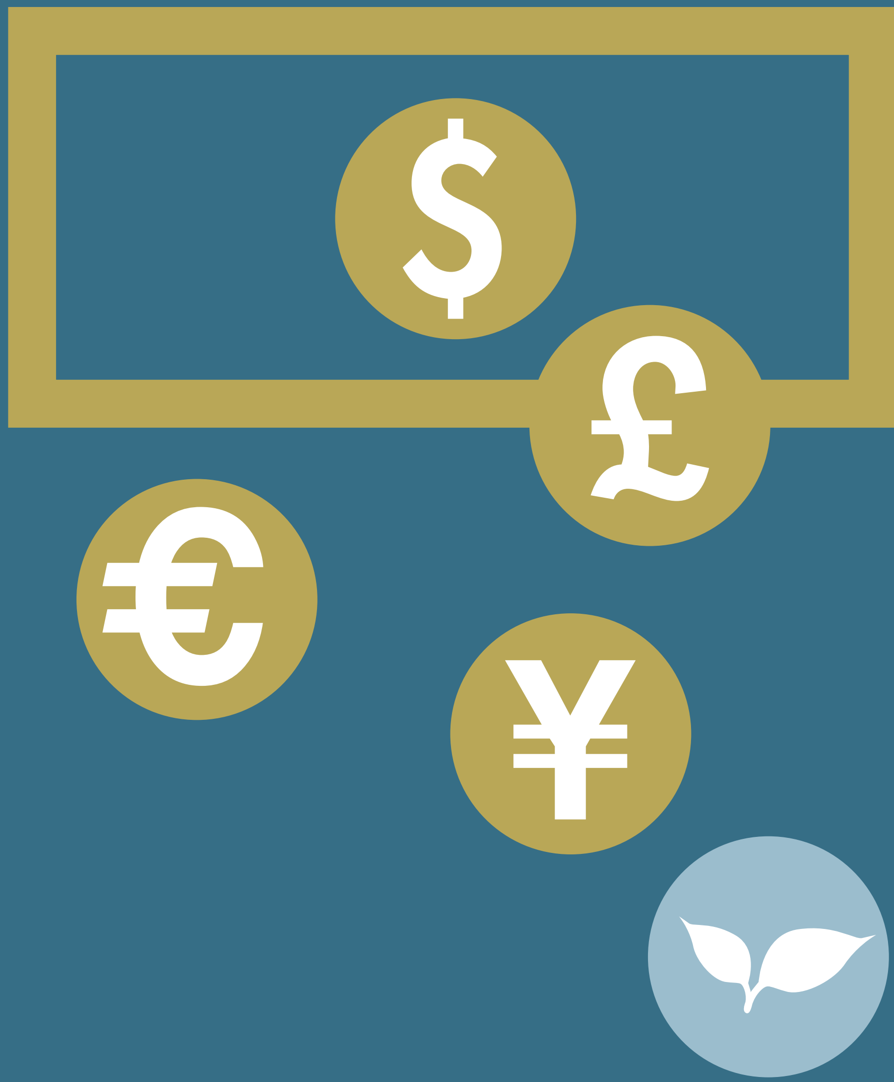

EXECUTIVE SUMMARY

THE BANKING SECTOR & ECOSYSTEM SERVICES

A META-ANALYSIS

November 2012

Coastal Quest and Blue Earth Consultants, LLC

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Project supported by the Gordon and Betty Moore Foundation

For additional information and to access the full report please visit www.Coastal-Quest.org or www.BlueEarthConsultants.com or send an email request to info@coastal-quest.org.

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EXECUTIVE SUMMARY

Non-governmental organizations (NGOs), inter-governmental organizations (IGOs), civil society organizations (CSOs), businesses, and governments are starting to use ecosystem services—the benefits people obtain from ecosystems—as a means to support natural resource protection. The concept of ecosystem services helps decision makers understand the values that ecosystems provide and consider these values when making resource management, policy, and business decisions.[i] While the concept has gained traction in recent years, the extent to which organizations, governments, and business are implementing it remains unclear. The degree of banks' attention to ecosystem services is especially opaque, as few banks share information regarding the considerations that shape their financing decisions. Yet banks' decisions and activities have a huge impact on ecosystem services across the globe. Banks underwrite and invest in companies that extract or use natural resources and that alter the function of ecosystem services. In turn, most of these companies rely on the benefits ecosystems provide for their long-term financial success.

