Climate Principles

Progress Review
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pwc

THE CLIMATE GROUP

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Cover Image: The Revenue Tower in Hong Kong's busy Wan Chai district. Photo by Jiri Rezac.

FOREWORD FROM THE CLIMATE GROUP

Mobilizing the finance and investment necessary to transform the way the world produces and consumes energy lies at the heart of the climate policy challenge. In fact, the single most important goal of climate policy should be to create the incentives that shift the way investment decisions are made and capital is allocated away from conventional high carbon technologies, processes and products to leaner, cleaner low carbon alternatives.

Unsurprisingly, therefore, climate finance took center stage in policy discussions throughout 2010 – at the international, national and sub-national levels and in the public and private sectors alike. From the report of the UN Secretary General's High Level Group on Finance on how to generate an additional US$100 billion a year of funding by 2020, to the proposals made by investor groups on how to use public finances to leverage private sector capital and the multiple local initiatives around the world, financing the low carbon transition has been at the heart of climate policy and politics. This will undoubtedly continue through 2011 and beyond.

Some concrete steps have been sustaining the importance attached to the vital issue of finance. The downward trend in clean energy investment that characterized 2009 was reversed as most of the world began to emerge from recession and by the end of the year had risen to its highest ever levels, with estimates indicating that total investments for the year will be close to US$200 billion. New financing mechanisms were put in place in India, China and a host of other countries, while the creation of a Green Investment Bank was part of the new UK government's election manifesto. At the policy level, the divisive debate about whether public and private finances should cover the cost of climate mitigation and adaptation has given way to increasing acknowledgement that the scale of investment required will not come from either sector alone but that new and innovative partnerships between the two will be needed. A successful clean industrial revolution will require the greatest public-private partnership in history.

Alongside this has been a small but perceptible shift in the way that both governments and the private sector view the purpose of climate policy itself. For the last two decades, although the discourse has emphasized the need to avoid dangerous climate change, the focus of discussions has largely been on how to equitably divide up the burden or cost of action. This has not yet disappeared but is slowly being overtaken by a discourse that accentuates the opportunities and benefits of the low carbon economy. For the first time, in Cancun, this was explicitly recognized in internationally agreed text. Like other trade races before it, the low carbon race is now firmly underway.

This new political reality only underscores the relevance and importance of the Climate Principles Financial Institutions' (CPFIs) work, making it more vital than ever. The growing group can play a pivotal role in shaping both how the sector responds and the effectiveness of policies in driving forward the coming clean revolution. The 2011 Climate Principles Progress Review shows that the CPFIs are already rising to the challenge and are leaders among their peers, with the working groups on coal and clean energy financing set to provide important leadership for wider markets. However, it is also clear that there remains much more to be done. The Climate Group is committed to helping make this happen.

Mark Kenber
CEO, The Climate Group

FOREWORD FROM PWC[1]

The outcome reached at COP16 in Cancun in December 2010, signed by 193 countries, has renewed confidence in the UN Framework Convention on Climate Change and the potential for an international legally binding agreement. The Cancun Accord has been described as both a historic compromise and a commitment to multilateralism. It recognizes the need to hold the increase in global temperatures to within 2°C, and contains a balanced package of measures covering forestry, adaptation, measurement reporting and verification (MRV) and, importantly, finance. A key component of this is the proposed Green Climate Fund (GCF) to mobilize US$100 billion of financing from developed to developing countries. What is less clear, however, is what role if any the private sector will have in this fund. Given the scale of the financing challenge – for example the World Bank estimates the incremental costs of climate mitigation to be US$140-175 billion per annum over the next 20 years – and the fiscal constraints facing many developed country governments, private capital is key. The Climate Principles Financial Institutions (CPFIs), and the wider financial services sector, will need to engage with policy makers and governments if they are to be involved in the design stage of financing mechanisms. If they do, they will be strategically well-placed to play an enabling role in unlocking a transition to a low-carbon economy.

As the CPFIs work towards addressing climate change across their business activities, PwC is pleased to provide once again an independent review on the progress of the CPFIs in fulfilling their commitments to the Principles. As with last year's review, PwC based its assessment on information available in the public domain and supported by supplemental interviews with each institution.[2] Our review, which forms the second section to this report, highlights year-on-year progress in addition to focus areas for action going forward.

Our review of the CPFIs' activities shows that important action is underway in fulfilling commitment to the Climate Principles and transitioning towards a low carbon economy, but gaps do remain. As a group, the CPFIs continue to demonstrate climate change leadership and innovation in financial services. A number of new and innovative climate-related insurance products were introduced targeting new technologies as well as evolving consumer habits. Additionally, in corporate banking there was strong evidence of financing in renewable energy and clean energy infrastructure projects, and despite uncertainty surrounding future climate regulation, many CPFIs continued to develop and participate in carbon markets. Climate research has also remained a core activity for the adopters.

There are other areas where more could be done by the CPFIs. In particular, greater disclosure on activities the institutions are taking to address climate issues internally (e.g. analyst training) and externally (e.g. with clients, investee companies) would help to demonstrate the group's leadership, and improve understanding and awareness within the industry and amongst the general public. Project finance continues to present challenges in terms of fulfilment to the Principles, though many noted the need for clarity from the

1 In this document, "PwC" refers to PricewaterhouseCoopers LLP (a limited liability partnership in the United Kingdom), which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.

2 Whereas PwC did not verify the data collected, the factual accuracy of the material contained within the report was confirmed by the CPFI members.

Equator Principles Strategic Review.[3] As with last year, progress was also limited across retail banking. These two sectors remain the lowest performing areas for the CPFIs. What is also clear is that, whilst the leadership and early action being taken by the CPFIs is a very welcome step in the right direction, the need to integrate climate change across their entire business operations remains a challenge. The progress made to date, as outlined in this review, establishes a firm foundation for future action.

With a global consensus on the need to take action on climate change within reach, the CPFIs can play an important role in moving this forward through their influence with governments, businesses, and key policy makers. The CPFIs can continue to demonstrate leadership as further clarity on the structure of financing for the Green Climate Fund unfolds, governments act towards implementing legally-binding regulation, and the Equator Principles undergoes its Strategic Review.

Jon Williams
Partner, Sustainability and Climate Change, PwC

3 The Equator Principles Strategic Review aims to assess progress to date since their inception in 2003, and address challenges and opportunities as identified externally and by the now 68 financial institutions that have adopted the voluntary guidelines for managing environmental and social risk in project financing.

INTRODUCTION BY THE CLIMATE GROUP

The finance and insurance sector is faced with considerable challenges and opportunities in its role as provider of finance and insurance for the low carbon economy. Financial institutions that adopt the Climate Principles have taken on a leadership role in engaging with this issue. With the help of the Principles, they are taking on increasing levels of responsibility for the impact of their operations on climate change, for the operations of their clients insofar as these have an impact on climate change and that relate to finance and insurance issues, and for engaging with stakeholders regarding climate change. In an effort to have positive impact, the CPFIs are working to embed an understanding of climate change and the solutions to it into their research, asset management, retail banking, insurance and reinsurance, corporate banking, investment banking and markets, and project finance businesses.

By adopting the Climate Principles, the CPFIs find guidance and support for meeting their obligations but also in taking voluntarily steps to avoid activities which exacerbate climate change and help respond to the impacts of climate change. This Review shows the progress which CPFIs have made over the last twelve months to fulfil the Climate Principles, compares their progress with the 2010 Review, describes focus areas for action, and illustrates highlights through case studies.

The main body of this Review considers each of the Climate Principles in turn. Annex I gives the methodology which PwC followed to undertake the Review. Annex II sets out the Climate Principles which are relevant to each CPFI. Finally, Annex III gives full results of the Review of the CPFIs. This Introduction describes the climate change context in which the Climate Principles operate as well as the major current initiatives of the CPFIs, namely:

- decarbonization of coal-fired power generation; and
- renewable power generation.

Constraints on future carbon emissions

Global efforts to reduce climate change mean changes to the status quo of energy production and use. Various scenarios envision the kind of changes that will be needed to limit global warming within acceptable levels.

