

3. RESPONSIBLE FINANCE

This chapter examines the provision of responsible financial services and products. The indicators consider whether banks offer services and products commonly deemed responsible, such as offering **microcredit** to disadvantaged communities, as well as the provision of **climate products** aimed at improving the environment. The chapter furthermore assesses whether banks practise **socially responsible investing** (SRI), while examining social and environmental risk management and the screening of high-risk sectors in lending practices; and lastly it takes a closer look at the validity of often used **sustainability indices**.

Products and Services

Despite financial scandals and crises, there is ongoing belief in financial solutions to social and environmental issues. Reliance on financial solutions to issues that are not exclusively financial is problematic, as market-driven responsibilities do not always equate with responsibilities towards the community.⁵² For example, **shareholder primacy**, acting in the interest of your shareholders, may contradict acting in the best interest of wider stakeholders. It is also vital to note that the social or environmental value of a product or service is not intrinsic: instead, the entire range of products and services a bank provides determines the value.

According to John Ruggie, author of the seminal work on business and human rights that bears his name, “[...] there is no equivalent to buying carbon offsets in human rights, philanthropic good deeds do not compensate for infringing on human rights.”⁵³ Even offsetting of carbon emissions is controversial and often branded as ‘polluting without the guilt’. The fundamental problem with carbon offsetting occurs when the link between the counterbalancing product and the actual reduction of emissions is severed, which can occur due to difficulties in measuring emissions, or fraud. Thus, offering responsible products and services does not simply absolve banks from social and environmental wrongdoing.

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
Microcredit	✓	✓	✓	✓	5/8	10/11	7/7
Climate products	✓	✗	✓	✓	5/8	8/11	5/7
SRI	✓	✓	✓	✓	4/8	10/11	6/7

Consequently, although the Australian banks and many peers from other regions offer microcredit, provide climate products and services, and are furthermore involved in socially responsible investing - among which are projects or businesses related to renewable energy, sustainable agriculture and green infrastructure, the material test to determine whether banks truly practise sustainable and responsible financing is to examine their most controversial financial activities. Thus the next section will take a closer look at social and environmental risk management and the screening of high-risk sectors.

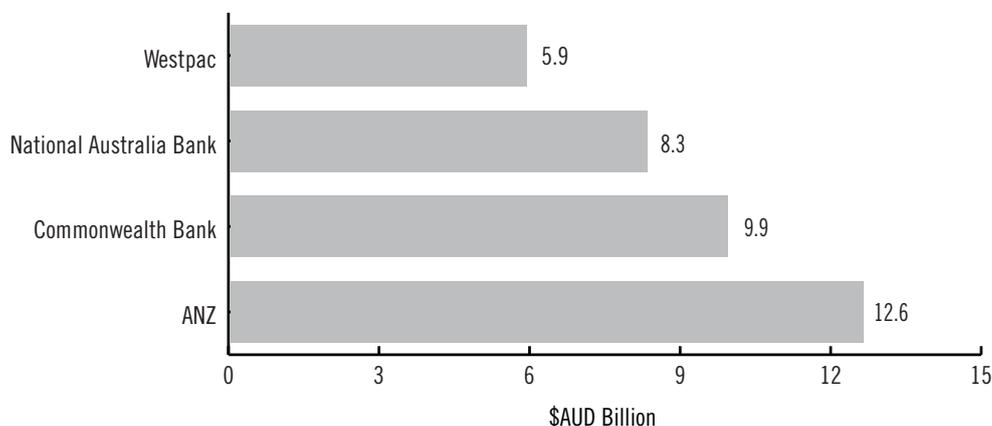
Risk Management and Sector Screening

In the Australia Institute survey, only 32% of respondents believe that banks should provide financing for projects even if there are social and environmental risks. The majority of Australian and other banks in the sample state that they evaluate environmental risk. Although this is encouraging, many environmental outcomes will only become evident over time, making it essential to apply a time scale that allows environmental consequences to manifest.⁵⁴ This fact illustrates the urgent need for a precautionary turn in risk management. Despite Australian banks stating that they screen high-risk sectors before making lending decisions, they nevertheless continue to fund a wide range of unsustainable activities.

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
Environmental Policy	✓	✓	✓	✓	8/8	10/11	7/7
Environmental risk management	✓	✓	✓	✓	5/8	11/11	7/7
Sector Screening	✓	✓	✗	✓	6/8	10/11	7/7
Equator Principles	✓	✓	✓	✓	2/8	8/11	6/7

For example, since 2008, the big Australian banks have provided \$AUD 36.7 billion in funding to the fossil fuel industry in Australia.⁵⁵ An example of such a loan is the Maules Creek coalmine in New South Wales, financed by a \$1.2 billion loan, with ANZ contributing \$AUD 325 million, while CBA, NAB and WBC each put in \$100 million. Local communities, including traditional land owners, are opposed to the construction of the mine, which is associated with deforestation, endangering vulnerable species, air pollution, competition for water resources and a billion tonnes of CO₂ emissions over the mine's life span.⁵⁶

Loans to the Australian Fossil Fuel Industry



In addition, when considering both coal and gas projects, in the period 2008 to 2012 alone the four banks funded \$AUD 3.8 billion worth of projects affecting the Great Barrier Reef, a World Heritage site.⁵⁷ In addition to projects already funded, another controversial plan is the development of the Alpha Coal project. The proposed coalmine and associated rail and port infrastructure will produce and transport around 30 million tonnes of coal annually, linking the mine in the Galilee Basin in Queensland to a port 495 km further north via a railway.⁵⁸

The mine would impact over 20,000 hectares of land, threaten endangered species, and emit 65 million tonnes of CO₂ annually. Associated port expansions would result in construction and dredging along the Great Barrier Reef, a World Heritage site, placing this area at risk.⁵⁹ Although it has not yet been fully funded, ANZ is advising on the financing of the project, and a funding arrangement similar to the Maules Creek coalmine will likely be finalised.

