

Conservation You Can Bank On

by Christopher Wright

*The **Ecosystem Marketplace** recaps the gradual greening of the world's biggest banks, kicking off a series of articles about financial institutions' role in mainstreaming markets for ecosystem services.*

LONDON—

In 1991, Mustafa Tolba, then Executive Director of the United Nations Environment Program (UNEP), invited a group of five financial institutions to join him in discussing environmental sustainability in the financial sector.

It was, in some ways, a strange move on Tolba's part. At the time, the environment only symbolized risks, liabilities and potential financial losses for most banks. Environmental issues caused headaches when they surfaced in investment decisions, and produced sighs of relief when they did not.

The defensive attitude of the world's financial institutions was, in part, a product of legislative history. A series of reinterpretations of U.S. Superfund legislation in the 1980s led to the landmark *U.S. versus Fleet Factor (1990)* decision, which found that secured creditors could be held liable for environmental damages at facilities they financed.

"In a well-connected industry where information is the commodity trade, environmental litigation news in the U.S. spread like wildfire across the global blue chips and changed the way financial institutions looked at risk," says Paul Clements-Hunt, current Director of UNEP's Finance Initiative.

Tolba's 1991 overture to NatWest Bank, Deutsche Bank, Royal Bank of Canada, HSBC and Westpac, then, was a sort of olive branch. Later, he dubbed it, simply, the Finance Initiative.

"Within UNEP, very little was known at the time about the financial sector and its role in sustainable development", says Clements-Hunt, "the genesis for the Finance Initiative was to have a collective discussion about common goals and how to work towards them."

The discussion launched under UNEP's Finance Initiative eventually led to a partnership between more than 160 financial institutions, with membership centering on a voluntary commitment to promote sustainable development. Since then, other voluntary frameworks have been created, including the Business Charter for Sustainable Development and the London Principles for Sustainable Finance.

Despite being largely devoid of concrete operational measures, Clements-Hunt argues such business principles have been critical to the gradual greening of finance. "In many cases, the act of signing on gives leverage to individuals inside the institution which can set in motion an internal learning process with regards to identifying and responding to emerging risks and opportunities."

Perhaps even more important, Tolba's decision to launch the Finance Initiative in 1991 signaled the beginning of a new approach to advancing environmental aims. For the first time, environmentalists pushed the world's financial institutions to center stage and asked them to choose between two starring roles: that of the environmental villain or the sustainable development hero.

Playing Hardball

While the conciliatory approach taken by multilateral institutions was key in coaxing big commercial banks to the table for environmental discussions, it may have been the less friendly tactics of international non-governmental organizations (NGOs) that ultimately kept them there.

Banks were enticed by a wave of privatizations and favorable regulatory reforms in developing countries during the 1990s. Many of the larger project finance banks stopped piggy backing on official aid and invested heavily in energy, transportation and communications infrastructure in middle-income countries. And growing numbers of commercial banks anteed up for projects in the extractives industry.

These investments concerned environmental NGOs focused on sustainable development. "We began to recognize that, increasingly, the private sector was driving the development trajectories of entire countries," recalls Michelle Chan-Fishel, Head of the Green Investments Program at Friends of the Earth (FOE).

In 1997, FOE began working with the National Wildlife Federation (NWF) to launch the Quantum Leap Project, a training and support program for NGOs wanting to meet with individual banks. Quantum Leap's goal was to pave the way for a series of coordinated campaigns against the lending policies of some of the world's largest financial institutions. The project would later evolve into the ngo network banktrack.

The Rainforest Action Network (RAN) launched what was perhaps the most notable advocacy campaign against Citigroup in 2000. RAN's strategy was simple: they would educate consumers, stage public demonstrations and lead boycotts until the bank adopted new lending policies that took environmental and social criteria into account.

Ilyse Hogue, the Director of the Global Finance Campaign at RAN, remembers their first meeting with Citigroup officials in 2001. "They were welcoming and perfectly willing to meet with us, which was different from our experience with companies in other sectors. But the substance was not substantial, and we disagreed on the interpretations of their responsibilities with regards to environmental and social issues."

Four years of sustained pressure and a period of dialogue and consultation with RAN followed. In 2004, Citigroup released its "New Environmental Initiatives."

"It marked the end of a gradual process and the dawn of acknowledging responsibilities," says Hogue. "[T]hey began to realize the power they had to change things for the positive. They realized they had an opportunity to lead."

RAN's campaign against Citigroup marked an important power shift. Suddenly, the power to determine lender liability was transferred from judges and legislators to NGOs, the media and public opinion. A decision to finance palm plantations in Indonesia could trigger consumer credit card boycotts in New York. And participation in controversial projects, such as the OCP- and Baku-Ceyhan-Tblisi pipelines, was almost certain to attract considerable attention.

For ABN AMRO, the lightning rod was its financing of the mining operations of PT Freeport Indonesia. At the hands of Friends of the Earth Netherlands, it was subjected to sustained criticism for its involvement in the project.

"It was a real wake up call for us", says Richard Burrett, Managing Director of Sustainable Development for Global Markets at ABN AMRO, and formerly its Global Head of Project Finance. "We examined the project and recognized that there were issues."

The Equator Principles

For some banks, the new public image risks posed by lending decisions forced them to systematically consider environmental and social issues for the first time. For others, including ABN AMRO, it was a matter of upgrading and formalizing existing practices and further integrating sustainability into their business units. Says Burrett, "by not having a framework with explicit guidelines in place, we discovered that we were reinventing the wheel with every project. Therefore, introducing a standard approach across all projects made a lot of sense."

Others agreed. In October 2002, the International Finance Corporation and ABN-AMRO hosted a meeting in London for numerous commercial banks to recount and share stories about their confrontations with civil society groups over controversial projects. They realized that developing a common set of investment guidelines made a lot of sense.