The International Energy Agency provides one of the most credible energy scenarios. Their 'Blue Map' scenario depicts the conditions and actions necessary to cut carbon dioxide (CO_2) emissions by 50% by 2050 relative to 2005 levels, in order to limit the average increase in temperature to between 2˚C and 2.4˚C. Of the CO_2 savings under this scenario compared with the business-as-usual situation, 53% are achieved through fuel switching and increasing end-use efficiency. Carbon Capture and Storage (CCS) and increasing the efficiency of fossil fuel-fired plants account for a further 19% and 5% of savings respectively, while a further 17% is attributed to the increased deployment of renewable sources of energy. Increased reliance on nuclear energy makes up the remaining 6% of the savings.[4]

4 International Energy Agency, Energy Technology Perspectives 2010, OECD/IEA, (2010)

This scenario tells us three major things: 1) fossil fuels are likely to be part of the energy mix until at least 2050 and so it is necessary to decarbonize them; 2) low-carbon sources of energy, such as renewable and nuclear energy, need to play a bigger part in the energy mix and so their use must be accelerated; and 3) increasing energy efficiency will be prominent in cutting CO_2 emissions, and will yield significant savings. In each case, the role of finance, and of supportive policies, can hardly be underestimated.

Challenges to low carbon investment

The cost of achieving a clean energy future is estimated to require additional investment of US$46 trillion.[5] Investment needs to shift away from fossil fuel technologies towards low-carbon energy technologies. Current annual investment in low-carbon technology is around US$165 billion per year; this needs to rise to US$750 billion per year by 2030, and to US$1.6 trillion per year between 2030 and 2050.[6] Governments are anticipated to provide direct investment into technologies during the development and demonstration stages, after which the private sector is expected to take up the mantle.

There are barriers, however, to achieving the required shift in investment. In both this and last year's Progress Reviews, the most serious challenges were seen to be faced in the area of project finance, especially in regards to investment in carbon intensive sectors like the power sector. Key reasons for this include the complexity of project finance deals, the lack of regulations for energy efficiency standards in the power sector, and the slow pace of public sector finance into clean-energy technology.

All of these factors make it challenging for financial institutions to act.

An initiative for voluntary action: a Guidance Note for financing coal-fired power generation

Progress will require advances in respect of each of the abovementioned challenges. Some are outside the CPFIs' control, but in an effort to focus on steps that could be taken voluntarily, a 'Clean Energy Working Group' has been established, with The Climate Group acting as Secretariat. A clean energy workshop was held by the CPFIs, hosted by Swiss Re in Zurich in February 2010. The Group agreed that the best approach to making a difference would be to tackle a specific issue – coal-fired power generation. With the existing lack of regulatory control and consistency, the CPFI Group decided to develop a Guidance Note[7] for financing in this area.

The draft Guidance Note recognizes that essential to cutting emissions the decarbonization of the power sector will entail both a major shift away from coal and the application of technologies to reduce emissions from its use. The Note recommends performance standards for financing and for insuring new coal-fired power stations, based on existing and expected advances in technology. The standards may specify the minimum emissions intensity for new plants, and these could become increasingly more stringent towards 2050.

5 International Energy Agency, Energy Technology Perspectives 2010, OECD/IEA, (2010)

6 International Energy Agency, Energy Technology Perspectives 2010, OECD/IEA, (2010)

7 The Guidance Note is currently going through consultation with key stakeholders. The aim is to publish it later in 2011.

The process of developing the Guidance Note has highlighted the fact that in the immediate term more efficient power generation can help to slow the growth of emissions at the same time as meeting energy demand and development goals in non-OECD countries. Public sector investment and strong policy measures will be needed, however, to drive more dramatic carbon emissions cuts in the medium to longer term and ensure that new technologies such as, but not exclusively, carbon capture and storage (CCS) are commercially viable.

The role of government policies in supporting renewables

The IEA energy scenario tells us that renewable sources need to provide at least 48% of energy by 2050 and also that nuclear energy is likely to provide 24% of energy needs by 2050 compared to 14% today.[8] This means that massive investment by the public and private sector in renewables is needed alongside continued investment in decarbonizing fossil fuel energy.

To secure a clean energy future, governments will need to act firmly to dispel uncertainty about the future cost of carbon intensive energy – whether through carbon pricing mechanisms or direct regulation of the sector so as to set emissions limits. In particular, government spending will be needed to support the early-stage demonstration and scaling up of technologies. Policies also need to ensure that the private sector can provide the flows of finance needed to accelerate scaling up.

Despite adverse policy and financial conditions in 2009, investment in renewables was nevertheless characterized by resilience and determination. The wind sector attracted US$67.3 billion, 14% more than in 2008; the amount of investment in smart energy technologies also grew by 34% relative to 2008. The overall investment was down from the previous year, but nonetheless the compound annual growth rate for the period 2004-2009 was 46%.[9]

It is also remarkable that 2009 witnessed greater investment in renewables in Asia and Oceania (US$40.8 billion) than in the Americas (US$32.3 billion).[10] This trend continued in 2010 as China was once again the leading country for investment, although there was also more investment in the US. Altogether, new financial investment in clean energy was worth US$65 billion in the first half of 2010, 22% greater than in the corresponding period for 2009.[11]

While investment in renewables is growing, it is not enough to achieve the scenario referred to above.

The role of the finance sector to ensure that local incentives and mechanisms support sustained growth in renewables

The Zurich workshop of the CPFI Group brought together a unique combination of power-sector experts, financing specialists and climate change practitioners to discuss current policy, technology, and financing barriers and solutions for renewable energy. In addition to providing finance for CCS already mentioned, the other key topic of discussion was

8 International Energy Agency, Energy Technology Perspectives 2010, OECD/IEA, (2010)

9 Bloomberg New Energy Finance, Global Trends in Sustainable Energy Investment 2010, UNEP (2010)

10 Bloomberg New Energy Finance, Global Trends in Sustainable Energy Investment 2010, UNEP (2010)

11 Bloomberg New Energy Finance, Global Trends in Sustainable Energy Investment 2010, UNEP (2010)

accelerating solar power in Europe, and considered various matters relating to the need for the large-scale uptake of renewables.

High-level policy incentives are helping to create a long-term vision for a low-carbon energy future and there are increasing incentives in the form of high-level policy frameworks from the major nations. As befits the increasing investments in clean energy in China, its government has announced a new energy plan that is likely to provide for an increase in wind capacity to 150 GW, in solar capacity to 20 GW, and for the annual sales of new-energy vehicles to hit one million by 2020. It has also been predicted that a cap-and-trade market could be in place in China by as early as 2013[12]. India is on track to begin implementation of their plan to install 20 GW of solar energy by 2020.[13] In Europe, EU members have submitted their national plans detailing how they intend to increase their share of renewables to hit a 20% target, and proposals have further been made to increase the EU emissions reduction target to 30%. In the US the stimulus package apportioned nearly US$100 billion to clean energy projects.[14]

Progress can also be seen at a sub-national level where regional governments are displaying considerable local leadership and setting aggressive targets. This is helping to build a policy framework in which private sector investment will flourish. Examples include: California's Renewable Energy Standard, which requires that one-third of all electricity sold come from renewable sources by 2020; Scotland's commitment to source 80% of its electricity consumption from renewable sources by 2020; and Upper Austria's aim for 100% renewable energy by 2030 and a 65% reduction in emissions by 2030.

These good intentions do not always seem to have the desired effect, however. Part of the reason for this is that although high-level policy frameworks exist to stimulate investment, the devil is often in the detail of local incentive schemes. The lack of coordination between planning departments and the lack of energy infrastructure to provide a reliable supply can sometimes be a barrier to the scale of investment and development that is needed to meet the targets.

Discussion at the Zurich workshop concluded that the solar industry is being hampered by short-term thinking behind regulations and incentives. Current policies lack cohesion and run the risk of attracting investments solely for short-term gain. This can create instability and lead to investment bubbles, which in turn will foster scepticism and distrust for the long-term sustainability of the sector. There was consensus at the workshop that two issues require attention before progress can be made: (1) financial institutions need to be fully acquainted with the actual and perceived risks of the process; and (2) a clear business model needs to be defined.