Apart from endangering the environment, banks also provide financing for other unsustainable activities. For example, from 2011 to March 2014, the banks under examination provided \$AUD 112.2 billion[†] to nuclear arms manufacturers, \$AUD 3.6 billion of which was lent by Australian banks.⁶⁰ The report by PAX and the International Campaign to Abolish Nuclear Weapons profiles eight financial institutions that have banned investments in nuclear weapons and another 27 that have taken steps but have not yet fully divested. The Australian banks are not part of these groups.

Banks do apply responsible financial principles to lending activities.[‡] The well-known **Equator Principles** are used as an instrument to determine and control environmental and social risks in project finance, such as infrastructure projects. A common criticism is the distinct focus on project finance, as its share is small compared to the value of global banking assets: \$USD 321.3 billion⁶¹ vs. \$USD 156 trillion.⁶² Furthermore, the project component allows for discriminatory application of the principles, and the voluntary nature prevents enforcement.⁶³

Despite all four Australian banks applying the Equator Principles, they also continue to finance activities that contradict these commitments. Furthermore, when the Equator Principles are applied, such as in the case of the Alpha Coal project, the far-reaching and adverse project impacts do not seem to discount its realisation. In other cases, such as the Maules Creek coalmine or the Liquefied Natural Gas project in Papua New Guinea⁶⁴, the Equator Principles are simply not considered. This suggests that the guidance provided by the Equator Principles is inadequate, not universally applied, or simply ignored.

[†] Using average US\$ - AUD\$ exchange rate for this period. Excludes banks with <0.5% holdings

[‡] The United Nations Principles for Responsible Investment are not considered, as these principles are more relevant to investment banks than retail banks.

Sustainability Indices

A growing number of sustainability indices gauge the environmental and social performance of companies. These indices are useful to investors, as research has shown there is a link between the (perceived) environmental and social functioning of a company and its financial performance.⁶⁵ Well-known sustainability indices are the FTSE4Good and the Dow Jones Sustainability Index (DJSI). Many banks in the sample are part of both indices, and ANZ was named as the global banking leader in the DJSI six times in the last seven years.

Indicator	ANZ	CBA	NAB	WBC	Asia	Europe	N. America
DJSI	✓	✓	✓	✓	2/8	8/11	6/7
FTSE4Good	✓	✗	✓	✓	2/8	10/11	6/7

Yet, how can ANZ achieve this credit if it is the largest funder of coal mining and related infrastructure projects in Australia? A closer look at the indices reveals a number of other dubious constituents. For example, at the time of writing, food and beverage giant Nestlé is included in the top ten of both the FTSE4Good and the DJSI⁶⁶, despite social and environmental controversies in past⁶⁷ and present times.⁶⁸ In addition, Apple Inc. leads the FTSE4Good index⁶⁹ despite widespread criticisms concerning labour rights violations in its supply chain.⁷⁰

Research into sustainability indices raises additional issues, such as the lack of standardisation and credibility of information, as well as rating bias, and lack of transparency and independence.⁷¹ Furthermore, methodologies and calculation of rankings are of vital importance but frequently opaque.⁷² It is also argued that the indices promote a narrow view of corporate responsibility: certain areas of performance are made increasingly visible, leaving others underexposed.⁷³

Consequently, it is highly questionable if these sustainability indices truly gauge the social and environmental performance of banks. The high rating of firms with dubious track records can perhaps be explained by research which shows that investors are inclined to reward firms that display overall positive behaviour, rather than to exclude companies based on certain unsustainable products or practices.⁷⁴ Thus, from an investor perspective, banks can be absolved from wrongdoing by offsetting their unsustainable activities with sustainable ones.

Summary

So what are the implications for responsible finance, in the shape of products and services, risk management, sector screening, principles and indices? The evident schism between *regular* finance and ethical variants is difficult - if not plain impossible - to reconcile. Unsustainable products and services cannot simply be 'offset', while risk management and the screening of high-risk sectors falls short and lacks the necessary precautionary approach, as evidenced by ongoing investment in unsustainable activities, while the DJSI and FTSE4Good indices fail to adequately measure the non-financial performance of banks.

A number of questions about responsible finance remain: can financial value creation coexist with the creation of non-financial values, or will it be based on a minimal degree of social and environmental responsibility and a maximum return on investment? Is responsible finance indicative of a sincere commitment to society and the environment, or is it merely market rhetoric? Regrettably, the evidence in this chapter suggests the latter is true. Voluntary responsible finance initiatives fall short in aligning incentives of banks and the community, and also in reducing social and environmental risk.