward-looking risk assessment methodologies (van’t Klooster & Prodani, 2025: 645).

We build on these contributions to suggest a typology of green financial policies (see Table 1). We distinguish between the governance *logic* of a policy and its *potential outcome*. Following van’t Klooster and Prodani (2025), the prudential category is divided into a deferential riskification and an alignment-focused approach. The promotional category falls into two approaches, which, based on Kedward et al. (2024), we term ‘carrots *without* sticks’, and ‘carrots *and* sticks’, i.e., credit guidance. Note that all four approaches have varying degrees of institutionalization, with credit guidance being the least embedded in international and EU banking regulations. Hence, when we refer to promotional approaches, this often represents a narrower version that entails incentives only.

Table 1: Green financial policy typology

	Prudential approaches		Promotional approaches	
	Deferential riskification	Alignment-focused approach	‘Carrots without sticks’ or promotional	‘Carrots and sticks’ or credit guidance
Logic	Risk (narrow)	Risk (broad)	Macroeconomic; competitiveness	Industrial policy
Potential outcome	Status quo	Status quo to green growth	Green market niches	Green growth (credit allocation)
Main devising institutions	Individual banks and rating agencies	Financial Supervisors	Policymakers	Policymakers
Instruments	Voluntary disclosure and risk assessment standards, non-binding methodologies	Climate-related supervisory expectations, Prudential transition plans	Green supporting factor (GFS)	Dirty penalizing factor (DPF) Green minimum and dirty maximum lending quotas

Source: Authors’ own illustration, based on Kedward et al. (2024) and van’t Klooster & Prodani (2025).

Analytical framework and methodology

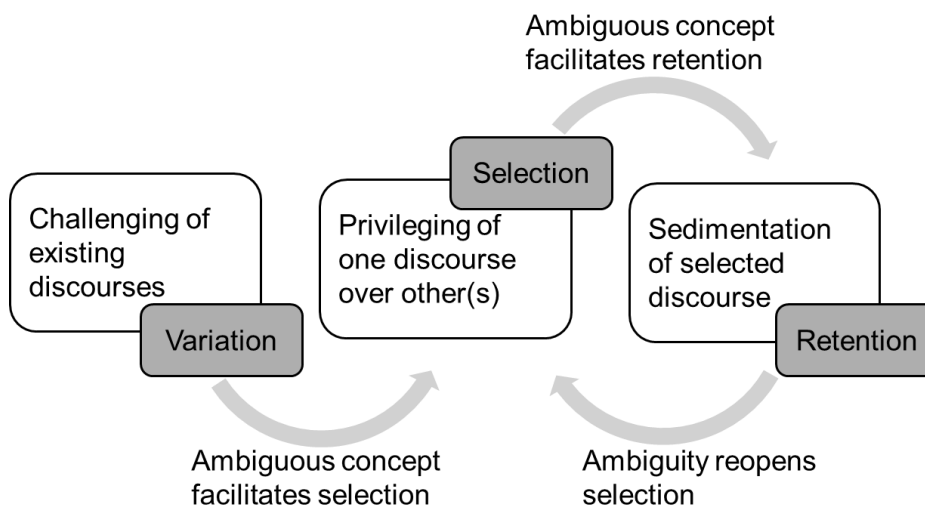
The study of political processes reveals that every system, however stable, requires constant reproduction and that political decisions, while contingent, are also path-dependent (Jessop, 2010; Wullweber, 2019). We conceive of banking regulation as a field with highly sedimented discourses, where past political struggles gave rise to both a promotional and a prudential approach. Jessop (2010) identifies a set of factors in the co-evolution of semiosis – i.e., (strategic) meaning making – and structuration – i.e., the contingent process of structuring reality – as integral to every political process: *variation*, *selection*, *retention*, *reinforcement*, and *selective recruitment*. Here, we focus on the first three factors and integrate the concept of strategic ambiguity before applying it to the area of banking regulation.

According to Jessop (2010), the semiotic process begins with the *variation* of discourses and practices when crises challenge existing policy approaches. While variation can be ‘arbitrary and short-lived, lacking long-term consequences for overall social dynamics’ (Jessop, 2010: 347), this process allows new elements to enter a field of established practices. *Selection* denotes the second factor in which specific discourses are privileged for interpreting events, legitimizing actions, and representing social phenomena, and displace others. This process is also shaped by what Jessop (2010) conceives of as material factors, such as ad hoc or entrenched power relations, path dependencies, and structural selectivities. The latter denotes a system’s bias towards favoring some types of political strategies over others. The integration of some parts of the selected discourse into institutional rules, accumulation strategies, state projects, or hegemonic visions characterizes the third factor of *retention*. Jessop (2010) describes retention as the phase of an ongoing *sedimentation* of discourses into actors’ practices. The more widely a discourse is retained, the more institutionalized — or hegemonic — it becomes.

While Jessop's (2010) conceptual framework suggests that making specific discourses hegemonic is a major power resource, different strands of literature have highlighted that keeping the meaning of something indeterminate can also be beneficial. Best (2008) suggests that *governing through ambiguity* is a widespread technique in financial market governance. The EU political economy literature has highlighted the strategic use of ideas by EU public officials, particularly their efforts to mobilize ambiguous concepts, such as 'the market', to build consensus around public policy objectives (Jabko, 2006; Jegen & Mèrand, 2014; Béland & Cox, 2016). Van't Klooster (2022: 772) argues that EU technocrats have employed strategic ambiguity to promote a paradigm shift towards 'technocratic Keynesianism,' a strategy that 'allows monetary technocrats to suggest continuity and minimize legislative involvement, while also successfully addressing new problems'.

Complementing Jessop's (2010) framework, we suggest that using ambiguity as a governance strategy – that is, *strategic ambiguity* – can facilitate the progression between the different phases of semiosis and structuration (see Figure 1). Ambiguous concepts enable policymakers to deliberately frame their objectives to mean different things to different audiences, and they provide participants ample room to interpret potential outcomes in line with their own visions (Hoffmann, 1995; Jabko, 2006). While facilitating a progression from one stage to another, strategic ambiguity can, however, also protract the phase of retention and result in an incomplete institutionalization (Jegen & Mèrand, 2014).

Figure 1: Three phases of semiosis and structuration and strategic ambiguity



Source: Authors' own illustration, based on Best (2008) and Jessop (2010).

Our methodology is based on an understanding of EU governance as characterized by a wide range of institutions and stakeholders where technical expertise and independent technocratic institutions play a crucial role (Vauchez, 2016). Accordingly, we compiled 130 publicly available documents from the European Commission, the European Parliament and the European Council, the High-Level Expert Group on sustainable finance (HLEG) and the Platform on Sustainable Finance, the ECB, EBA and the ESRB, as well as from civil society organizations (CSOs) published between 2017 and 2025. We focused on issues related to sustainable finance and sustainability in EU banking regulation connected to Basel Pillars 1, 2, and partly 3. Furthermore, we compiled three databases from public consultations conducted by the European Commission and the EBA, which sought feedback on the EU implementation of

Basel III and the sustainability risk aspects in Pillar 2 (see Annex I). Based on our documentary analysis, we constructed a timeline to identify different policy approaches and build hypotheses about turning points in the policy process. In parallel, we conducted semi-structured expert interviews with staff from the European Commission, the ECB and other financial supervisors, the private financial sector, and CSOs across the EU and UK between November 2022 and October 2024 (see Annex II). Maintaining a standard set of questions regarding actor strategies in EU sustainable finance throughout the interviews, we progressively included more specific items on sustainability-related banking policies in our questionnaires. At last, we tested our hypotheses in three workshops between 2023 and 2025 with a small group of experts comprised of banking practitioners, central bankers, CSOs, and academics.