The CPFI Group recognizes the importance of ensuring that the voice of the finance sector is heard by policy makers in developing and revising renewable energy policies to ensure that long-term goals set by national governments can be realized. Further workshops on renewable energy are planned for 2011.

12 Bloomberg New Energy Finance, China: is a green leap forward on the agenda?, BNEF (2010)

13 http://in.reuters.com/article/idINIndia-44092520091119

14 McKinsey & Company, The US stimulus program: Investing in energy efficiency, 2009

LIKE OTHER TRADE RACES BEFORE IT, THE LOW CARBON RACE IS NOW FIRMLY UNDERWAY.

SECTION 1: MANAGING OPERATIONAL EMISSIONS

1.0 We have a robust low carbon strategy or position and are managing our operational carbon emissions

Principle 1.1: We have issued a strategy or position that indicates how we undertake our business in a way that reduces the climate and operational carbon impact of our activities.

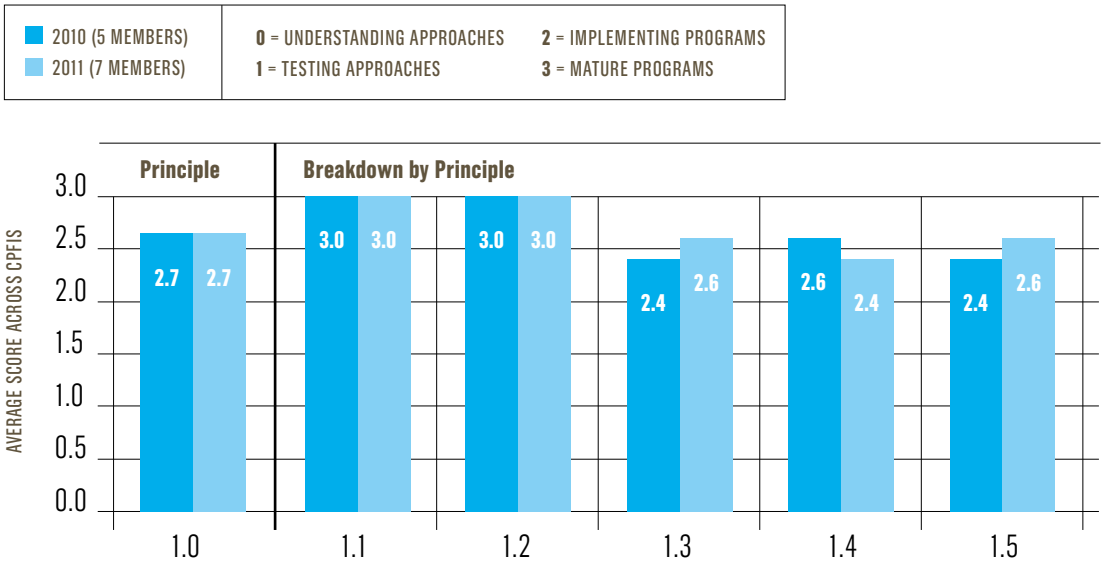
Principle 1.2: We have board level commitment for the strategy or position and a named senior executive who has responsibility for implementing it across our organization and for ensuring that decisions taken are consistent with it. This executive has the necessary resources to meet the commitments contained in our strategy or position.

Principle 1.3: We have measured a significant proportion of our operational GHG emissions using an internationally recognized or equivalent domestic standard and we disclose this information.

Principle 1.4: We have issued clear and challenging, yet achievable, targets for making reductions in our operational GHG emissions.

Principle 1.5: We engage our employees on our commitment to addressing climate change and support them in playing an active role in meeting this commitment.

Figure 1.
Principle performance across the CPFIs[15]



15 The graphs in this Review provide a comparison of scores averaged across the CPFIs on a Sub-Principle level for 2010 against 2011. The 2010 data in each graph reflect scores averaged for the five founding CPFIs (where applicable); the 2011 data also incorporate the scores of the two CPFIs who joined in 2010 (F&C Asset Management and BNP Paribas) (where applicable). See Annex II for an overview of the CPFIs to which each Sub-Principle applies.

Although Munich Re is no longer a CPFI, the 2011 data include Munich Re's scores in order to reflect its membership for the majority of the year.

Image: Geothermal heat radiators on the ceiling of the main hall of the Green building museum at the Energy and Environment Industrial Park outside of the city of Hangzhou, China. Photo by Jiri Rezac.

PROGRESS

All CPFIs continue to develop their activities in the key areas of strategy, governance, measuring emissions, targets, and employee engagement.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: Last year the Progress Review recommended that climate change strategies be better aligned to business priorities and that engagement with employees on climate change should form part of an on-going strategy rather than conducted on an ad hoc basis. The institutions have shown noteworthy improvement in engaging with employees to raise awareness of climate change issues and in empowering them to reduce their own emissions. However, there is potential for institutions to continue to do more to link their climate change strategies to business priorities and to report on this externally.

STRATEGY: Swiss Re has designated climate risk as a 'Top Topic', recognizing it as an issue of long-term, group-wide importance, and HSBC considers climate change to be a long-term influencing factor in the development of its group strategy. For the other institutions there is limited information on how climate change activity is linked to business priorities.

GOVERNANCE: All institutions report board level commitment for the strategy and a named senior executive with responsibility for implementing it. At F&C, for example, primary responsibility for managing climate change strategy sits with the Corporate Responsibility Committee, which is a chaired by a board director.

MEASURING EMISSIONS: The CPFIs all measure and report emissions from electricity use, fuel consumption, and business travel. HSBC, for example, measures emissions from 95% of its operations and during 2010 trialled new software that virtually monitors and manages energy use in its property portfolio. Three of the six institutions currently have their emissions data externally verified or assured.

REDUCING EMISSIONS: To support their strategies the CPFIs have developed targets to reduce operational carbon emissions: two of the institutions have established absolute reduction targets and three have established intensity reduction targets. For example, Swiss Re has committed to reducing carbon intensity by 45% from 2003 levels by 2013. As part of its commitment to reduce carbon emissions on air travel by 35% between 2008 and 2011, Standard Chartered has implemented a 'green your flights' initiative, where a US$70 levy is imposed on each flight taken by staff in the Group Technology and Operations team. This has a two-fold effect: (1) the levy discourages non-essential business travel; and (2) proceeds of the levy are used to further develop staff engagement programs on carbon reduction.

EMPLOYEE ENGAGEMENT: All institutions are implementing innovative methods to increase employee awareness of climate change and meet company reduction targets. For example, over 3,500 of Crédit Agricole's employees have participated in an initiative to vote on which eco-programs the company should implement. Another example is Swiss Re's 'COYou2' program, which offers subsidies to employees for taking action to reduce their personal carbon footprints – now been taken up by 20% of all its employees. F&C offers employees the opportunity to offset their personal emissions through a tax-advantaged benefits scheme which offsets emissions through the financing of clean energy projects.

Image: Installation of solar photovoltaic panels on the roofs of the Hongqiao Passenger Rail Terminal in Shanghai, China. There are a total of 23,000 solar panels planned for the CECIC-funded project, each panel with a production capacity of 280 KWh to feed into the electricity grid. Photo by Jiri Rezac.

FOCUS FOR ACTION

Climate change strategies and targets appear most often focused on short-term priorities. Long-term targets to, for example, 2020, supported by interim milestone targets, can assist business units to understand and plan for the task ahead. Developing a longer-term action horizon would reinforce the institutions' commitment to climate change and provide stakeholders, in particular investors, with confidence that the risks are being managed in the long term. In addition, long-term goals may help institutions to align climate change activity with business priorities, including environmental and commercial key performance indicators (KPIs).

The CPFIs should also consider setting absolute targets rather than intensity-based targets only. The absolute targets should be in line with science based targets and at a level to reflect reduction required in the countries where the CPFIs operate; for example at a global level a reduction of 60-80% by 2050 to avoid the worst potential impacts of climate change.

