



Carbon Accountability Programme

Banking on Carbon Accountability



Introduction

Financial institutions control investment in economic activities across the globe; do banks have a responsibility for related carbon impacts, including the beneficial?

Finance is still one of the world's largest industries and will play an integral part in the solution to climate change. The sector has a highly significant if poorly defined and opaque role in shaping the level and pattern of the world's greenhouse gas emissions.

How do banks affect global emissions? Retail banks provide mortgages and loans to individuals for houses and cars; commercial and corporate banks finance business of all sizes to extract oil, build power stations, to develop renewable energy and a plethora of other activities; and asset managers direct the world's capital investment and trading in assets like bonds, shares, equity and property.

Banks handle investment for many of the world's economic activities and when considering global carbon accountability and responsibility it is clear the financial sector has an important role.

Banking on a carbon footprint

How does a financial institution consider its carbon footprint and how does carbon accountability relate?

Some banks claim to be carbon neutral through lower 'direct' emissions, reduced power consumption and the purchase of carbon credits.¹ Banks have aimed to lower emissions by switching to green-tariff electricity, installing efficient office equipment, adopting office travel plans and other methods. In their December 2006 progress update HSBC reported a 7% reduction in carbon dioxide emissions from their buildings on 2004 levels.²

Important questions of control and responsibility remain however. Does a financial institutions' responsibility for emissions of greenhouse gases include only the 'direct' and power-generation emissions described in the paragraph above? Given its core business of financing other ventures, should a carbon footprint also cover these activities?

Banks and NGOs would generally agree that both lenders and borrowers share some responsibility for a financed project's outcomes, be they financial, social or environmental. The world's largest project financiers have signed the Equator Principles, accepting in principle that at least for some kinds of lending there is a need for banks to assess sustainability implications.

1 In this briefing 'direct' emissions are defined as GHG Protocol Scope 1 emissions and include onsite fuel combustion and owned transport. Power consumption is defined as GHG Protocol Scope 2 emissions.

2 Update on HSBC Group Consolidated Environmental Reduction Targets: 2006, HSBC

Relevant considerations

There are some key considerations underlying an investigation of a financed project or activity and carbon accountability.

- 1 Responsibility relates to control and power. Where banks can practically assess the carbon impacts of lending, and where they have a legitimate ability to influence those carbon impacts, then they should do so; where carbon implications are hard or impossible to assess, or where banks have no legitimate power, their responsibility to take action is diminished.
- 2 Banks are (generally) private institutions with duties to shareholders. This limits their ability to turn down commercially attractive (legal) lending opportunities. However, they do have an obligation to assess the risks associated with that lending – including both the carbon risks associated with the loan, and the reputational risks for their organisation.
- 3 Following paragraph 2, a bank will make strategic choices as to the markets they enter and the skills they develop. For example a bank with a specialised renewable energy team will be more able to assess risk in a proposed renewable project and therefore more likely to provide finance here. Both stakeholder duties and strategic choices strongly influence a bank's investment decisions.
- 4 Following paragraph 1, there is a need to distinguish between high-information, high-control activities like project finance, and low-information, low-control activities like general lending.

Where is all the carbon?

The 'external' emissions of various banks have been calculated by environmental NGOs. Platform calculated the carbon emissions arising from oil and gas projects project financed by RBS in 2005. Milieudefensie compared the carbon emissions arising from a wider range of financial activities for six Dutch banks; and most recently Rainforest Action Network produced a similar study for seven banks in Canada both researched by consultancy Profundo.³

The banking group Caisse d'Epargne along with consultancy Utopies have developed a climate labelling methodology for some banking products. In this method the carbon intensity of a bank's investments are assessed for each type of saving account and disclosed through a simple label, similar to energy efficiency labels on fridges and washing machines.⁴

Work done already has demonstrated it possible to assess the carbon impacts of lending, although more work is required to assess accuracy. But, what of control? Where do financial institutions have the control or power to influence carbon emissions?

³ The Oil & Gas Bank: RBS and the financing of climate change, Platform et al, 2007; Investing in Climate Change: Dutch Banks Compared, Milieudefensie, 2007; Canadian Banks and Fossil Fuels, Rainforest Action Network, 2008

⁴ Sustainable Development Labeling of banking products, Groupe Caisse d'Epargne and Utopies, 2008

Accountability where?

A bank will tend to have the greatest knowledge and control over the activities it funds through project finance.⁵ Thus, following from the carbon accountability principles it is here that a lender has the greatest responsibility to take action to reduce carbon emissions.