Variation between the sustainability-related promotional and prudential approach

Sustainable finance was one of the central political responses to the landmark Paris agreement in 2015, which aims to limit global warming to 1.5°C above pre-industrial levels and make ‘finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development’ (UNFCCC, 2015). Borne out of earlier efforts to link environmental objectives to the financial business, sustainable finance was one of the EU’s central political projects during the past decade (Dimmelmeier, 2021; Mertens & van der Zwan, 2025). With the establishment of the High-Level Expert Group on sustainable finance (HLEG) in 2016, the approach of *harnessing private capital* to decarbonize the economy moved to the top of the EU’s agenda (Baioni et al., 2025).

EU policymakers’ and supervisors’ role in forging a sustainability-related promotional and prudential approach

The early phase of the EU’s sustainability-related financial approach was marked by a *variation* between different ideas of how to relate sustainability to financial regulation. We identify three broad camps: the information-based, the promotional, and the prudential camp, which were already nascent in the debates in the HLEG. The first camp, comprising representatives from the financial industry, CSOs, and the Commission, advocated sustainability taxonomies and disclosure. The literature has discussed taxonomies and disclosure as the continuity of a market-fixing approach (Christophers, 2017; Ameli et al., 2020; Chenet et al., 2021), as epitomized by one EU regulator: ‘Within the Commission, it was a conscious decision [...] to leave it to the markets [...] to decide which activities to change or phase out’ (interview 5).

The second camp, which involved the European Parliament and CSOs alongside the European Commission, was promotional, supported by the Paris Agreement’s central theme of ‘finding the money for the transition’ (interview 28). Faced with a lack of fiscal space, EU policymakers often intend to pursue macroeconomic policies through a regulatory approach (Braun & Hübner, 2018; Baioni et al., 2025). Lowering capital requirements promised to enable the Commission to respond to demands from the financial industry to improve the competitiveness of EU banks (interview 28). For the European Parliament and CSOs, a promotional policy approach was broader and entailed moving beyond the prevailing risk-based rationale towards *credit guidance* (e.g., Barmes & Livinstone, 2021; Dafermos et al., 2021; interview 28).

The third camp, composed of EU financial supervisors such as the ECB and the EBA, and some CSOs, gathered around sustainability as a financial stability concern: The financial industry's investments in carbon-intensive sectors entailed climate-related risks that, if undisclosed, could increase systemic risk (Carney, 2015; interviews 6, 7, 24). At the outset of the EU's policy process, however, financial supervisors were more concerned with a potential *green bubble* — an unregulated market of financial products with unstandardized environmental, social, and governance (ESG) investment criteria (Fontan, 2025; interviews 20, 26).

In 2017, the European Commission and the European Parliament began advocating for a promotional policy instrument (see Figure 2). A so-called *green supporting factor* (GSF) was proposed to make credit to sustainable firms or projects relatively cheaper by allowing banks to set aside less capital when lending to 'green' sectors (Dombrovskis, 2017). The European Commission aimed to close the green investment gap – the difference between current green investments and the investments needed to shift the economy to net-zero by 2050. The Commissioner responsible at the time, Valdis Dombrovskis, proclaimed:

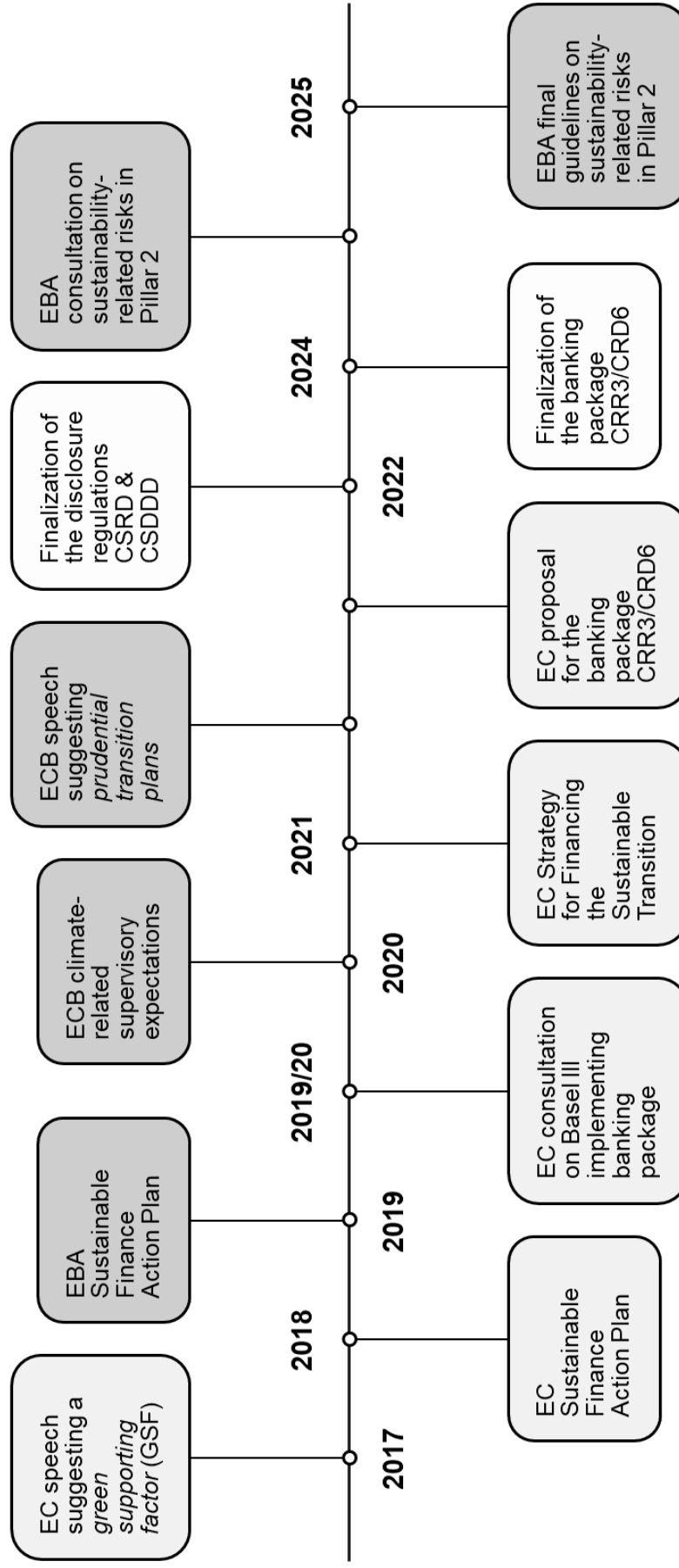
To reach that target, we will need around 180 billion euro in additional yearly low-carbon investments. [...] European banks play a major role in financing the economy. To incentivize lending, we are looking positively at the European Parliament's proposal to amend capital charges for banks to boost green investments and loans by introducing a so-called green supporting factor. (Dombrovskis, 2017)