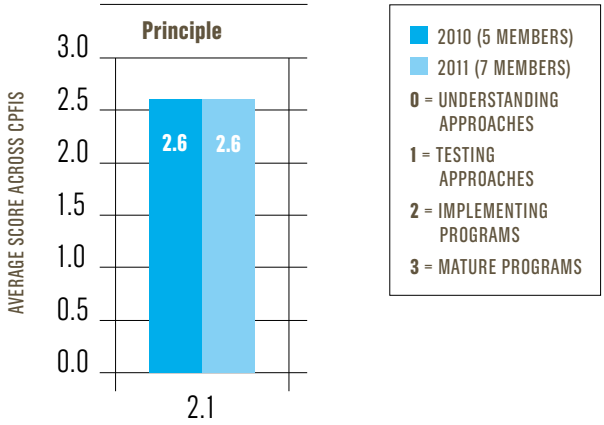
THERE IS FURTHER OPPORTUNITY TO DEVELOP BROADER SUITES OF ‘GREEN’ INVESTMENT OPTIONS...

SECTION 2: DEVELOPING APPROACHES THAT INTEGRATE CLIMATE ISSUES INTO BUSINESS ACTIVITIES

2.1 Research Activities

Principle 2.1.1: We will incorporate climate and carbon issues into our research activities and, where relevant, will utilise the findings to develop products and services that benefit our customers and clients.

Figure 2.
Principle performance across the CPFIs[15]



PROGRESS

The CPFIs continue to conduct research into the potential financial and non-financial impacts of climate change for their businesses, their clients, and society as a whole. Although noteworthy examples are emerging that demonstrate how institutions have used their research to develop commercially viable opportunities, greater transparency (even if at a high level) would help demonstrate the commercial value of investing in climate research.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: There has not been a significant change in performance across the CPFI Group for this Principle. Last year's Progress Review encouraged the CPFIs to report on how climate research drives product and revenue development and is integrated into investment decisions. Some progress has been evidenced; however this point remains a Focus for Action.

RESEARCH: All of the CPFIs continue to conduct research, which they make publicly available on the potential economic, environmental, and social impacts of climate change. Crédit Agricole's broker arm, CA Cheuvreux, releases Carbon Research and Green Tech Research, including a recent report concerning the risks and opportunities of investing in green technology in China. Standard Chartered, together with a number of other financial services companies, worked with WWF to produce a discussion paper on the financial sector's perceptions on water issues, including the impact of climate change on the availability of freshwater resources.

Image: Margaret Lo measures light intensity at a LED lighting pilot project at Hong Kong's Science and Technology University. Photo by Jiri Rezac.

BUSINESS DEVELOPMENT: Examples are emerging of where an institution has leveraged research into commercial opportunity. One such example is how Swiss Re used the Economics of Climate Adaptation methodology to quantify the climate risk for a major utility company's portfolio of properties, infrastructure, and assets located on the US Gulf Coast. Standard Chartered's Equity Research team hosted a Clean Technology and Utilities Corporate Day in Hong Kong, attended by 88 company and individual investors, to discuss opportunities in renewable energies and environmental finance.

FOCUS FOR ACTION

There is considerable evidence of innovative research undertaken by the CPFIs. Although some proprietary research would have to remain confidential for commercial reasons, there is still scope for greater transparency on whether, and how, research drives investment and lending decisions and product development. Even high-level information of this type could be valuable in demonstrating the business rationale for investing in research.

There also needs to be further disclosure on how climate research is used commercially to engage clients on climate risks and opportunities. This transparency would allow stakeholders to see how investment in climate research can translate into commercial value and also drive strategic investment in low-carbon and climate adaptation solutions.

CASE STUDY

'INVESTING IN CLIMATE RESEARCH'

In order to capture the potential opportunities presented by the transition to a low-carbon economy, HSBC has committed to carry out research into the commercial implications of climate change to support its own operations and those of its clients in the 'climate business' sector. As part of this commitment, HSBC established the Climate Change Centre of Excellence, which consists of a team of specialists dedicated to conducting research on the scientific, regulatory, and economic dimensions of climate change. This research is used to inform HSBC's own climate strategy development and those of its clients.

In 2009, the Centre published 30 reports on the likely risks and opportunities of climate change. For example, in one report the Centre recently estimated that by 2020, the low-carbon energy market will triple to US$2.2 trillion, and the global market for efficient lighting will be worth US$79 billion. It also estimated that US$521 billion of 'green' fiscal stimulus had been allocated by governments across the world in 2009 for climate-related investments. Another example of research produced by the Centre particularly suited to helping clients incorporate climate-related issues in their investment and business decisions was a comparative assessment of the vulnerability of the G20 nations to climate impacts up to 2020.

HSBC's Quantitative Research Team is another important part of HSBC's response to the investment challenges presented by climate change. The Team established and maintains the HSBC Global Climate Change Benchmark Index, as well as four investable climate change sub-indices. These indices can be used to create portfolios for investments such as hedge funds, exchange traded funds, discretionary funds and structured products, facilitating access for investors to over 300 companies that are well positioned to benefit from climate change challenges.

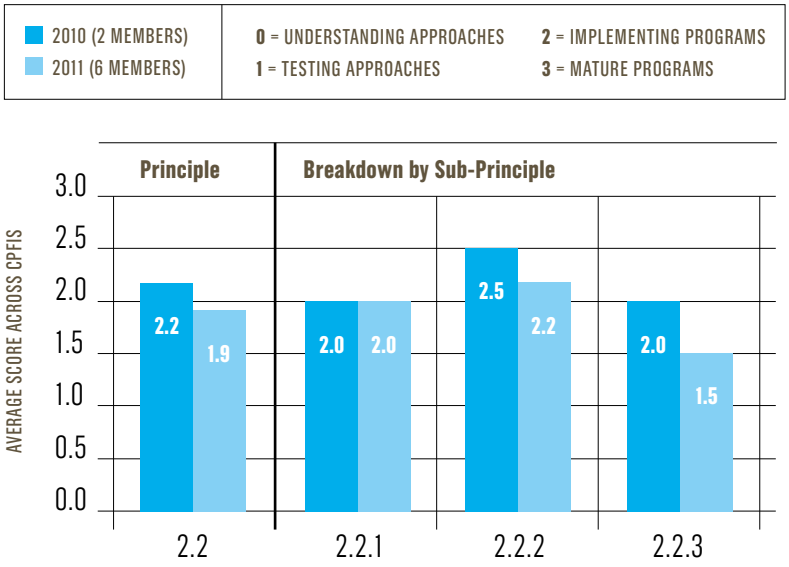
2.2 Asset Management

Principle 2.2.1: We will enable our analysts to incorporate carbon and climate risks and opportunities into their research and investment decisions where relevant.

Principle 2.2.2: We will engage our clients to understand the carbon and climate change risks and opportunities relevant to them and we will develop products and services that support them in managing those risks and exploiting those opportunities.

Principle 2.2.3: Where consistent with our fiduciary responsibilities, we will engage with the companies our clients invest in to understand how they are minimizing the risks and maximizing the opportunities presented by climate change and climate policy. We will also encourage these companies to improve their governance and disclosure of climate risks and opportunities.

Figure 3.
Principle performance across the CPFIs[15]



PROGRESS

This year there are some notable examples of how asset management can be used to engage clients and portfolio companies to drive low-carbon and adaptation activity.

It should be noted that this year's Progress Review on asset management now includes the two reinsurance institutions as well as the two new CPFIs.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: One notable area of progress from last year's Focus for Action is the efforts of the institutions to mainstream climate considerations beyond socially responsible investment (SRI) products into investments that drive development of low-carbon technologies such as renewable energy (see paragraph on 'New and evolving products' below).

Last year's Focus for Action also challenged the institutions to enhance engagement with investors to help raise understanding of climate risk and opportunities. There have been some noteworthy examples of investee engagement in the CPFI Group (see paragraph on 'Engaging investee companies'); however cases of deep client engagement are more the exception than the norm.

