Climate Safe Lending Network

Redirecting the Flow of Finance: an examination of bank strategy

Summary of discussion, 4th April 2023
(Event held under Chatham House Rules)

- Chair: James Vaccaro, Executive Director, Climate Safe Lending Network
- Facilitator: Rebecca Self, Founder, Seawolf Sustainability Consulting
- Guest Speakers:
  - Thorbjørn Lundholm Dahl, Deputy Head of Group Sustainability, Danske Bank
  - Clarissa Lambourne, Senior Project Associate, The Chancery Lane Project
- In attendance: 18 senior bank executives (including five global systemically important banks) and 12 bank experts from across the world

INTRODUCTION

The Climate Safe Lending Network published *Taking the Carbon Out of Credit* (July 2020) as a guide for banks to fully decarbonize their balance sheets. **A key pillar of action set out in this paper were strategies to stop the flow of finance towards fossil fuels** and increase their investment in the transition to a net zero economy.

In January 2023, Danske Bank published its *Position Statement on Fossil Fuels* that outlines the company's plan for limiting investment in and lending to fossil-heavy sectors. Although many banks have announced restrictions on fossil fuel finance, they have been limited in scope and/or coverage, such as geography, type of fuel extraction (e.g., Arctic drilling), or type of finance (e.g., direct project finance).

Danske Bank's announcement to not renew corporate level facilities to energy companies involved in the expansion or exploration of fossil fuels and to place conditions on investments that meet transition criteria, **marks a significant strategic turning point for a global and systemically important bank**. This decision is part of a growing trend in the banking sector whereby some lending institutions have already exited fossil fuels (e.g., Handelsbanken and Banque Postale) whilst at the other end of the spectrum, mission-oriented banks (e.g., Amalgamated Bank and Triodos Bank) apply environmentally and socially responsible criteria to financing. Following conversations with Danske Bank executives they agreed to participate in a special closed-session meeting, under Chatham House Rules, with the Climate Safe Lending Network and other senior executives in the banking sector who may be considering similar strategic questions within their organisation.

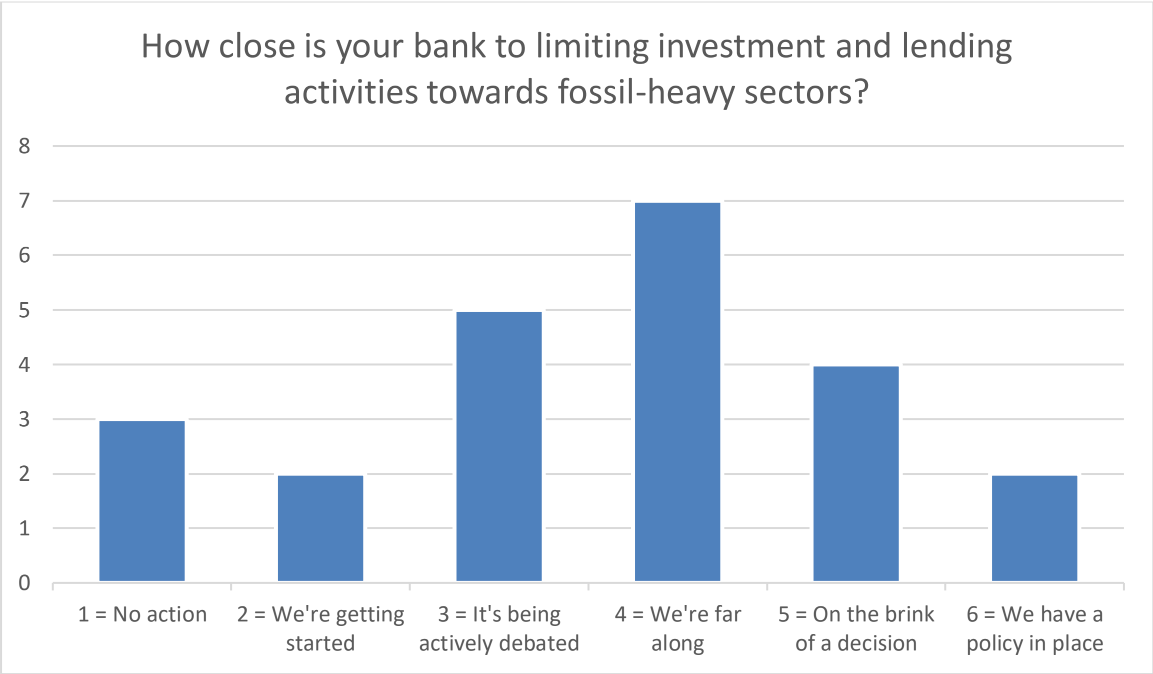
DISCUSSION HIGHLIGHTS & KEY TAKEAWAYS

Using a case study approach, this workshop explored the internal dynamics and strategic considerations that led to Danske Bank's decision to no longer finance fossil fuel proliferation. The workshop began with a conversational-style interview about the mechanics of this policy decision and key questions that arose as part of this process.

