CENTRE ON GREEN FINANCE AND INVESTMENT FORUM 2018

SESSION NOTE

The Role of Banks in Aligning Financial Flows with Climate Objectives

13 November 2018- 11:45- 13:00

This panel will discuss the role of commercial and investment banks for re-orienting financial flows from brown to green investment in accordance with the Article 2.1c of the Paris Agreement, in addition to the role of broader capital markets. The panel will also discuss the role of financial instruments to help channel financing from capital markets into green infrastructure assets, in addition to bank loans. It will also discuss how governments are looking to help banks re-shape their role in the financial system and draw in other financial actors to help put the economy on a greener path.

Article 2.1c of the Paris Agreement adopted at the 21st Conference of the Parties (COP21) recognises the importance of "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development".[1] Commercial and investment banks and other financial actors can contribute to implementing Article 2.1c, by increasing their investments in low-emissions infrastructure projects and by reducing their exposure to fossil-fuel assets.

Since Bank of England Governor Mark Carney's 2015 call-to-action speech[2], and the adoption of the Paris Agreement, climate change has steadily been making its way onto the agenda of commercial and investment banks and other financial stakeholders. Several banks made commitments to reduce their exposure to coal and other fossil-fuel assets at COP21. This was strongly reinforced at the One Planet Summit in Paris in December 2017, and in New York in September 2018, with several banks announcing commitments to support climate action or reducing their exposure to coal and other fossil fuels.

Traditionally, banks have been key players in the financial system, transforming savings into long-term private investment, including in infrastructure projects. Banks can support infrastructure investment through various financial channels, whether through corporate and consumer loans, project finance, bond underwriting, advisory services for mergers and acquisitions, and other products and services.[3] Despite changes in the banking system (towards wholesale markets, disintermediation and the growth of capital markets) as well as deleveraging (due to the 2008 financial crisis or capital requirements under prudential regulations like Basel III), banks remain a major source of finance for infrastructure projects, be it green, brown or other types of infrastructure.

The report *Banking on Climate Change,* led by BankTrack Rainforest Action Network, Sierra Club and other organisations, shows that 36 of the world's biggest banks continue to finance fossil fuels. Banks funneled USD 115 billion funneled into "extreme fossil fuels" (like tar sands or coal) in 2017, an increase of 11% from 2016.[4] Fossil-fuel companies themselves are increasingly pressured to factor climate change in their business strategies, through shareholder action and a changing public opinion. The Chairman of Shell Chad Holliday recently urged oil and gas companies to better understand the implications of climate pressures and elevated geopolitical risk on their business.[5]

At the same time, banks are actively contributing to financing sustainable infrastructure projects. Globally, the world's debt (mostly loans) for low-carbon and other sustainability projects is largely

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[1] https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf
[2] https://www.bankofengland.co.uk/speech/2015/breaking-the-tragedy-of-the-horizon-climate-change-and-financial-stability
[3] https://www.oecd.org/finance/private-pensions/G20reportLTFinancingForGrowthRussianPresidency2013.pdf
[4] https://www.banktrack.org/campaign/banking_on_climate_change_2018_fossil_fuel_finance_report_card
[5] https://www.c-resource.com/2018/11/06/securing-the-license-to-operate-will-only-get-more-difficult/?utm_source=Publications+master+list&utm_campaign=780bb4dca7-CR_Briefing_September_2017_COPY_01&utm_medium=email&utm_term=0_191a1e7aa1-780bb4dca7-381055869

originated by banks. As the Synthesis Report of the G20's Sustainable Finance Study Group points out, bank loans currently provide the largest source of financing for sustainable assets and investments.

The diversity of banks, their business strategies and their operating environment means that they have very different levels of experience in implementing sustainable lending practices. Best practice sharing and principles could support banks in finding a common path to be more active and responsible financial actors in the low-carbon transition, drawing for instance on the OECD Guidelines for Multinational Enterprises on responsible business conduct. The UNEP FI Principles for Responsible Banking initiative is another example for how principles could align banks' business practices with societal and environmental goals.

Moreover, banks play a central role for issuing green bonds, which reached an annual issuance of USD 160 billion in 2017. Packaging sustainable loans into bond formats preferred by institutional investors, and thereby refinancing these loans and removing them from bank balance sheets, can enable banks to provide additional loans to sustainable, green projects to build the pipeline of bankable projects needed on a global basis to meet climate objectives and Sustainable Development Goals (SDGs).

Apart from banks shaping their role as responsible lenders, financial and environmental policy naturally has an impact on the role of banks as well, as does the awareness of the general public which could drive business models. Depending on national circumstances, policy interventions may be used to keep or put banks on a greener course. Governments are also considering policy interventions in other areas, including to raise awareness, increase capacity-building, create sustainability classifications and taxonomies, or enhance climate-related disclosures.

In addition to mobilising finance to promote climate goals, responsible lending also means undertaking due diligence to seek to identify and respond to potential unforeseen adverse environmental, labour and human impacts associated with a client's activities. International financial institutions have signalled plans to mobilise USD 400 billion towards achieving the SDGs. Strong due diligence processes can help ensure that these funds are put towards projects and companies that behave responsibly and ultimately help achieve the objectives of the SDGs. This is particularly important in the context of large-scale infrastructure projects, to avoid adverse impacts on society, e.g. on local indigenous communities. In this respect the OECD has been developing guidance on how to carry out due diligence for the financial sector, including for banks in the context of their lending and underwriting activities.

Useful Links and references

- Röttgers, Tandon & Kaminker (2018 forthcoming), *Progress Update on Approaches to Mobilising Institutional Investment in Sustainable Infrastructure.*
- OECD (2011), OECD Guidelines for Multinational Enterprises.
- OECD (2014), "Due diligence in the financial sector: adverse impacts directly linked to financial sector operations, products or services by a business relationship", background paper to the Global Forum on Responsible Business Conduct, 26-27 June 2014, OECD headquarters, Paris, France.
- G20 Sustainable Finance Study Group (2018), 2018 Synthesis Report.
- Bank of England Prudential Regulation Authority (PRA) (2018), Transition in thinking: The impact of climate change on the UK banking sector.
- UNEP FI (2019 forthcoming), *Principles for Responsible Banking,* http://www.unepfi.org/banking/bankingprinciples/.
- https://sebgroup.com/about-seb/sustainability/our-priorities/finance
- https://www.ing.com/Newsroom/All-news/ING-further-sharpens-coal-policy-to-support-transition-to-low-carbon-economy.htm.
- https://oilandgasclimateinitiative.com/.
- HSBC (2018), "HSBC strengthens energy policy", Press release (April 2018).
- Friends of the Earth France (2018), Press Release, (26 October 2018).