ENABLING ANALYSTS: All CPFIs to which this Principle applies are also signatories to the UN Principles of Responsible Investment (PRI) and equip their analysts with training and support on climate change as part of this commitment. For example, in addition to providing training on climate change, HSBC has five PRI specialists to support analysts on climate issues including carbon intensity and water resource management. BNP Paribas has a specialist SRI team that researches the impact of mega-trends, including climate change and water scarcity, on valuations and markets, and helps other teams within the business to incorporate relevant research into investment decisions.

ENGAGING CLIENTS: There are noteworthy examples where CPFIs continue to engage clients on their risks and opportunities from climate change. BNP Paribas co-hosted an event with the Institutional Investors Group on Climate Change (IIGCC) at which it engaged over 170 institutional clients on climate change through workshops and discussions. BNP Paribas also conducted a survey of the general public in France, Belgium, and Italy, which examined the level and extent of investor interest in environmentally and socially 'responsible' financial products. In response to customer feedback, F&C recently launched '***reo***® viewpoint', an initiative designed to engage clients more effectively about key business topics including climate change by discussing the issues, why they are relevant to investors, and how F&C engages its portfolio companies to address them.

NEW AND EVOLVING PRODUCTS: Investor interest has increasingly shifted from generic SRI funds to thematic based investment, with climate change related funds leading, albeit from a low base. BNP Paribas offers a number of 'Sustainable Investment Solutions', including a Green Future Fund, which invests in companies whose products and services provide solutions to environmental challenges. HSBC's Climate Change Benchmark Index, which was mentioned in last year's report, is now used by three of the top ten largest pension funds in the world and was also profiled as a 'key index' by Environmental Finance magazine.

ENGAGING INVESTEE COMPANIES: The CPFIs have committed to engaging investee companies on carbon and climate-related risks and opportunities, as well as governance and disclosure. F&C's Responsible Engagement Overlay (***reo***®) program demonstrates exemplar proactive engagement (see Case Study below). HSBC also takes an active ownership approach to its investments by combining voting practices on governance issues with direct engagement on environmental and social topics identified as material for that company or the industry in which it operates.

FOCUS FOR ACTION

As highlighted above, some institutions have made good progress in mainstreaming carbon and climate considerations in different forms of investment. There is further opportunity to develop broader suites of 'green' investment options, such as sustainable property portfolios or products that finance low-carbon activities (e.g. renewable energy, energy efficiency, adaptation, and reforestation projects). Following the Copenhagen Climate Change Conference, the CPFIs could also consider solutions which allow investors to participate in public-private partnerships offering "fast-start financing", i.e. funding for climate adaptation projects in developing countries. These partnerships could offer attractive rates of return under a clearly defined social and environmental mandate.

Although there is evidence the institutions are engaging clients on climate issues (see paragraph above on 'Engaging clients'), greater transparency on the outcomes of this engagement is encouraged. Such knowledge-sharing would drive increased investor interest in the topic, and further support and encourage asset managers to develop more and further enhanced products to meet investor demand.

The institutions are also extending their engagement of investee companies on behalf of their clients. However, the focus is most often prevention and mitigation of climate risks. In order to encourage innovation and pro-active behavior, the institutions should also engage companies on identifying commercial opportunities, such as new products and markets relating to climate adaptation, energy efficiency and renewable energy.

Finally, the institutions should try to increase transparency on the outcomes of engagement with investee companies. This can demonstrate that the institutions take their commitment to improving portfolio companies' management of climate risks seriously.

CASE STUDY

'RESPONSIBLE ENGAGEMENT TO INSTIGATE CHANGE'

F&C's Responsible Engagement Overlay (***reo***®) program encourages investee companies to adopt better ESG practices using various techniques, including one-on-one dialogue, voting rights, and participation in collaborative investor networks. The ***reo***® approach can be applied to any equity or corporate bond mandate, irrespective of whether the money is managed by F&C.

One issue F&C recently engaged investee companies on through ***reo***® is deforestation, which is estimated to account for 20% of global greenhouse gas emissions. F&C alerted investee consumer brand companies, as well as oil palm growers, to expect tighter government policies aimed at curbing deforestation linked to palm oil production. A number of major consumer brands have since led the way by committing to sourcing 100% of palm oil from sustainable, certified sources.

Three major consumer brands also recently suspended trading with a palm oil producer due to alleged involvement in tropical rainforest destruction. F&C conducted its own investigatory trip to a plantation in Indonesia, resulting in detailed recommendations to the owner of the palm oil producer for improvements. The owner has since adopted some of these recommendations, including an independent investigation into allegations of poor practice and tighter controls to protect rainforests.

2.3 Retail Banking

Principle 2.3.1: We will undertake research to understand:

I. The potential impacts of climate change and climate change policy for our customers;

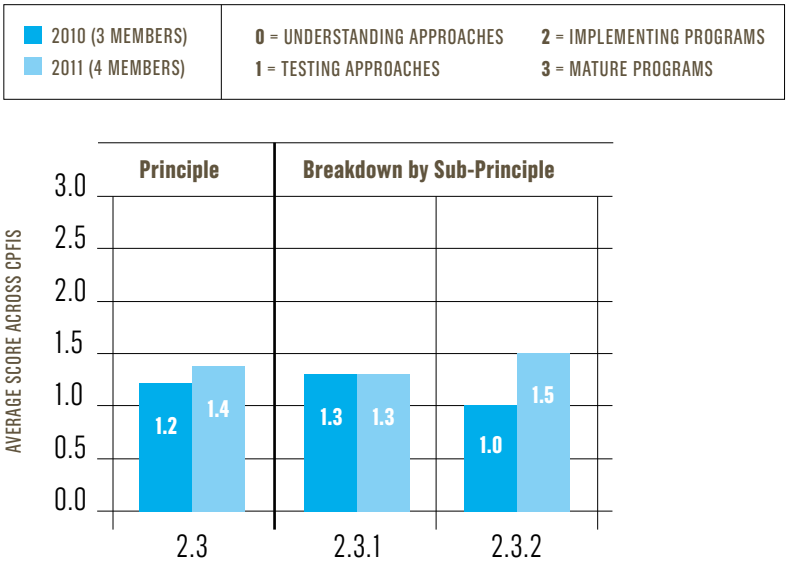
II. The willingness of our customers to address these impacts;

III. The products and services that customers need to address these impacts and the barriers to addressing them; and

IV. The approaches needed to raise awareness of how our customers manage their GHG emissions and reduce their carbon footprint.

Principle 2.3.2: Based on our understanding of our customers, we will develop products, services and communication and engagement strategies to enable them to address potential impacts and reduce their carbon footprint.

Figure 4.
Principle performance across the CPFIs[15]



PROGRESS

This year's Progress Review has seen a small rise in performance up from the low scores of last year. This rise can be attributed to the development of new financial products that allow customers to reduce emissions.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: Last year the Progress Review recommended institutions engage more directly with retail customers and develop innovative finance products that enable and encourage energy reduction, low-carbon energy generation, and associated behavioral change. The CPFIs have shown improved performance in the development and offering of products and services that enable customers to manage their carbon footprint (see Case Study). However, this is just the start of a journey to engage more directly with customers to raise awareness of issues and encourage further action.

RESEARCH: A barrier for understanding the products and services that customers require could be attributed to limited research into consumer willingness to address climate change through their choice of financial products and services. One of the few recent examples of research can be seen in the HSBC's Climate Confidence Monitor, now in its fourth year, which is designed to gauge consumer's knowledge and concern about climate change, measure their levels of optimism that solutions will be found, and their willingness to personally take action. This research indicates there is still currently limited interest in the retail market and not enough to drive launching a suite of green products. This is hardly surprising given the impacts of reduced economic growth on household income and net assets in some markets.

PRODUCT DEVELOPMENT: Across the CPFIs there remains a limited number of retail products that enable customers to reduce their carbon footprint. Crédit Agricole and BNP Paribas both offer 'eco-loans' – low-interest or interest-free loans to finance energy efficient equipment and materials for customer homes (see Case Study).