Soon after this announcement, several actors began linking the GSF proposal to a previous promotional policy initiative, namely a supporting factor for small and medium-sized enterprise (SME) lending. Thereby, the GSF inherited some of the underlying lines of conflicts: The SME supporting factor, introduced in the wake of the euro crisis to ramp up lending to the real economy, was largely acclaimed by the financial industry (EACB, 2015; EBF, 2015; interviews 14, 16). By contrast, financial supervisors perceived the policy as detrimental to banks' resilience and contradicting the spirit of the Basel III framework (EBA, 2016; Montalbano & Haverland, 2023; interviews 27, 29, 30). Therefore, EU financial supervisors had begun to call for increasing capital requirements elsewhere in the framework (interview 26). Following this pattern, the GSF proposal soon triggered a debate about *increasing* minimum capital requirements, in this case a so-called *dirty penalizing factor* (DPF) for banks when lending to carbon-intensive sectors (Dafermos & Nikolaidi, 2021; interviews 10, 11, 19, 21).

One of our interviewees who participated in the HLEG on behalf of an institutional investor, summarized this emerging conflict in the early phase of linking sustainability to banking regulation:

The reason why the green supporting factor and the brown [dirty] penalizing factor became political was that it wasn't presented as a financial stability argument. [...] So, there was a big pre-prepared fight-back, and they were annoyed within the financial stability community that the purity of their work was being tarnished by political reasons. (Interview 20)

Figure 2. Timeline of relevant official communications in sustainability-related EU banking regulation



Source: Authors' own illustration. Light grey = EU policymakers; dark grey = EU financial supervisors; white = final legislation. EC = European Commission.

The emerging dichotomy between a *political*, i.e., promotional, and a risk-based, *prudential* approach, however, was not neutral but advantageous for the financial industry: The debate about climate-related risks at that time could have justified raising capital requirements for prudential reasons. However, juxtaposing a penalizing factor with a supporting factor helped to present the *status quo* regulation as prudential and balanced (Finance Watch, 2021a). The fact that financial supervisors were still divided on whether the climate crisis constituted a relevant concern for financial and monetary policy played a key role in this (Aguila & Wullweber, 2025; Deyris, 2023). This indecision was reflected in the way financial supervisors positioned themselves in relation to a DPF. Some were convinced that banks and rating agencies were better suited to integrate (novel) risk concerns into their own practices before supervisors prescribe them to do so, namely a *deferential riskification* approach (interviews 29, 30). Others had more strategic arguments: Financial supervisors hesitated to demand increasing capital requirements loudly since they expected strong opposition from the financial industry (interviews 26, 27, 29, 30). Thus, when the GSF first appeared in discussions on sustainability-related financial policies, the prudential discourse worked towards fending off demands for stricter banking regulation.

When the European Commission (2018) launched its Sustainable Finance Action Plan in March 2018 (see Figure 2), both the promotional and prudential discourses became more intertwined with the information-based approach, in the form of the upcoming Taxonomy and disclosure regulations. Adherents to the prudential camp argued that banking regulation should primarily focus on *single materiality*, as financial actors are mainly *affected by* climate-related risks through their counterparties (EBA, 2021: 30; interviews 6, 28). While acknowledging that the financial industry may also *affect* its counterparties by setting the terms of credit, considering this an impact mechanism is usually perceived as outside of the scope of the prudential framework (interviews 11, 14). By contrast, the promotional camp sought to establish *double materiality* as the core principle of EU sustainable finance (interviews 3, 6, 13). This also comprised ideas of credit guidance that would link sustainability disclosure to capital requirements (interviews 12, 16, 20, 28). Thus, when the Commission began developing its flagship policy, the ‘EU Taxonomy for sustainable activities’ (henceforth ‘Green Taxonomy’), it also announced its intention to connect this policy to the GSF proposal (Dombrovskis, 2019). While this implied that policymakers planned to provide ‘carrots *without* sticks’ (Kedward et al., 2024), advocating double materiality meant keeping a foot in the door for introducing some *sticks* later on. As one HLEG-member confirmed: ‘The Taxonomy was a step towards tilting, or a more granular approach to capital weightings’ (interview 20).

From the outset of the policy process, policymakers faced difficulties in establishing a promotional policy approach within EU banking regulations. This was particularly due to the narrow prudential stance of EU delegated authorities (Baer et al., 2021). The Commission’s Sustainable Finance Action Plan (2018) contained several mandates for the European Banking Authority (EBA), a delegated microprudential authority tasked with supporting financial policy development (Smoleńska & van’t Klooster, 2022). An ECB public official problematized how EU policymakers’ agenda clashed with the logic established among financial supervisors:

So, they [the European Supervisory Authorities] were involved in all these policy processes, which were double materiality rather than prudential, and the EBA was utterly unsuited to do the job. [...] The authorities and the architecture in the EU [are] overwhelmingly prudential. And so, there is no authority that is in charge of double materiality, right? Which is [...] creating a lot of problems. (Interview 28)

The corresponding EBA (2019) Sustainable Finance Action Plan (see Figure 2) reflected this narrow prudential perspective. Even though it only followed the timeline set out by policymakers, the sequencing the EBA suggested began to assume some political content: It communicated that it would start providing expertise on how to integrate sustainability into Pillar 2 and Pillar 3 before moving on to Pillar 1. Since the delivery date for the latter was scheduled for 2025, after the finalization of the then ongoing banking reform, the EBA advice would come too late to provide evidence for any adjustment to Pillar 1 minimum capital requirements – including the proposed GSF and a potential DPF.

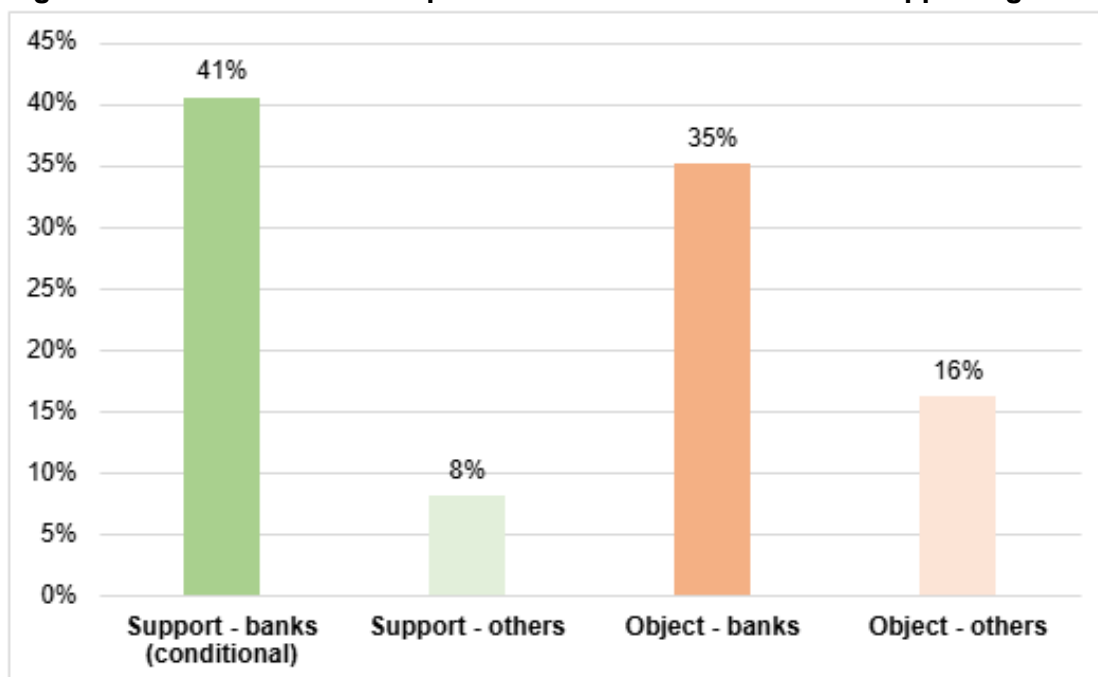
Thus, the first phase of EU sustainability-related financial policymaking still *varied* between a promotional and a prudential policy discourse. As one ECB public official pinpointed the discussion around the year 2020: ‘For the moment the two things don’t seem to clash, but there might be conflicts over time’ (interview 28). Besides the growing resonance between EU prudential authorities and the prudential discourse, we demonstrate next how the lack of clear support for a GSF from the financial industry prepared the ground for the selection of the sustainability-related prudential over the promotional discourse.