Blue Earth Consultants conducted a meta-analysis that evaluates the extent to which banks identify, assess, and mitigate their impacts on the sustainability of natural resources and ecosystems, as well as the degree to which banks proactively finance projects that have a positive impact on ecosystems. The report focuses on banks' financing decisions, not their internal operations such as carbon emissions or water use, since banks' financing activities generally exert a greater impact on natural resources.
For this study we conducted web-based research and a literature review of 61 commercial/state-owned, investment, and bilateral/multilateral banks. They included a broad cross-section of banks selected by: 1) bank type (commercial/state-owned, investment, and bilateral/multilateral), 2) size of assets, 3) geography (countries or regions in which the banks were based and operate), and 4) the approach used to incorporate sustainability in their activities. We also conducted semi-structured interviews with 41 representatives from 22 banks and with 6 cross-cutting experts in the banking sector. In-depth research was conducted for 15 "snapshots" of banks that incorporate innovative ways of implementing ecosystem services approaches. The subjects of these snapshots were selected based on information gained from the semi-structured interviews, web-based research, and literature.

REPORT SECTIONS AND HIGHLIGHTS

1. Introduction

The introduction provides background to the report, a discussion of its purpose and the research methods used, and a description of the report outline.

2. Overview of Bank Types and Environmental Sustainability

Section 2 provides an overview of the banking sector, including bank types and activities. It describes key milestones in banks' evolving approach to environmental sustainability, as well as factors motivating banks' increasing attention to natural resources and ecosystems.

Key findings include:

- Inherent differences exist between commercial/state-owned, investment, and bilateral/multilateral banks in terms of their purposes, activities, and sources of funds. In addition, banks vary by size, scope, countries of operation, corporate culture, and motivations for considering sustainability.
- Commercial/state-owned and investment banks tend to adopt environmental policies and procedures for four main business reasons: 1) risk management,[1] 2) compliance with regulation and

i. Ecosystem services are typically categorized into four broad service areas: *provisioning services* provide resources such as water, timber, and seafood; *regulating services* support ecological processes such as weather and nutrient regulation; *cultural services*, such as recreation and natural beauty, promote humans' emotional and spiritual well being; and *supporting services* underpin ecological processes and functioning, such as nutrient cycling and photosynthesis. Millennium Ecosystem Assessment, 2005.

directives,[2] 3) protection against financial costs,[3] and 4) a means to capitalize on business opportunities.[4] Bilateral/multilateral banks are motivated to adopt sustainability policies as part of their efforts to maintain their social license to operate, as well as by their understanding of their environmental and social impacts.[5]

Four Business Reasons Motivating Banks' Attention to Environmental Sustainability

- Risk management
- Legal compliance
- Protection against financial costs
- Business opportunities

3. Banks' Consideration of Natural Resources and Ecosystems through Policies

Section 3 discusses banks' high-level policies and sector-specific guidelines related to natural resources. Such policies are important means by which banks demonstrate attention to natural resources and ecosystems, and their adoption indicates senior leaders' support for sustainability. Policies can help to guide a bank's actions and direct staff attention to sustainability.

Key findings include:

- Bilateral/multilateral banks have the most robust policies regarding natural resources and, unlike most commercial/state-owned banks and investment banks, explicitly mention ecosystem services in their environment policies and strategies.
- Commercial/state-owned banks and to a lesser extent investment banks have policies and sector-specific guidelines that commit them to actions related to environmental sustainability, but the rigor and extent of their implementation vary significantly.
- In addition to developing internal policies, a growing number of banks are signing on to global principles and standards, the most common of which is the Equator Principles.

4. Banks' Consideration of Natural Resources and Ecosystems through Bank Management Structure

A bank's management structure influences the degree to which policies are implemented and the way in which natural resources and ecosystems are considered in financing decisions. Section 4 describes banks' use of both the hard and soft mechanisms that help to ensure assessment of natural resources and ecosystems.