FOCUS FOR ACTION

A continual dialogue between institutions and customers on the issues and solutions can provide value to both parties. During the previous Progress Review, CPFIs were recommended to engage more directly with retail customers through a range of activities including climate change forums, customer surveys, and customer outreach programs. With the aim of achieving greater output from engagement this should continue to be a focus for action.

Good examples of innovative financial products that enable energy reduction, low-carbon energy generation, and changing behaviors are beginning to emerge from the CPFIs. The institutions should see these types of products as an opportunity to build relationships with customers and encourage the development of other types of products with high take-up. The eco-loans concept, already used to promote domestic investment in energy efficient equipment, could also be applied to financial products including mortgages and insurance products.

Current research suggests the market for green retail banking products has not reached critical mass, making it a challenge for banks to justify investment in this area. The focus should therefore be on products which have little upfront cost and generate savings over the product lifetime, such as pay-as-you-save energy efficiency and the financing of renewables. It should also seek to leverage public "green" subsidies and other assistance that is available and make it easy for customers to access these resources. In addition, by undertaking more frequent research integrated with other products and services, the CPFIs can keep up to date with changing consumer attitudes and position their brands in this space to benefit from increased consumer readiness.

‘ENVIRONMENT-FOCUSED SERVICES’

In addition to offering its clients ‘Bons Plans Écologie’ loans, BNP Paribas Personal Finance has partnered with EDF to offer a unique type of loan for purchasing and installing solar panels at customer homes. The loan covers installation by EDF and getting the system up and running. Customers receive government subsidies and a VAT rebate, which they use to repay part of their loan. The rest of the loan can be paid off annually with the help of income received by selling back any unused power to EDF.

'THE INTRODUCTION OF ECO-LOANS'

The introduction of interest-free eco-loans by the French Government in April 2009 has allowed financial institutions operating in France the opportunity to make these types of products accessible to their customers. For example, by the end of March 2010 Crédit Agricole had issued 37,000 interest-free eco-loans, worth €606 million. Since 2007, Crédit Agricole has also issued 690,000 Energy-Saving Loans worth €812 million and financed €250 million for farmers investing in solar voltaic projects.

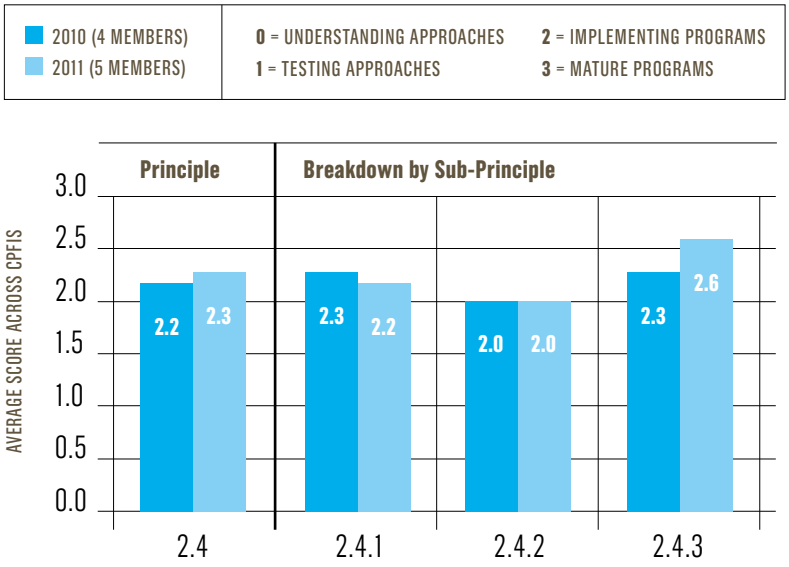
2.4 Insurance & Reinsurance

Principle 2.4.1: We will develop the necessary knowledge, skills and tools to assess carbon and climate risks associated with our transactions and the financial implications they have for our business.

Principle 2.4.2: We will develop risk assessment techniques to assist our clients to understand better and respond to climate change.

Principle 2.4.3: We will develop insurance products and services that encourage our customers to reduce their carbon and climate risks, assist the development and adoption of GHG mitigation technologies and strategies and take advantage of the carbon market.

Figure 5.
Principle performance across the CPFIs[15]



PROGRESS

Although there has not been a significant change in overall performance scores, continued efforts to develop new insurance products, both specialised and mainstream, demonstrate the institutions' commitment to this Principle.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: One recommendation in last year's Focus for Action was for institutions to continue to develop innovative insurance products and services in response to climate change. Progress on this is evidenced by a 13% improvement in the average score for Sub-Principle 2.4.3, product development, a rise particularly attributed to the efforts of the non-reinsurance companies to introduce climate-related insurance products.

Last year's Focus for Action also encouraged CPFIs to offer risk assessment methodologies to insurance clients to increase engagement and further drive risk management of climate change. Swiss Re continues to offer such tools; though there is limited evidence of offerings among the banking institutions.

Image: Nighttime illumination of a footbridge in the docklands, London. LED and other energy-saving lighting methods are increasingly applied across London to reduce the city's carbon footprint and contribute to climate-friendlier use of energy. Photo by Jiri Rezac.

KNOWLEDGE, SKILLS, AND TOOLS: The CPFIs continue to strengthen their knowledge on the physical and social risks of climate change and the related economic impacts. Swiss Re has a team of specialists dedicated to the development of commercial opportunities from climate change: one example is the index-based insurance program, where farmers are paid an indemnity when the vegetation index of a region falls below a certain guaranteed level, from factors including drought.

ASSISTING CLIENTS: The reinsurance company, Swiss Re, is leading the CPFI group in providing services to clients to assist them in understanding and managing climate change risks. Swiss Re provides face-to-face and webinar training for clients on climate-related topics, including natural catastrophe modelling, and also has a web-based tool that clients can use to undertake geographic risk profiling (CatNet).

PRODUCT DEVELOPMENT: The institutions have made good progress in developing new climate-related insurance products. HSBC has launched a global 'Green and Sustainable Insurance' plan; a suite of more than 30 products with an aim to encourage customers to reduce their carbon footprint; provide insurance for, and investments in, new green sectors; and protect consumers against climate change impacts. Crédit Agricole's Property and Casualty insurance subsidiary Pacifica, has been working with the Université Paris-Dauphine and the Institut Europlace de Finance to develop insurance products tailored for farmers that take into account climate risks.

FOCUS FOR ACTION

Good progress has been made this year in the development and offering of insurance products and services that encourage insurance customers to reduce their carbon and climate risks. The institutions should continue to monitor customer needs and non-reinsurance companies can continue to increase client engagement. For example, banks could leverage their risk assessment expertise to provide training sessions, newsletters, or online tools for their insurance clients to help them understand and manage climate change risks. This can be done in conjunction with encouraging clients to adopt low-carbon behavior (e.g. domestic solar panels, electric cars, energy-efficient house building), for example through favorable premiums.

Amongst the CPFIs, there are some clear leaders in climate research and risk analysis. As also recommended by the 2010 ClimateWise Principles Report, the CPFIs could improve their engagement with policy makers on adaptation and regulatory structures by linking this with their research efforts more effectively. The CPFIs should also consider developing collaborative communication channels within the industry to share climate research and demonstrate its strategic importance, especially in relation to pricing and scalability of insurance solutions for developing countries and new climate mitigation/adaptation technologies.

Image: Solar-powered charging station for electric vehicles in Brooklyn, New York. Run by the Beautiful Earth Group, this station is a demonstration site designed to prove that solar power can charge and run electric vehicles. Photo by Jiri Rezac.

CASE STUDY

‘INNOVATIVE PROTECTION AGAINST CLIMATE RISKS’

Using the Economics of Climate Adaptation (ECA) methodology, Swiss Re has developed parametric insurance cover against hurricane damage for the Alabama State Insurance Fund. Under parametric solutions, compensation payable is based on a specified scale (in this case, wind speed of a hurricane) rather than on traditional damage assessments. This allows payment to be made quickly to the State of Alabama – within two weeks in the event of a significant hurricane – thereby alleviating the burden of emergency costs which normally falls on the shoulder of governments (and ultimately, taxpayers). The payment can be used for any purpose, including emergency response, reconstruction, replacing lost tax revenue and funding of increased insurance costs.