Financial industry stances on the sustainability-related promotional and prudential approach

Our evaluation of a public consultation by the European Commission (Consultation database I, 2020, see Annex I) shows how the financial industry responded to the policy proposal of a GSF and how it related to the promotional and prudential motives articulated in the EU policy discussion. It highlights that while there was some support for a promotional approach, banks’ own risk-based governance and strategic considerations contributed to an embrace of the prudential approach. The consultation sought feedback from banks and other stakeholders on the EU implementation of the international Basel III agreement. Notably, sustainability figured at the fringes of the consultation, with only *one* out of 213 questions dedicated to the topic. However, it still reveals a relatively high level of politicization surrounding potential sustainability-related changes to Pillar 1 minimum capital requirements: even though the question asked openly about the desirability of further measures to sustainability disclosure (Pillar 3), many respondents explicitly referred to a GSF and DPF (Pillar 1). Of the 52 respondents to the sustainability-related question, 37 explicitly expressed their views on a GSF.

A slight majority of 51% of overall respondents opposed the promotional policy, while 49% supported its introduction under certain conditions (see Figure 3). Among the respondents from the banking sector, more banks positioned themselves in favor of a GSF (41%) than against it (35%). The difference between the overall turnout and the one by banks was primarily driven by the opposition of supervisory authorities and CSOs (16%). This group disapproved of a GSF, arguing that it would equate to an undue relaxation of regulatory standards, i.e., lowering capital requirements. By contrast, respondents in favor of a GSF highlighted that only an *incentive-based*, promotional approach could help the EU close its green financing gap.

Figure 3. Banks' and other respondents' views about a Green Supporting Factor



Source: Authors' own illustration, based on Consultation database I (2020), sustainability-related question No. 191, coded for feedback on a GSF, N=37.

While this turnout may be interpreted as a positive stance on a GSF, the concrete wording of the responses, relating to the consultation's political character, conveys the challenges associated with introducing a promotional policy approach. If banks were to gain from a GSF, why was their support for lowering capital requirements not more pronounced? Based on our empirics, we identified three factors. First, EU policymakers' intention to link capital weights to the Green Taxonomy did not sit squarely with how banks manage their credit risks internally (interviews 15, 19, 25). This was reflected in the fact that even most respondents *in favor* of a GSF made their support conditional on a prior risk assessment, expressed in statements such as the European Banking Association's: 'Sustainable assets, where a lower prospect of financial risk related to the ESG factors can be demonstrated, should benefit from a preferential prudential treatment' (Consultation database I, 2020). However, the consequence of giving the risk assessment priority over a sustainability assessment would effectively eliminate the GSF's purpose, as reflected in this feedback: 'If a green investment is successful, automatically that will be reflected in its P&L [profit and loss statement]/balance sheet and result in a better probability of default which in turn leads to a lower capital requirement for credit risk' (Consultation database I, 2020).

Second, the fact that banks are increasingly engaged in market-based business models that involve 'connecting, typically in the capital markets' (interview 18) and therefore lend less to the productive economy also affects the kind of policies they embrace (Aguila et al., 2025; interviews 10, 14, 25). For instance, securitization and significant risk transfers have become a preferred instrument to capital relief, as these not only allow banks to leverage their portfolios without an upper limit but also to move risks off the balance sheet (Schairer et al., 2025).

Third, beyond these institutional factors, our analysis suggests that banks opted for a prudential over a promotional approach for strategic reasons. Since the framing of policy options at that time associated the GSF with a potential launch of a DPF, some banks may have favored a prudential approach to avoid the introduction of a DPF. As pointed out by one ECB public official, ‘if you ask for one [i.e., supporting factor], you’re not sure that the other one [i.e., penalizing factor] might not also come in the end’ (interview 26). Often, when banking practitioners were asked about the desirability of a GSF, this triggered a positioning on a DPF: ‘The way I’ve seen it [a GSF] pitched in the past, [we would] probably not [support it]. What we’re really afraid of is [...] to have capital add-ons or any brown factor. That’s what we’re most concerned about’ (interview 19). In other words, weighing the relatively small current gain from a GSF against the detriments of a potential DPF, we suggest some banks strategically opted for the prudential approach. This is also reflected in statements of banks opposing a GSF, such as ‘we are of the view that the phased approach considered is the right way to encourage the integration of ESG-related risks in risk management processes by financial market participants’ (Consultation database I, 2020). This ‘phased approach’ referred to the EBA Action Plan (2019), which meant that no adjustments to minimum capital requirements were to be expected anytime soon. Embracing the prudential approach at that time meant supporting *deferential riskification* with minimal state interference.

In summary, EU policymakers’ intention to embed a sustainability-related promotional element into EU banking regulation and connect the information-based regime to capital rules faced several obstacles in the first phase of the policymaking process. The unambiguous dichotomy between a promotional and a prudential approach created two camps – which policymakers faced difficulties bridging – neither winning support from supervisors and CSOs nor clearly from the financial industry. While there was some acknowledgement that a promotional policy approach rather than a risk-based one may help the EU to reach its climate targets more effectively, the highly sedimented prudential discourse and strategic behavior still privileged the status quo.

Strategic ambiguity and the selection of the sustainability-related prudential approach

In 2020, amid significant monetary and fiscal interventions to counter the recession caused by the COVID-19 pandemic, the ECB started acting more decisively on sustainability issues. As some of these policy interventions faced criticism of violating the tenet of market neutrality, it employed several discursive strategies that linked climate change to its different mandates, intending to legitimize its actions (Aguila & Wullweber, 2025). In this context, the ECB (2020) also published its supervisory expectations on the matter in the ‘Guide for climate-related and environmental risk management’. The financial industry usually pays great attention to these supervisory expectations, since central banks’ risk conception may translate into additional capital requirements as part of the supervisory review process in Pillar 2 (Coombs, 2022; van’t Klooster & Prodani, 2025). While an ECB public official acknowledged that with this intervention, ‘we [may have] proceeded a lot [of] what the Commission did’ (interview 26), CSO pressure and changes to its board composition, among other things, drove the institution towards greater action (Di Leo et al., 2023; Deyris, 2023).