Key findings include:

- For all banks, buy-in from senior leadership is an important component of the bank's attention to natural resources. This buy-in can help to combat traditional incentive structures and a corporate culture that may not be conducive to consideration of natural resources.
- Bilateral/multilateral banks are the most advanced in creating management structures that support the consideration of natural resources. Not only do they staff an array of technical environmental experts who provide assistance to projects, but several have ensured that senior leaders have responsibilities related to sustainability.
- Overall, leading practices include integrating sustainability teams or experts into the overall structure of a bank, ensuring that environmental issues are a central part of all financing decisions, and staff training that is robust and ongoing.

5. Banks' Consideration of Natural Resources and Ecosystems in their Financing Activities

Bank financing activities can exert a significant, if indirect, impact on natural resources and ecosystems. In addition, their financing of particular projects or particular sectors (e.g., agriculture, forestry, fisheries) can result in extensive environmental impacts. Section 5 describes banks' attention to natural resources in their financing activities.

Key findings include:

- Banks' consideration for natural resources and ecosystem services varies by the type of financing. It is the most robust for project finance but remains significantly more limited for corporate loans and investment bank activities.
- Risk assessment remains banks' primary means of considering natural resources.
- Explicit attention to ecosystem services is nascent. Overall, bilateral/multilateral banks are ahead of commercial/state-owned and investment banks

in their consideration of natural resources and ecosystems, including explicit attention to ecosystem services.

Risk Assessment is Key

Risk assessment is central to banks' consideration of natural resources. Most banks have an environmental and social risk management tool, but vary in terms of the number and type of deals to which they apply the tool, the rigor of the risk analysis they conduct, and the consequences of a negative finding about a particular deal.

6. Banks' Approach to Monitoring and Reporting

Monitoring and reporting provides a transparent means for banks, stakeholders, government officials, customers, and the public to assess banks' activities and environmental impacts. A number of monitoring and reporting tools exist, including internal and external audits of risk management systems, externally verified sustainability reports, deal disclosures, and public forums. Section 6 describes banks' approach to monitoring and reporting.

Key findings include:

- Bilateral/multilateral banks lead the sector in monitoring and reporting. Several have disclosure policies that establish a commitment to opening bank records and details to the public.
- Sustainability reports abound, but the quality and degree of transparency vary significantly.

7. Engagement with Non-Governmental Organizations and Civil Society Organizations

This section describes banks' motivations for and approaches to partnering with NGOs and CSOs. Banks' increasing attention to natural resources and environmental sustainability over the past decade is partly due to activism and public scrutiny by the nonprofit sector, specifically NGOs. Currently, banks are expanding the scope of their collaborative relationships with NGOs and CSOs to improve the reach of their socially and environmentally focused efforts. Section 7 describes banks' motivations for and approaches to partnering with NGOs and CSOs.

8. Bank Priorities Related to Natural Resources

Research shows that banks share common priorities related to natural resources in their sector-specific priorities (e.g., forestry and agriculture) and issue priorities (e.g., climate change).

Key findings in this section include:

- Energy generation constitutes the greatest sector priority for all bank types, followed by forestry, metals and mining, and agriculture for commercial/state-owned banks, and agriculture, forestry, and metals and mining for investment banks. Bilateral/multilateral banks show strong engagement in the agriculture, forestry, fisheries, and transportation and infrastructure sectors.
- All banks share a focus on climate change.

9. Leading Banks and Innovative Projects

Section 9 identifies leading banks and innovative projects related to natural resources and ecosystems.

Key findings include:

- Leading banks are those that integrate natural resources and ecosystem consideration throughout their internal operations.
- Bilateral/multilateral banks frequently utilize best practices in these areas; they also have integrated environmental considerations more thoroughly into daily operations than commercial/state-owned and investment banks.

Leading Banks Integrate Natural Resources and Ecosystem Considerations into All Four Internal Areas

Leading banks have strong policies, effective management structures that ensure implementation and oversight of policies related to natural resources, robust consideration for natural resources in financing policies, and transparent monitoring and reporting. Bilateral/multilateral banks tend to be on the cutting edge and have adopted best practices in these four areas.