Participants explored some of the barriers, considerations, and questions around restricting fossil fuel financing, particularly: managing reputational risk, mechanics of managing client transition, introducing contractual clauses within financial documentation, and rebalancing business activity by replacing lost business with sustainable finance flows.

Experiences and insights shared by guest speakers and attendees offered insights and strategic guidance for banks that may be considering a similar policy decision.

A highlight of the workshop was an anonymous participant poll which revealed that many banks are either already having discussions about developing a fossil fuels non-renewal policy or are close to putting one in place.



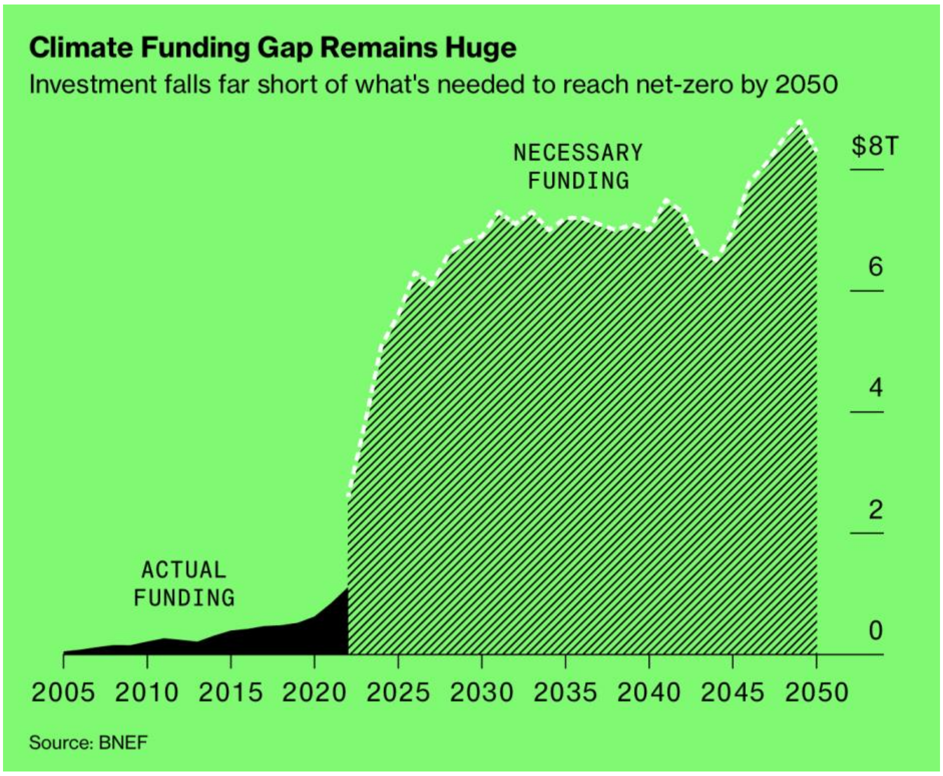
Key Takeaway #1: A sign of positive progress. The participant poll revealed that many banks are making progress towards setting a fossil fuels nonrenewal policy. This is an indication that banks are grappling with the challenge set by the International Energy Agency, UN Net Zero Expert Group, and others to stop the flow of finance for fossil fuel expansion. As hurdles are overcome and more policies are publicly announced, a ripple could grow into a wave in which no longer financing fossil fuel proliferation becomes the norm.

Engage in policy change as a whole-of-bank approach rather than a siloed effort. Obtain buy-in and support at all levels of the company and across all business units. Be strategic in your process by mapping out key decision makers and preparing a timeline of upcoming meetings so as to know when to bring information to senior executives for decision making.

It's important to embed a fossil fuels non-renewal policy in an overarching strategic vision of the future. This involves having conversations across the organisation and coming to an agreement about how bank employees see the world. Pivotal to this process is building a consensus within the bank about making a critical shift from business as usual to a desired future. This entails exploring strategic questions, such as: What role do we want to play in society? How might we finance the transition to a net zero/Paris-aligned economy?

Developing a policy for no longer financing the expansion or exploration of fossil fuels is not only about 'doing the right thing.' To get everyone on board across all management levels and departments there needs to be a compelling business case that considers projected supply and demand for oil and gas in the future. In presenting the business case, it's essential to have transparent conversations about the upsides (e.g., green products and services) and downsides (e.g., loss of income as part of a worst case scenario). The business case should also be grounded in solid data, such as the IEA scenarios that call for a limit to new fossil fuel projects beyond those that were approved as of December 2021.

GIven the scale of the funding gap and business opportunity in green finance for the net-zero transition (see below image), future opportunities may vastly outweigh the 'foregone profit' from fossil fuel expansion; however, this may be difficult to model if banks only project forward figures from the past.