This is the first example of parametric cover provided to a US state government, and paves the way for similar solutions to be deployed by governments and insurance companies against other natural disaster risks.

2.5 Corporate Banking

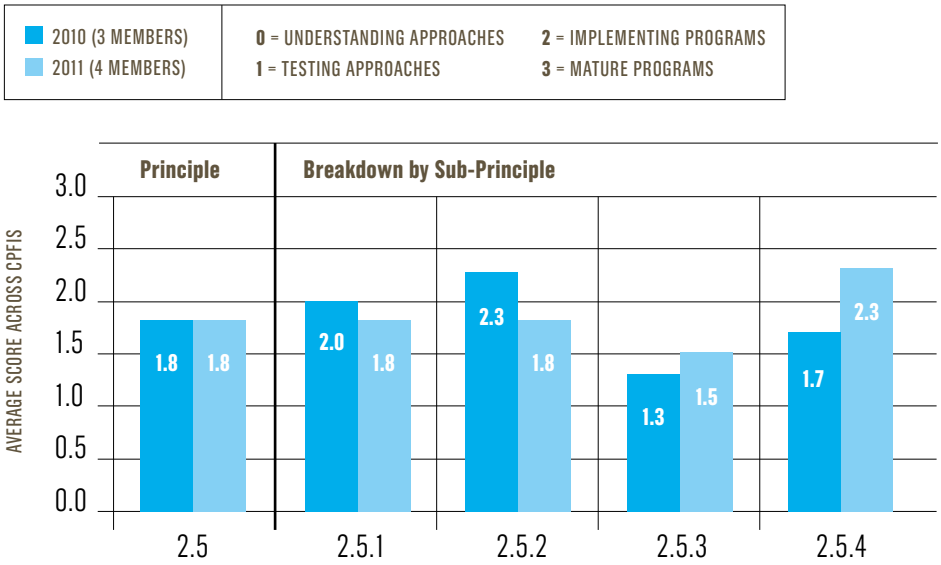
Principle 2.5.1: We will develop and implement a process to consistently assess the financial implications of carbon and climate risks relevant to our clients and will train employees to implement this assessment.

Principle 2.5.2: We will consider practical ways to assess the carbon and climate risks of our lending and investment activities. Where a feasible and relevant methodology can be found, we will develop and implement this approach.

Principle 2.5.3: We will engage our clients to understand the carbon and climate risks and opportunities associated with their business. This might include encouraging them to develop a strategy to manage these risks; to measure and disclose their carbon footprint; and, to set meaningful targets to reduce carbon emissions.

Principle 2.5.4: We will develop financing solutions to facilitate investment in low carbon technologies and GHG reduction projects.

Figure 6.
Principle performance across the CPFIs[15]



PROGRESS

Significant progress has been made in corporate banking offerings that facilitate low-carbon and climate adaptation technologies. However, more can be done to publicly disclose how the institutions are incorporating climate issues into mainstream lending and investment activity.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: One of the recommendations in last year's Progress Review was for CPFIs to further support development around renewable energy, water and wastewater management, and sustainable agriculture. The CPFI Group has made significant progress on this, evidenced by the 35% increase in average score for Sub-Principle 2.5.4. Another area highlighted for focus last year related to Sub-Principle 2.5.3: deeper engagement with clients to drive action to measure, manage, and disclose their own carbon footprints. The institutions' score for Sub-Principle 2.5.3 shows slight improvement; though there remains significant potential for further development.

There has been little evidence of progress in respect of the other points of focus noted in last year's Review: increasing disclosure of investment methodologies used and their outcomes, and incorporating relevant information to rebalance their portfolios towards 'low-carbon' lending.

ASSESSING RISK AND EMPLOYEE TRAINING: The institutions appear to understand the importance of assessing climate risk relevant to the business of their clients. Standard Chartered has recently incorporated specific climate change related questions for clients in its corporate advisory business, including the score the client achieved in the latest Carbon Disclosure Project, or the reason for non-participation in the scheme. For each specific industry sector, BNP Paribas has tailored methods for integrating environmental risks into its ratings models. HSBC's Sustainability Risk Rating system tracks and rates the sustainability performance of every corporate customer operating in certain sensitive sectors, allowing HSBC to monitor its exposure to sustainability risk across its portfolio.

There is currently not much information published by the institutions explaining how they train their analysts in the use of tools to assess climate risk. This is one area in which the institutions could improve, for example by providing greater transparency on the scope, frequency, and type of training given to analysts.

ENGAGING CLIENTS: A suggested focus for action in last year's Progress Report was for CPFIs to increase engagement with corporate clients to encourage them to develop a strategy for carbon management. Crédit Agricole's Sustainable Banking team aims to do this by supporting clients to increase their environmentally-friendly or socially-responsible transactions. The team's efforts have contributed to the 30% increase in Crédit Agricole's revenues arising from transactions in Greentech & Renewable Energies, Carbon Markets and Responsible Investments. HSBC's Living Business is a program to help small & medium-sized businesses be more profitable and productive through implementing socially and environmentally responsible business practices. Both these programs support clients in developing a strategy to manage carbon and encourage them to establish reduction targets. Progress on metrics such as number of clients with new reduction targets or carbon management plans should be considered in external reporting.

FINANCING SOLUTIONS: The institutions are active in financing low-carbon technologies, especially renewable energies. BNP Paribas has over €2 billion invested in renewable energy funds. In 2009, Crédit Agricole Leasing provided over €390 million of lease financing for wind, hydroelectric, solar photovoltaic and biomass energy projects, generating a total of 350 MW of power.

A notable trend is that banks are establishing teams devoted to carbon-related investment. HSBC established a CleanTech Equipment Banking group in 2009 to provide advice, equity, debt, and project financing to customers focused on low-carbon technologies, including electric vehicles, fuel cells, solar photovoltaic and thermal products, and wind turbines. Standard Chartered's dedicated Renewable Energy and Environmental Finance (REEF) team is currently focussed on investing in emerging markets and other developing countries, and in projects such as wind, biomass, solar power, grid distribution, and water infrastructure.

FOCUS FOR ACTION

The CPFIs are devoting significant time and resources to understanding the climate risks and opportunities of their investment and lending activities, evidenced by their growth of specialist carbon-related investment teams. However, the institutions could be more transparent on the training that employees (including those not in specialist teams) receive on incorporating climate change into financing decisions. This would help demonstrate efforts to embed consideration of climate issues across corporate banking activities.

Training on how climate issues affect clients' businesses will also help to ensure client-facing staff have sufficient knowledge and awareness to have meaningful conversations of this nature with clients. Other channels, such as interactive workshops and training sessions, can also be used to help clients understand climate risks and opportunities, implement strategies to manage these, and measure and report on carbon. Not only will the sharing of expertise benefit the client, but the increased engagement can also deepen the bank's relationship with, and understanding of, the client, thereby reducing credit risk for the institution.

Last year's Progress Report suggested that the institutions provide greater disclosure with regard to how they assess climate risk in their own mainstream lending and investment decisions. There has been little evidence that this has been addressed. In particular, institutions should consider disclosing the types of risk evaluated, the timeframe applied, and crucially, how this information contributes to the decision of whether to carry through with an investment.

It is evident that CPFIs are active in capturing climate opportunities by investing in low-carbon financing. However, there is little information on whether they are actively managing climate risks, for example by reducing lending to carbon intensive industries or actively engaging with clients in this sectors to understand how they are reducing emissions. The CPFIs should consider making longer-term commitments to re-balance their portfolios away from high-carbon lending, and in the shorter term adopting internal, voluntary targets.

CASE STUDY

'INCREASING BUSINESS THROUGH INCREASING YIELDS'

Standard Chartered's African Commodity Traders and Agriculture Division provides financing to commercial farmers, small-scale outgrowers and agri-traders in 13 African countries. Traditionally, farmers have struggled to obtain finance as conventional lending practices ask for bonds over farmland, which is not generally available. As a result, farmers are unable to obtain high-quality fertilizers, seeds, and pesticides, leading to diminishing crop yields.