10. Challenges, Barriers, and Lessons Learned

Banks face many challenges and barriers that prevent them from paying more comprehensive and meaningful attention to natural resources; Section 10 identifies the lessons learned from their efforts to increase that attention. Challenges relate to internal factors, including banks' lack of data, tools, and capacity, as well as their business concerns and corporate culture. Other challenges are related to factors external to the bank, such as the lack of established monetary values for ecosystems services, and the limited environmental regulation and liability found in some countries. While applicable to all bank types, these challenges are more pronounced for commercial/state-owned and investment banks that must make a financial profit. Figure 1 highlights the challenges commonly faced by banks, which are described in detail in the report.

In addition, our research identified the following lessons from banks that have attempted greater consideration for natural resources and ecosystems in their financing activities. A full discussion of these lessons can be found in the report.

Lesson 1: It is important to make the business case for greater consideration of natural resources and ecosystem services.

Lesson 2: Senior leadership buy-in and support for meaningful integration of natural resources and ecosystems is key.

Lessons 3: External pressures, such as NGO activism, are huge drivers causing banks to increase their attention to natural resources and ecosystems.

Lesson 4: Partnerships with NGOs can help banks and NGOs achieve goals.

Lesson 5: A need exists for efficient and simple tools that can assist banks in their consideration of natural resources and ecosystems.

Lesson 6: Legislation and policies play a significant role in compelling banks' actions and creating changes.

Lesson 7: Banks want to learn from their peers regarding best practices and ways to overcome barriers.

Figure 1: Matrix of External and Internal Bank Challenges to the Considerations of Natural Resources and Ecosystems

	Gaps in Data/Knowledge, Tools, and Capacity	Business Concerns/Constraints
Internal Factors	› Lack of Awareness › Lack of Internal Capacity › Difficulty Assessing Impacts on Natural Resources › Limited Data on Companies	› Corporate Culture and Incentive Structure › Fear of Losing Competitive Advantage › Lack of Bank Transparency
External Factors	› Cross-Cutting Nature of Ecosystem Services › No Established Monetary Values to Ecosystem Services › Inadequate Standardized Tools, Best Practices, and Frameworks › Challenges of One-Size-Fits-All Tool	› Limited Markets for Ecosystem Services › Lack of Regulation › Limited Ability to Influence Client Activities

11. Opportunities and Levers to Facilitate Change

Section 11 describes the business opportunities for banks that increase their attention to natural resources. It also identifies a suite of levers that could incentivize banks to improve their consideration of natural resources. These levers are described in detail in the report.

Key findings in this section include:

- A number of business opportunities exist for banks, including reputational benefits, new products and services, increased market share, and new markets.
- Four primary levers can help to compel banks to increase their attention to natural resources and ecosystems: senior leadership, external scrutiny/demand, legal requirements, and new tools and practices.

Four Levers to Advance Banks' Practices

- Foster senior leadership buy-in
- Leverage the power of consumer scrutiny/demand
- Create mandatory frameworks
- Support new tools and best practices

ENDNOTES

1. Mulder, Ivo, and Thomas Koellner. 2011. "Hardwiring Green: How Banks Account for Biodiversity Risks and Opportunities." *Journal of Sustainable Finance & Investment*. Web. 2 July 2012. http://www.tandfonline.com/doi/abs/10.1080/20430795.2011.582323.; UNEP FI Biodiversity & Ecosystem Services Work Stream. 2010. *Demystifying Materiality: Hardwiring Biodiversity and Ecosystem Services into Finance*. Web. 2 July 2012. http://www.unepfi.org/fileadmin/documents/CEO_DemystifyingMateriality.pdf.; Mulder, Ivo. *Biodiversity, the Next Challenge for Financial Institutions? A Scoping Study to Assess Exposure of Financial Institutions to Biodiversity Business Risks and Identifying Options for Business Opportunities*. Rep. Gland, Switzerland: IUCN, 2007. Print.
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