In setting a climate-safe lending policy it's important to consider changes that affect all parts of the institution, such as business strategies, products, financing models, etc. External validation and third-party frameworks, like SBTi, are helpful for measuring and setting targets. Also, don't underestimate the importance of project management resources to support business units in moving in the same direction at the same pace.

Key Takeaway #2: Alignment is necessary on the inside and out.
Putting a policy in place for transitioning financial flows from fossil fuels to renewable energy involves internal alignment (i.e., getting buy-in and support at all management levels and across all business units) as well as bringing along key stakeholders, including fossil-fuel heavy clients and civil society organizations.

An important part of the policy development process is having conversations with all of your clients, including ones that are not fossil-heavy, about changes your bank is planning to make and the basis for these changes. Invite clients to provide their feedback on a draft version of the policy ahead of publishing it. An important part of engaging with clients on transition is discussing how future financing agreements will be assessed. Closely related to this is determining how credible transition plans will be evaluated.

Key Takeaway #3: Financing transition is possible. Changing the terms of client contracts to include restrictions on fossil fuel financing is an approach banks can take as part of setting a fossil fuels nonrenewal policy. A notable resource is The Chancery Lane Project, which has developed climate aligned clauses for inclusion in client contracts, such as applying a financial penalty to the borrower for meeting requirements and reducing loan interest rates in proportion to carbon emissions saved.

Participants acknowledged opportunities and challenges of engaging clients in a net zero/Paris-aligned transition, including whether there is a role for fossil-heavy companies to finance renewable energy. One approach that banks might consider is signalling their intention to finance the transition to a net zero economy by ring fencing fossil fuel financing. Participants also recognised that continued expansion of fossil fuels, alongside investing in renewable energy, is incompatible with the goal of the Paris Agreement to limit the global increase in temperature beyond 1.5℃. It's important for banks and clients to work together to ensure that the capital provided is used for its intended purpose and the impact produced moves the needle on addressing climate change.

Key Takeaway #4: Get the balance right. Engaging clients in net zero/Paris-aligned transition entails walking a fine line between providing a supportive environment for transition and holding fossil-heavy companies accountable for making meaningful change at the scope and scale necessary to address the climate crisis. Banks and clients need to work together to identify climate-safe solutions.

Be sure to include key stakeholders, like civil society organisations, in the policy development process. Instead of informing NGOs about a decision that has already been made, engage in a dialogue about the basis for the policy change and what your bank wants to achieve through it. Provide an opportunity for NGO representatives to meet with your bank's senior management so that they can provide their views on the proposed policy and offer constructive feedback on areas for improvement.

Key Takeaway #5: There are mutual benefits to working with unlikely allies. Just as banks can benefit from understanding societal considerations for inclusion in their lending and investment policies, civil society organizations can also benefit from understanding banks' commitments for net zero/Paris-alignment and complexities around engaging clients in exiting fossil fuels.

Lastly, there was a recognition that making progress at scale requires pushing on all key levers in the financial system that are maintaining the status quo—from supporting banking professionals who are pushing for bolder climate action within their institutions to clearer regulatory signals from policymakers for creating a level playing field for exiting fossil fuel financing, and engaging civil society in holding the private and public sectors accountable for progress.

RESOURCES

Links shared during the Redirecting the Flow of Finance workshop:

- Danske Bank Fossil Fuel Position Statement: https://danskebank.com/-/media/danske-bank-com/file-cloud/2017/5/danske-bank-position-statement-fossil-fuels.pdf

- Danske Bank Climate Action Plan: https://danskebank.com/-/media/danske-bank-com/file-cloud/2023/1/danske-banks-climate-action-plan.pdf

- The Chancery Lane Project: https://chancerylaneproject.org/

- Global Oil and Gas Exit List: https://gogel.org/about

- Andrew Bailey's Green Swan Conference speech: "Tackling Climate for Real: progress and next steps": https://www.bankofengland.co.uk/speech/2021/june/andrew-bailey-bis-bank-of-france-imf-ngfs-green-swan-conference

- Carbon Tracker Initiative: Home - Carbon Tracker Initiative

- Carbon Tracker Initiative Report: *Absolute Impact: Why Oil and Gas Companies Need Credible Plans to Meet Climate Targets*: https://carbontracker.org/reports/absolute-impact-2022/

- Financial Times article (April 3, 2023): "Only 5% of FTSE 1000 companies have 'credible' climate transition plans, says EY": https://www.ft.com/content/5bc9bdf5-1e13-4a53-ab90-e71d9fb6c759

- Transition Plan Taskforce Publications (disclosure framework, implementation guidance, recommendations, etc.): https://transitiontaskforce.net/publications-2/

- International Energy Agency Press Release: “Record clean energy spending is set to help global energy investment grow by 8% in 2022”: https://www.iea.org/news/record-clean-energy-spending-is-set-to-help-global-energy-investment-grow-by-8-in-2022

- Climate Safe Learning Lab: https://www.climatesafelending.org/learning-lab