At that time, EU policymakers faced growing discontent from parts of the financial industry and civil society with their nascent sustainable finance approach. On the one hand, one of its centerpieces, the Green Taxonomy, was criticized for defining 'dark green' economic activities that only represented a minuscule share of the economy instead of helping to finance the transition of carbon-intensive industries towards more sustainability (ICMA, 2021; interviews 2, 12, 15, 23, 28). On the other hand, a controversy emerged around the composition of the 'Platform on Sustainable Finance', the successor of the HLEG. CSOs began canceling their participation as they perceived the Green Taxonomy as highly influenced by lobbying and potentially ineffective in achieving the Paris goals (Fontan, 2025). The Commission attempted to attenuate these tensions by adopting the new narrative of a green *transition*. In its 2021 'Strategy for Financing the Transition to a Sustainable Economy' (that renewed the 2018 Sustainable Finance Action Plan), the Commission (2021a) announced the exploration of a 'Transition Taxonomy'. It thereby incorporated the financial industry's framing that the challenge was not so much supporting green investments or penalizing dirty ones, but rather to finance the economic *transition* to net-zero. However, while giving in to some of the financial industry's demands, policymakers still intended to preserve an element of credit steering in their articulation of regulatory measures to foster the green transition.

In this latest attempt to advance the sustainable finance agenda, EU policymakers once again faced difficulties in introducing new elements into highly entrenched banking rules. As an ECB public official suggested, EU political bodies had limited institutional capacities to pursue their agenda compared to more established expert bodies and delegated authorities:

The Commission didn't have sufficient resources to do all these jobs themselves. So, they had to rely on the stakeholder groups, like the Platform [on] Sustainable Finance, [...] and the ESAs and the EBA for all the advice. But this has created conflicts of competences and unclear objectives. (Interview 28)

Furthermore, the amendment of the *banking package* (CRR3/CRD6¹) became a central area of contestation, since it provided a unique opportunity to regulate banks' risk approach to sustainability. Accordingly, the European Commission (2021b) proposal for the banking package moved sustainability from the sidelines to the center of legislative concerns. In this context, policymakers awaited the EBA's advice on how to integrate sustainability into capital requirements and disclosure frameworks (Smoleńska & van't Klooster, 2022). Upon arrival, the Commission was dissatisfied with how the EBA continued to stick to a purely prudential, single materiality approach, instead of also considering promotional elements:

The legislators [...] got the feedback from the EBA that was negative [on promotional policies]. And they said, okay, let's micromanage them to do another report, trying to get them to conclude what we want. Because that's what the CRR3 [the banking package] does: micromanage the EBA to try to get them to a positive conclusion [...] [but] the EBA is not going to. (Interview 28)

This 'micromanagement' is reflected in the Commission's proposal for the banking package: First, the Commission moved the EBA's deadline for submitting its expertise on Pillar 1 to an earlier date to ensure that minimum capital requirements could still be adjusted. Second, it also included an explicit mandate to the EBA to explore a GSF. In addition, and as a consequence of the political discussion at the time, the proposal also mentioned the exploration of a DPF –

¹ Capital Requirements Regulation (CRR) and Capital Requirements Directive (CRD)

the policy that the financial industry had heavily opposed. However, demands from CSOs and some policymakers to incorporating the principle of double materiality were likewise disregarded, arguably due to the heavily entrenched prudential discourse in banking regulation that precludes overt promotional elements (European Commission, 2021a; Finance Watch, 2021b).

In this challenging terrain of ‘unclear objectives’ and ‘conflicts of competences’ (interview 28), the ECB’s suggestion of an *alignment-focused approach* to sustainability (van’t Klooster and Prodani, 2025) marked a turning point. By ambiguously framing intentions of credit allocation from a risk perspective, it contributed to the *selection* of the prudential over the promotional discourse. The political stalemate in the discussions about a GSF/DPF (which was still formally ongoing) shifted policymakers’ and supervisors’ attention to other possibilities for addressing sustainability, crucially in the supervisory review process of Pillar 2, where the ECB plays a key role.

This change in focus enabled the ECB to respond to at least two challenges that it began facing at that time. First, it became increasingly clear that banks were still reluctant to engage with climate-related risks, despite growing awareness of the materiality of those risks and the EU’s dedication to decarbonize (interviews 27, 28): In 2021, 90 percent of large EU banks deemed their practices as not or only partially aligned with the supervisory expectations the ECB had published one year earlier (ECB, 2021). Second, the role of the financial sector in driving decarbonization efforts was increasingly questioned (interviews 2, 14, 17, 22, 25). Since banks are not large emitters themselves but finance carbon-intensive investments, the threat the financial industry invoked was one of so-called *portfolio decarbonization* (interview 27). This denotes a process in which banks decarbonize more quickly than the real economy. This can be done by divestment or offloading dirty asset exposures to other parts of the financial sector, such as the shadow banking system and non-bank financial intermediaries (Schairer et al., 2025). While this could have the desirable effect of raising the cost of capital for carbon-intensive investments, such a scenario, however, could also increase climate-related risks outside of the purview of financial supervisors (interviews 17, 21, 25, 28). Thus, while giving in to the financial industry’s demand to allow for more ‘time to adjust’ (interview 28) its portfolios, the ECB tried to find an approach that would scale up banks’ integration of climate-related risks and at the same time motivate them to finance the transition of the productive economy.

This context provided the occasion for the newly appointed Vice-Chair of the ECB’s Supervisory Board, Frank Elderson, to propose *prudential transition plans* as part of an emerging *alignment-focused approach*. In his speech, he proclaimed:

[B]anks need transition plans compatible with EU policies implementing the Paris Agreement, with concrete intermediate milestones, to enhance their long-term strategies and decision-making. And I would call on the legislator to make this explicit by introducing a legally binding requirement for banks to have such Paris-compatible transition plans [...]. (Elderson, 2021)

Mirroring the Commission’s strategically *ambiguous* framing of a transition, the ECB’s intervention came with some force and directly entered the Commission (2021b) proposal for banking regulation. One of our interviewees, who was involved in the ECB’s work on the topic, reflected on the institution’s elevated imprint on the legislative process:

We prepared the speech [...] for Frank [Elderson] [...] having in mind [...] that the Commission was gathering ideas on the CRD [the banking package]. And [...] it's always important when we intervene, to make sure that it's with equal treatment [incomplete sentence]. So, we tried to do it via speech, [so that] everybody knew what we wanted from it. And then [...] a few weeks later, when the CRD proposal came out, there was a proposal for transition plans. (Interview 27)

Where transition plans had previously been mainly discussed as an instrument of voluntary and mandatory sustainability *disclosure*, the ECB's proposal to apply them to banking *supervision* gave them a new impetus (Dikau et al., 2024). In the supervisory review process under Pillar 2, improper risk treatment can become costly, since supervisors can, next to raising capital charges, impose penalty payments, demand to divest from certain assets, terminate products, or force a change to the board of executives of a penalized bank (Elderson, 2023; ECB, 2024b). As one banking supervisor summarized their role: 'Supervisors [...] see the bank completely naked' (interview 8). In this way, the ECB began proposing a narrative that aimed to straddle the dichotomy between a promotional and a prudential approach. As one financial stability expert from the ECB recalled:

Frank Elderson [...] took a very strictly prudential perspective in what he said, always framing prudentially, but I'm 100% sure that he knows exactly that he's playing an ambiguous game. [...] Eventually, what he cared about was not the risk in themselves, [but] [...] pushing the banking sector to do something promotional, [...] to reallocate credit. (Interview 28)

Upon finalization of the banking package, the efficacy of this strategy became apparent. While different camps still intended to anchor a GSF and a DPF into Pillar 1 (minimum capital requirements), the *ambiguity* of the prudential transition plans proposal allowed it to become successfully attached to the final piece of legislation in Pillar 2. Regarding the GSF, the EBA published its report that continued to be critical of the policy (EBA, 2023). Behind the DPF, in turn, a civil society coalition had formed that, with some support from the European Parliament, argued that the 'inadequate current prudential risk-weighting of fossil fuels in effect subsidizes the banking and insurance sectors [...] making fossil fuels artificially cheap' (Finance Watch, 2021c) (interviews 6, 9). However, the narrative of the need to transition successfully undermined further considerations of a DPF, as one of our interviewees from an NGO reported:

At some point, there were very different compromise proposals on the table, such as increasing capital requirements, but not for the companies that have made sufficient progress in their transition. [...] And we weren't really happy with that because, based on findings from climate science, we know that all these fossil fuel producers [...] are not at all compatible with net-zero. In other words, how can we talk about the transition of this sector? (Interview 6)

Hence, the ambiguity entailed in the ECB's proposal of prudential transition plans appeared most capable of settling the opposing stakeholder demands, while contributing to the *selection* of the prudential over the promotional discourse in the process of integrating sustainability concerns into EU banking regulation.

Retention delayed: Ambiguity and continuous struggles

Growing geopolitical tensions accompanied the finalization phase of the banking package in 2023/24. The EU feared that its banks would lose competitiveness vis-à-vis US ones, and both jurisdictions decided to postpone some of Basel's key provisions, dubbed the 'Basel III endgames' (Palma et al., 2024). In this context, political struggles over how to interpret and implement the EU's sustainability-related financial policy approach continued. In the realm of EU sustainable finance regulation, two further legislative pieces had passed, requiring financial and non-financial firms to also prepare transition plans, namely the Corporate Sustainable Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD). However, in contrast to *prudential* transition plans, these plans solely focused on firms' *Paris-alignment*, and a discussion emerged on how financial risks and Paris-alignment were related (Dikau et al., 2024; interviews 27, 28).

In this final phase, the ambiguous framing that had helped prudential transition plans become one of the EU's primary tools in its approach to sustainability-related banking regulation now hampered their proper institutionalization. Central to the debate was the question of how to interpret climate-related risks in the supervisory process, as well as *when* and *to what extent* they would materialize through exposures to carbon-intensive sectors. In its communications, the ECB attempted to establish climate-related risks as 'risks arising from misalignment with EU policy targets' (Elderson, 2022), or short, *risks from misalignment* (Elderson, 2022; 2024; ECB, 2024c). This definition suggested that it constitutes a risk for banks to diverge from their relative share in financed emissions as determined by widely used decarbonization pathway scenarios, thereby linking financial risks to Paris-alignment. This also promised to address the challenge that the financial industry can decarbonize either *too quickly*, by engaging in portfolio decarbonization, or *too slowly*, in continuing to finance carbon-intensive sectors excessively. As one of our interviewees from the ECB summarized the institutions' perspective on sustainability-related aspects in the supervisory review process:

[In] the prudential assessment, we also look at the business model sustainability. If as a bank, your business model is financing polluting counterparties and finding 'banking solutions' for them [i.e., divestment and shadow banking], when once you have offloaded all of these exposures, which kind of business model is left? How do you make your money? So, it's not just a matter of the risks, but it's a matter of preserving the ability of the bank to be profitable in the future market. (Interview 27)

This emerging approach towards sustainability-related banking regulation has been described as a shift away from *deferential riskification*, based on financial institutions' own internal credit risk assessment methodologies, towards a novel *alignment-focused approach* in which supervisors ensure banks account for climate-related risks alongside the transition trajectory (van't Klooster & Prodani, 2025).

We argue, instead, that the ECB faced difficulties defending its ambiguously framed approach against its own and the EU's more general prudential architecture. This has led to a situation where EU sustainability-related financial governance still oscillates between a narrow risk-based discourse that remains firmly entrenched in EU financial supervision and an emerging *alignment-focused approach*. We point towards three notable instances. First, the ECB communication that followed Elderson's initial proposal of prudential transition plans in

2021 reflected the structural selectivity of the prudential architecture. In a 2022 speech, Elderson rectified that the ECB's position 'should not be interpreted as stretching beyond the current risk-based focus of supervision' (Elderson, 2022). Instead, he explained, banks could still decide to finance any sector, regardless of its carbon emissions, if they made sure to be prepared for and helped mitigate ensuing climate-related risks (Elderson, 2022). This was, according to an ECB public official, a narrower risk interpretation than was intended when Elderson first launched the idea of prudential transition plans:

The concrete functioning of transition plans was not fully thought through. [...] There is a tension between these [Paris-alignment] transition plans [...] [and] this thing that Elderson started pushing. [...] And then they've tried to reframe, 'what we mean with transition plans is that you need to have the risk [under control]', they kind of made it a risk interpretation. (Interview 28)

Second, the EBA's narrow prudential stance continued to shape the EU's sustainability-related financial approach before and after prudential transition plans were proposed. We exemplify this by an evaluation of two EBA public consultations on sustainability-related risks in Pillar 2 from 2021 and 2024. In the first consultation, it becomes evident that the EBA (2020) primarily drew on existing risk methodologies from the private sector (Consultation database II, 2021, see Annex I). While being an established practice in financial supervision (interviews 27, 29, 30), this points towards the prevalence of a *deferential riskification* approach. In the second consultation that followed, the EBA (2024) took a similar stance. Various CSOs criticized the draft guidelines for not sufficiently accounting for *risks from misalignment*, 'mislead[ing] banks into thinking that alignment with climate goals is not meaningful to risk management and meeting regulatory and supervisory expectations' (Reclaim Finance, 2024). Furthermore, they noted that the draft repeatedly failed to explicitly cover risks related to fossil fuel production (Consultation database III, 2024).

The reason why some financial supervisors were critical of departing from a single materiality risk-based evaluation was that financial markets still priced carbon-intensive assets with better risk ratings, as one public official from an EU supervisory authority pointed out: 'What the banks that we are talking to [...] keep showing us is actually very often the brown ones are the companies that have [a] much better financial standing than the green projects' (interview 29). With regard to the scale that climate-related risks affect banks' individual resilience, the same interviewee also held some reservations:

Stranded assets [...] it's a catch phrase [...] a buzzword [...]. Who's going to have those stranded assets? Those big companies that have super diversified business, they don't really care [...]. Is that going to significantly change the credit risk related to financing these counterparties? [...] There is no evidence that this is actually going to happen. (Interview 29)

Consequently, the banking regulatory framework was perceived as inapt to scale up the political objective of decarbonizing the economy: 'If we are talking about risks within the 20, 30 years' time horizon, does it make sense to hold [more own] capital right now? Not really' (interview 29). Reflecting this cautious stance, the EBA (2025) final guidelines on sustainability-related risks currently do *not* prescribe which decarbonization pathway scenarios banks to use but rather leave the choice of risk methodologies to banks – consistent with *deferential riskification*.