The Equator Principles follow this reasoning. The Principles apply only to project finance and define a responsibility on banks to '*determine, assess and manage social and environmental risk in project financing*'. The preamble states signatories '*will not provide loans to projects where the borrower will not or is unable to comply with our respective social and environmental policies and procedures that implement the Equator Principles*'.⁶

The principle of control and responsibility would suggest that a bank has some responsibility for project financed carbon-intensive activities such as fossil fuel exploitation. But equally, a bank would have some responsibility for other project-financed activities such as renewable energy. Do banks hold a view on this subject?

In response to Platform's report '*The Oil and Gas Bank*' RBS argues that responsibility lies with the borrower, not the lender; and if banks are held responsible for carbon emissions associated with lending decisions then by implication they could be held responsible for just about every activity involving money at some stage or other. On the other hand RBS highlights the high level of investment it makes in renewable energy projects as an environmental '*credential*'.^{7,8}

There is a logical contradiction between taking credit for the positive environmental impacts of its investments while disowning responsibility for any negative ones. The principle of control and responsibility can resolve this in part; it asserts where a bank has more information and more control more responsibility can be expected. But how is this responsibility manifest?

Emissions for say a coal-fired power station are clearly not completely the responsibility of a bank. Including these emissions in a carbon footprint for the financing bank, the power generation company and all of its customers will lead to serious double- or triple-counting.

While a bank's responsibility may not include all emissions from financed activities we believe that at a minimum there exists a responsibility to understand, assess and disclose these emissions.

5 Project finance is a method of funding in which the lender looks primarily to the revenues generated by a single project, both as the source of repayment and as security for the exposure.

6 The Equator Principles, revised version 2006

7 Royal Bank stands up for size of its carbon footprint, The Herald, 11/7/2007
www.theherald.co.uk/business/news/display.var.1534803.0.0.php

8 RBS and the Environment, RBS, 2007

It is likely a bank has wider responsibilities to stakeholders, in other words those that its activity affects or is affected by, as suggested by the Equator Principles and a body of corporate social responsibility literature. There may be wider responsibilities too with regard to international agreements, particularly with multinational enterprises under the OECD Guidelines for Multinational Enterprises.⁹

Carbon risk assessment

Risk assessment decisions are within a bank's control and therefore any failure is their responsibility. The Stern Review famously referred to climate change as the '*greatest and widest-ranging market failure ever seen*' demonstrating how climate change is a material risk in investments.¹⁰

As a result carbon risk assessment has developed rapidly in recent years to include 'serious physical risks caused by extreme weather events, regulatory risks resulting from policy development, competitive risks as consumers are increasingly valuing environmental impacts, and reputational risks from either perceived inaction on climate change, or green-wash.'¹¹

How are companies responding? In 2008, 77% of the FTSE500 responded to the Carbon Disclosure Project's annual questionnaire. This demonstrates a greater appreciation of carbon risk but we were unable to identify any evidence that this risk is systematically considered in decision-making in financial institutions. Banks are attempting to understand and assess their carbon risk but disclosure of information has remained limited.

Disclosure and transparency

If we accept that banks have some responsibility for activities financed through high-information, high-control project finance and a responsibility to shareholders and other stakeholders to assess risk appropriately, where does transparency play its part? What is reasonable for a bank to disclose regarding climate change and its project finance?

Investigations here are required. The forces of commercial confidentiality, appropriate risk assessment, market transparency and climate change responsibility will affect any judgment of disclosure but a standardised approach is essential. A common framework for evaluating a bank's carbon exposure will provide confidence, lower assessment costs and allow investors and others to compare portfolios.

A banking sector tool to develop "*an industry standard to account and categorize GHG emissions from financial transactions; to provide portfolio managers with information to assess climate risk exposure in portfolios; and systematically identify which elements of an investment portfolio need more in-depth climate risk analysis.*" is currently in development through the World Resources Institute.¹²

9 The OECD Guidelines for Multinational Enterprises, Organisation for Economic Co-operation and Development, 2000

10 Stern Review on the Economic Impacts of Climate Change 2006

11 Carbon Risk briefing note, Climate Group, 2007

12 GHG Protocol Newsletter - Issue 21, February 2007



A way forward

Climate change campaigns are making stronger links between corporate clients and their banks and represent a considerable reputational risk to banks. Current environmental claims based on financing renewable energy are valid but would be strengthened with greater disclosure and third-party verification.

The Carbon Accountability Programme proposes a stakeholder process to develop:

- A middle way response to environmental criticism;
- Opportunities for more robust environmental claims related to investments in renewable energy.

Stakeholders, including financial institutions, energy companies with renewable investments, academics and NGOs, are invited to a roundtable proposed for April 2008.

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