Accordingly, a working group of four banks--ABN AMRO, Citigroup, Barclays and West LB--was established to consider a set of common standards that could be used by commercial banks in project finance deals. After additional consultations, the Equator Principles were launched less than a year later, introducing lending standards based on the IFC's environmental and social policy framework. It was an event that promised to transform the global project finance market.

Since its original ten signatories in June 2003, an additional 29 financial institutions have declared their intentions to adopt the Equator Principles. Combined, they account for over 80 percent of the global project finance market.

"The Equator Principles emerged because many banks saw the same need for action", argues Burrett. But for ABN AMRO, he continues, "it was really just a first step. We felt developing better environmental and social risk policies would improve the quality of risk management, better protect our assets, and ultimately provide better loans and more responsible business."

Clements-Hunt suggests this view is slowly becoming more prominent. "With Citigroup, Bank of America, J.P Morgan Chase, and now Goldman Sachs, there is definitely a sea change there", he says. "They are beginning to see it as a real business issue."

Market Push

While Hogue agrees that the launch of the Equator Principles, "demonstrated that, without a doubt, financial institutions had collectively realized that they should be accountable for their investment decisions and their impact on the world around them," she adds, "the framework is not near industry best practice. It is more of a baseline, and we encourage signatory banks to go beyond them by expanding definitions and applying them to other lines of revenue apart from project finance."

As part of a new strategic step, some banks have elected to actively engage with environmental markets, where the business case for considering sustainability is perhaps most clearly articulated.

Risks abound, however, since nascent markets are often associated with numerous uncertainties. In the early 1980s, for instance, many investors bet on U.S wind energy entrepreneurs and were left empty-handed when federal and state-level tax credits were discontinued. Foreign firms subsidized by their own governments eventually took over the market, leaving many U.S investors gun shy of environmental markets that rely on public support for profitability.

Regulatory certainty and consistent policy signals thus are vital to the mainstreaming of emerging markets for ecosystem services. In relation to the carbon market, for instance, Clements-Hunt argues, "If policy signals are not correct, the rug can be pulled out from underneath it." The good news, he says, is that, "based on what happened at the Montreal Conference, this will not happen, as everyone is now recognizing the reality of a carbon constrained future."

Apart from long-term regulatory stability, Burrett argues that the issue of scale is also critical to making markets for ecosystem services attractive to large investors. "At this point in time, the carbon market is the only ecosystem service market of any real scale and even that is in its infancy. Scale is critical for developing a sustainable business case. Pursuing complex one-off transactions is a difficult way to make money on a consistent basis...developing and demonstrating a business case is critical to getting traction for these new markets internally."

Carbon is King

Clements-Hunt argues that for carbon, at least, the business case is already strong. "This currently immature market," he says, "will in the future become a vibrant, liquid and immensely significant global commodity market and the leaders in the finance sector already understand this and are positioning to benefit from it commercially."

To wit, some banks have launched carbon initiatives in recent years. HSBC, for instance, committed to carbon neutrality in 2004. In 2005, they achieved their goal by managing and reducing their direct emissions, purchasing electricity from less carbon-intensive sources, and offsetting their remaining greenhouse gas emissions by entering the retail market for carbon credits. Citigroup, meanwhile, has improved energy-efficiency at its facilities, implemented a green power-purchasing scheme, developed a methodology to report carbon emissions associated with power projects, and established a Sustainable Development Investment Program.

J.P Morgan Chase has announced it will add carbon disclosure and mitigation to its client review process, and quantify the financial cost of greenhouse gas emissions in project transactions in the power sector. Bank of America's policy includes a reduction target for its operations as well as its energy and utility portfolios of 7 per cent by 2008. The Credit Suisse Group is aiming to achieve carbon neutrality at its Swiss facilities by 2006, partly by way of offsets, and Goldman Sachs recently established a Center for Environmental Markets in partnership with academia and civil society.

Like other banks, ABN AMRO is seeking to reduce its direct carbon impact by increasing energy efficiency and making green power purchases in its Dutch operations. Additionally, it has introduced new products for the emerging carbon markets. In 2005, for instance, ABN-AMRO arranged the world's first bank intermediated carbon credit trade between two private-sector organizations (a Fiji based exporter of carbon credits and a UK utility). The bank is also pursuing a number of Clean Development Mechanism (CDM) and Joint Implementation (JI) projects under the Kyoto Protocol, and is developing products for clients trading allowances under the EU Emissions Trading Scheme (EU ETS).

"Going forward," Burrett predicts, "there will be opportunities for banks to provide services around mitigation and adoption of new technologies to manage climate change... If you show the private sector that there is a smart and responsible way to do business, they will take the lead."

From Promises to Performance

Clearly, many of the world's biggest commercial banks have come a long way towards environmental sustainability since Tolba launched the Finance Initiative 15 years ago, but don't expect the NGOs to reduce their pressure anytime soon.

A new Banktrack report on the future of sustainable finance, for instance, urges the banking sector "to move from promises to performance." The report assesses the implementation and application of sustainable development policies of 39 banks and compares them to a variety of internationally recognized legal norms and best practice standards.

"The time has come for us to judge these institutions, less by what they put on paper and more by what they put into action," says Hogue. Chan-Fishel concurs, "Now that these environmental and social commitments have been made, there needs to be an accountability mechanism."

Ultimately, both Chan-Fishel and Hogue hope that the Equator Principles will move beyond project finance to other financial products. And on that point, at least, they seem to agree with Burrett. "As project finance is often a small part of a multinational bank's business," he says, "the legacy of the Equator Principles will be what they cause banks to do outside project finance."

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