Third, national supervisory authorities, and German ones specifically mentioned here, worked towards softening the requirements for prudential transition plans in the banking package. As one ECB public official recalled:

There was a proposal for [prudential] transition plans that had a clear wording that was ‘the misalignment with the transition pathway’. [...] Some member states [...] were very concerned that we prudential supervisors would take the role of enforcing net-zero with banks. And that’s why it ended up with this wording that says ‘process of adjustment towards the transition path’. (Interview 27)

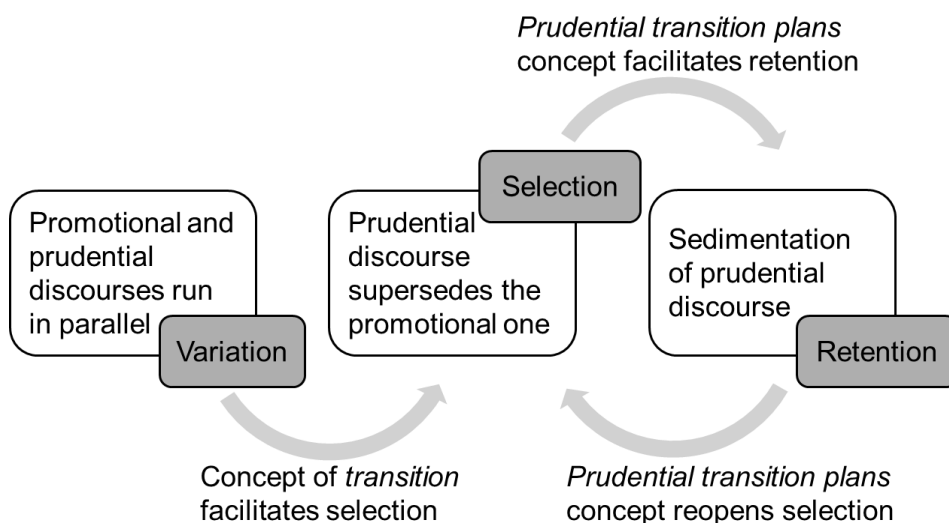
The Sustainable Finance Strategy, published by the German national supervisory authority BaFin in 2023, reflects this narrow risk interpretation. The institution emphasized that, in monitoring transition plans, it follows a risk-based perspective by which it intends to ‘not overstep its supervisory mandate’ (BaFin, 2023). Furthermore, in 2025, a controversy arose around a speech held by BaFin president Mark Branson, who suggested that his institution would only partially implement the final EBA (2025) guidelines on sustainability-related risks in Pillar 2 (Kuster, 2025).

Despite those instances showing how the selection of the prudential discourse contributed towards the retention of specific prudential elements, there are indications that the ECB’s ambiguous strategy still saved some elements of credit steering in the most recent version of the EU’s sustainability policy approach. First, compared to the EBA draft guidelines on the management of sustainability-related risks in Pillar 2, the final guidelines partly incorporated the ECB’s risk interpretation by mentioning *risks from misalignment* several times (EBA, 2025). In addition, the guidelines also defined concrete carbon-intensive sectors for which banks must have proper climate-related risk management tools in place, an aspect that was already present in the draft document (EBA, 2025; interview 27). Second, in July 2025, the ECB (2025) announced that it would introduce a so-called climate factor for a share of assets eligible as collateral in its monetary policies. This signaled, after all, that it intends to keep a door open towards penalizing the financing of carbon-intensive investments in the future.

Discussion: Strategic ambiguity as a lopsided governance strategy

This paper examined the political struggles underlying different approaches to sustainability-related financial policy by reconstructing the policy process of integrating sustainability into EU banking regulation. Our analysis suggests that the prudential architecture of banking regulation and private sector decision-making played out *structurally selectively*, by favoring prudentially framed strategies over promotional ones. We highlight how *strategic ambiguity* initially helped conserve an element of credit steering within a prudentially framed approach, which ultimately hampered its institutionalization (see Figure 4).

Figure 4: Strategic ambiguity in EU sustainability-related banking regulation



Source: Authors' own illustration.

When sustainability moved to the top of the EU political agenda, policymakers primarily perceived it as an economic opportunity: They intended to address the green financing gap by proposing to reduce minimum capital requirements for banks when lending to green sectors, through a GSF. However, major stakeholders began interpreting this proposal through an established narrative, differentiating between a *political*, i.e., promotional, and a *prudential* approach to capital rules, which contributed to an impasse in policymaking. While the prevalence of this dichotomy reflected that financial supervisors were still divided on how to address climate-related risks, it helped the financial industry to obstruct debates about increasing minimum capital requirements. Beyond an instrumental notion, our analysis suggests that the prudential discourse, however, also constrained the actors involved: It prevented EU policymakers from successfully developing an approach to sustainability that included allocative elements and left the financial industry without the incentives of a promotional policy approach.

When financial regulators and supervisors became increasingly aware of financial instability risks from climate change and developed a willingness to support the EU's economic policies, i.e., through CSO pressure, strategic ambiguity served to unsettle these highly sedimented discourses: The ECB picked up on the ambiguous concept of a transition from EU policymakers by proposing the introduction of prudential transition plans. While this helped shift the narrative from the dichotomy towards a broader risk conception, i.e., the *alignment-focused approach*, the content of this approach remained contested. We highlighted various instances where the selection of the prudential discourse constrained the retention of an alignment-focused approach, with both EU and national supervisory authorities challenging a broader risk conception, thereby reopening the selection phase. However, instead of reversing the policy process altogether, it appears that the Commission and the ECB at least partly succeeded in governing through ambiguity, as prudential transition plans and risks from misalignment have remained a key feature in the EU's current approach to sustainability-related financial policies.

Conclusion

This paper argued that the introduction of the current sustainability-related financial policy approach in the EU was conditioned on an ambiguously framed risk narrative. Where other contributions have either stressed continuity with a narrow risk-based approach (Kedward et al., 2024) or a divergence from it (vant' Klooster & Prodani, 2025), we found support for the latter in the EU case. However, we perceive the current approach as inherently contradictory, as it attempts to maintain a promotional spirit in prudential disguise. Drawing on the literature, we proposed a typology for financial policies that differentiates between sustainability-related promotional and prudential discourses. By reconstructing the policy process, we demonstrated how and why different actors, including EU policymakers, financial supervisors, the financial industry, and civil society organizations, affected, or failed to affect, change through and in response to highly sedimented political discourses in banking regulation. We suggested that the current approach represents an unbalanced mediation of stakeholders' interests, which also limits its allocative potential.

We want to outline why we believe that, despite its inherent ambiguity, the *selection* of the prudential discourse on sustainability has consequences for its allocative potential. We point towards three observations. First, the way sustainability has been integrated into Pillar 2 still lends significant authority to banks' own risk models – however forward-looking they might be – compared to the prescriptive character of Pillar 1. Where Pillar 2 may have been a suitable alternative to Pillar 1 when banks were still committed to their voluntary net-zero statements, this is likely to change in the current political environment: The individualized treatment may rather contribute to competitive struggles between banks, who are asked to justify their investment strategies based on *any* decarbonization pathway scenario they can choose to their liking. Without knowing what other banks do, conservative investment strategies are likely to prevail, given the continuously attractive risk ratings of carbon-intensive assets.

Second, while the financial industry's argument that it can support but not drive the transition is warranted to some extent, this should not obscure the fact that it also holds considerable power to fend off prospective regulation. The twist towards *transition* finance now provides the financial industry with significant leeway to continue financing carbon-intensive sectors under a new banner. Third, we assess the role financial supervisors played in advancing the policy process somewhat more critically than others have done. While we contend that the current technocratic solution has insulated sustainability-related banking regulation from the regulatory backlash in other areas of sustainable finance, it has nevertheless displaced other promotional policy options. We highlighted several instances where EU policymakers were open towards giving sustainability features prevalence over risk considerations by attempting to link disclosure to capital weightings. However, all attempts failed due to prudential concerns and the role of expert bodies. This shows that if policies of credit guidance were to be considered more seriously again, this would not only require the development of *promotional institutional capacities*, but also the readiness to a much greater level of *politicization*.

In summary, we argue that the current sustainability-related financial policy approach in the EU is a political, rather than a rational, outcome of a policy process, and it continues to leave the tensions between credit steering, financial stability concerns, and profit motives of the banking sector largely unresolved.

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ANNEX

Annex I: Empirical analysis of three EU public consultations on banking regulation and sustainability-related banking regulation

1. Consultation database I (2020): Alignment EU rules on capital requirements to international standards (prudential requirements and market discipline) (European Commission)

Consultation period: 11 October 2019 - 03 January 2020

Respondents: N = 119 – all questions
N = 52 – sustainability-related question
N = 37 – GSF (coded)

Link: https://ec.europa.eu/info/law/better-regulation/have-your-say/initiatives/12015-Alignment-EU-rules-on-capital-requirements-to-international-standards-prudential-requirements-and-market-discipline-/public-consultation_en

2. Consultation database II (2021): Discussion Paper on management and supervision of ESG risks for credit institutions and investment firms (European Banking Authority)

Consultation period: 03 November 2020 - 03 February 2021

Respondents: N = 43

Link: <https://eba.europa.eu/publications-and-media/events/discussion-paper-management-and-supervision-esg-risks-credit-institutions-and-investment-firms>

3. Consultation database III (2024): Consultation on draft Guidelines on the management of ESG risks (European Banking Authority)

Consultation period: 18 January – 18 April 2024

Respondents: N = 52 (two separately submitted responses by the same company (Alior S.A.) merged)

Link: <https://www.eba.europa.eu/activities/single-rulebook/regulatory-activities/sustainable-finance/guidelines-management-esg-risks?phase=consultation>

Methodology for the evaluation of the Consultation database I (2020)

We drew on the publicly available feedback to the European Commission consultation (2020) 'Alignment EU rules on capital requirements to international standards (prudential requirements and market discipline)' to gain insights about sustainability-related reform proposal to this piece of legislation. After an initial search for sustainability-related key words through the lemmas 'climat', 'environment' and 'sustainab', we identified question 191 as the only one dedicated to the issue and excluded occasions in which these words meant something different. Question no. 191 asked 'In your view, which further measures, if any, could be taken to incorporate ESG risks into prudential regulation without pre-empting ongoing work as set out above? Please elaborate and provide relevant evidence to substantiate your view'. In a second step, we imported the 52 answers to the sustainability-related question to the qualitative research software MAXQDA, and, after an initial reading, started coding for references to a green supporting factor (GSF) and a dirty penalizing factor (DPF) (including alternative terms, such as sustainability supporting factor or brown penalizing factor). In a third step, we refined the coding, by establishing two categories of 'supporting' or 'objecting to' the introduction of a GSF and a DPF. 37 out of the 52 respondents provided their judgement on the GSF. Based on the reconstruction of the policy process, we identified the statements that supported the approach suggested by the EBA, as opposition to a GSF. We also evaluated the responses to a DPF. However, since the number of respondents was lower (N=20) and the result was little surprising, with 75% opposing and 25% supporting it, we decided to leave it out in the paper.

Methodology for the evaluation of the Consultation databases II & III (2021 & 2024)

We further drew on the publicly available feedback to two EBA consultations on the management and supervision of ESG risks since they provide important insights into questions of implementation. We downloaded the publicly available responses from the EBA website and started an initial reading. We made two major findings relating to our research question that we, however, decided not to code. The first insight we gained was that the EBA (2020) suggested methodologies that some banks were already using in practice. This way of developing new standards was confirmed in our interviews. The second insight pertained to the EBA's (2024) perspective on 'risks from misalignment', and the perspectives and expectations CSOs expressed on prudential transition plans, and some other Pillar 2-related matters.

Annex II: List of expert interviews

1. Member of supervisory board of large bank, Germany (14 December 2022).
2. Member of supervisory board of small bank, Germany (1 September 2023).
3. Staff member of civil society organization, Belgium (11 October 2023).
4. Staff member of European Union, Belgium (11 October 2023).
5. Staff member of European Union, Belgium (27 October 2023).
6. Head of research at civil society organization, Belgium (27 October 2023).
7. Director of civil society organization, Netherlands (1 November 2023).
8. Team lead at EU financial supervisor, European Union (14 November 2023).
9. Staff member of civil society organization, Belgium (17 November 2023).
10. Head of sustainable finance of large bank, Germany (20 November 2023).
11. Sustainable finance expert at large bank, France (22 November 2023).
12. Sustainable finance and regulation expert at large bank, France (22 November 2023).
13. Head of sustainable finance at civil society organization, Germany (27 November 2023).
14. Head of sustainable finance of large bank, Germany (4 December 2023).
15. Project manager sustainability of large bank, Germany (4 December 2023).
16. Member of supervisory board of asset manager, Germany (4 December 2023).
17. Head of sustainability of small bank, Germany (13 December 2023).
18. Head of sustainability for markets and securities at large bank, UK (15 January 2024).
19. Head of sustainability risk at large bank, UK (15 January 2024).
20. Chief responsible investment officer at asset manager, UK (16 January 2024).
21. Head of sustainability at large bank, UK (17 January 2024).
22. Director for green finance at public development bank, UK (18 January 2024).
23. Head of sustainability at industry association, Germany (22 February 2024).
24. Finance expert at civil society organization, Germany (22 April 2024).
25. Head of EMEA Sustainable Finance Debt Capital Markets at large bank, UK (10 September 2024).
26. Senior Team Lead at European Central Bank, Germany (1 October 2024).
27. Team Lead at European Central Bank, Germany (15 October 2024).
28. Financial Stability Expert at European Central Bank, Germany (16 October 2024).
29. Team lead at EU financial supervisor, European Union (18 October 2024).
30. Staff member at EU financial supervisor, European Union (18 October 2024).



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