Standard Chartered has developed an innovative 'Input Financing' solution which addresses this issue by using a farmer's crop (soya, corn, wheat, etc.) rather than fixed assets, as collateral. Standard Chartered's Contract Managers also provide hands-on precision farming and agronomic expertise on topics such as fertilizer application, tillage practices, and crop rotation to help farmers increase the quality and quantity of their crops while also promoting best practice water and soil preservation. Conversion to no-tillage farming also has the benefit of exponentially decreasing diesel usage (and related carbon emissions) for land preparation. Another key aspect of the Input Financing solution is the provision of multi-peril insurance which reduces the farmer's exposure to potentially devastating climate and disease risks, thereby ensuring his survival on the land in times of drought, floods, or related perils.

Standard Chartered's regional agricultural financing portfolio in Africa is now valued at over US$2 billion. Standard Chartered's experience is now also being used in partnership with the German Development Bank (DEG) to deliver €100 million of financial support to Africa's agriculture sector over the next three years.

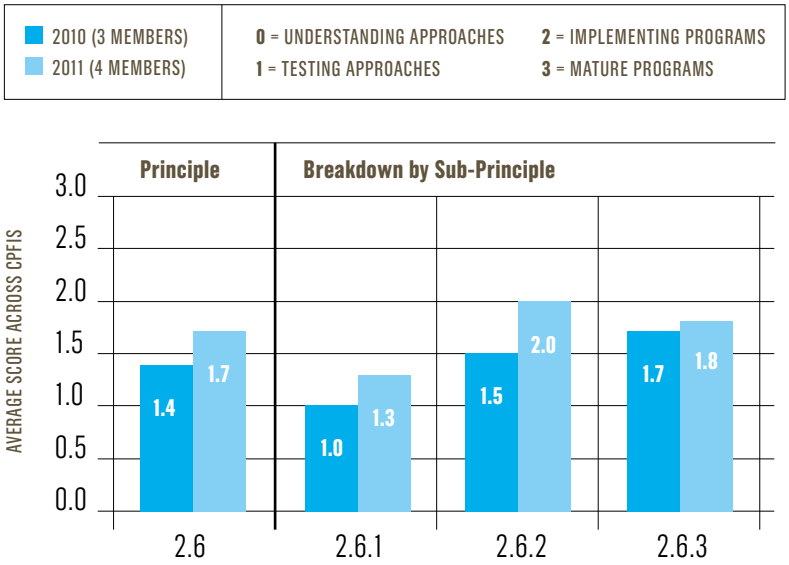
2.6 Investment Banking and Markets

Principle 2.6.1: Corporate Advisory - We will develop the knowledge, tools, and skills necessary to advise our clients of the potential financial implications of carbon and climate risks and opportunities associated with their business transactions.

Principle 2.6.2: Structured Lending & Venture Capital - We will develop viable financing solutions to facilitate investment in low carbon technologies and GHG reduction projects.

Principle 2.6.3: Trading - We will develop expertise to support emissions trading, weather derivatives, renewable energy credits, and other climate related commodities, and look for ways to play a constructive role in promoting these.

Figure 7.
Principle performance across the CPFIs[15]



PROGRESS

The CPFIs have taken some steps to advance their performance in investment banking activities, particularly in the development of new financing solutions for low-carbon technologies and renewable-energy infrastructure (Sub-Principle 2.6.2). However, the overall score for Principle 2.6 is still relatively low, indicating that there is significant opportunity for further improvement.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: In last year's Progress Review, the institutions were encouraged to incorporate climate risks and opportunities into corporate advisory roles. Although there is some evidence of this (see paragraph on 'Corporate Advisory'), there remains limited public information, resulting in a still relatively low score for Sub-Principle 2.6.1. Last year's Review also challenged the institutions to take a proactive role in the development of carbon markets. Some institutions do now report that they intend to expand carbon trading activities into new regions.

CORPORATE ADVISORY: There is some evidence that the CPFIs leverage their climate expertise to engage corporate advisory clients, though it is less clear whether this expertise is also provided through advisory teams during client transaction activity. One example of good practice is the REEF team, which provides advice on climate issues to corporate

advisory clients in relation to, for example, debt and equity placement, and cross-sector, or cross-country M&A transactions.

STRUCTURED LENDING AND VENTURE CAPITAL: Good progress has been made in developing opportunities for the financing of renewable energy and related infrastructure projects. In 2009 Standard Chartered's private equity arm invested US$23 million in a Chinese company that produces domestic digitised solar water heaters that allow users to remotely control water temperature and pressure. BNP Paribas's Clean Energy Private Equity team has recently been involved in the acquisition of a commercial wind power operation in Ireland, and in raising debt finance for the construction of a solar photovoltaic power plant in Italy.

An example of infrastructure financing is HSBC's Environmental Infrastructure Fund, which invests in new infrastructure projects that protect or enhance the environment, including renewable energy, water treatment, and waste management. In 2010, HSBC also announced a US$125 million investment in Better Place, a leading provider of large-scale infrastructure for recharging electric vehicles.

TRADING: Some CPFIs are involved in carbon trading and related market activity. BNP Paribas is a particularly active participant in carbon futures (see Case Study).

FOCUS FOR ACTION

The CPFIs are encouraged to continue their development of commercially driven ways to incorporate climate issues into corporate advisory activity. Due to the increasing financial and stakeholder pressures that businesses are facing in relation to climate change (for example, to measure, disclose, and cut carbon emissions), banks that help clients to identify climate risk and opportunity are likely to build long and trusted client relationships.

The institutions continue to advance in the quantity and variety of funding they make available to develop low-carbon technology business and emissions reduction projects. Continued research into the breadth of sectors which are presented with commercial opportunities from climate change should help the CPFIs to assess how funding can drive value most effectively for both themselves and the investee organizations. The end goal for the CPFIs should be to move from niche, high-tech carbon sector investment to more mainstream funding, such as the public-private partnerships to fund low-carbon infrastructure in developing countries. This has been given added impetus post-Cancun with the creation of the Global Climate Fund. Not only do these partnerships present enormous opportunities for banks, but will also be crucial in the global effort to combat climate change.

Finally, there could be greater transparency on the steps institutions are taking to investigate the need for carbon trading vehicles and the form these should take to be most effective. As part of this, the institutions can have a continued role in promoting opportunities in the carbon markets, and other climate related commodities, to their clients.

Image: CO2CRC researcher Kohei Endo, from the University of Melbourne, adjusts the solvent rig that is part of the Australia's first pre-combustion carbon capture project. Photo by CO2CRC.

CASE STUDY

‘PIONEERING CARBON MARKETS’

BNP Paribas has a dedicated Carbon Team focussed on supporting global environmental markets though emissions trading. It is one of the largest liquidity providers in emission allowance markets under the European Union Emissions Trading Scheme (ETS), and also participates significantly in international carbon futures markets, clearing approximately 20% of all emissions contracts on the European Climate Exchange.

One example of BNP Paribas’ carbon market pioneering is its involvement in the first ever Joint Implementation (JI) project in Russia with an oil and gas company. These projects will generate Emission Reduction Units (ERUs) that can be traded on the EU ETS. Progress in introducing JI projects had been slow in Russia, but BNP Paribas’ experience in carbon markets and strong relationship with the company and the French and Russian governments allowed it to successfully close the deal.

BNP Paribas is also one of the first financial institutions to become active in the forest carbon market, including Reduced Emissions from Deforestation and Degradation (REDD) projects. For example, in September 2010, BNP Paribas announced an agreement with Wildlife Works Carbon to develop a portfolio of large scale REDD projects in Africa. The facility provides funding for Wildlife Works’ efforts to source, develop, implement, and manage REDD projects in Africa. BNP Paribas will have the option to purchase avoided-emissions credits created within the portfolio.

2.7 Project Finance

For projects that release or are likely to release 100,000 tons CO_2 equivalent per year (aggregate emissions of direct sources and indirect sources associated with purchased electricity for own consumption), except where justified deviation is provided, we will request the client to:

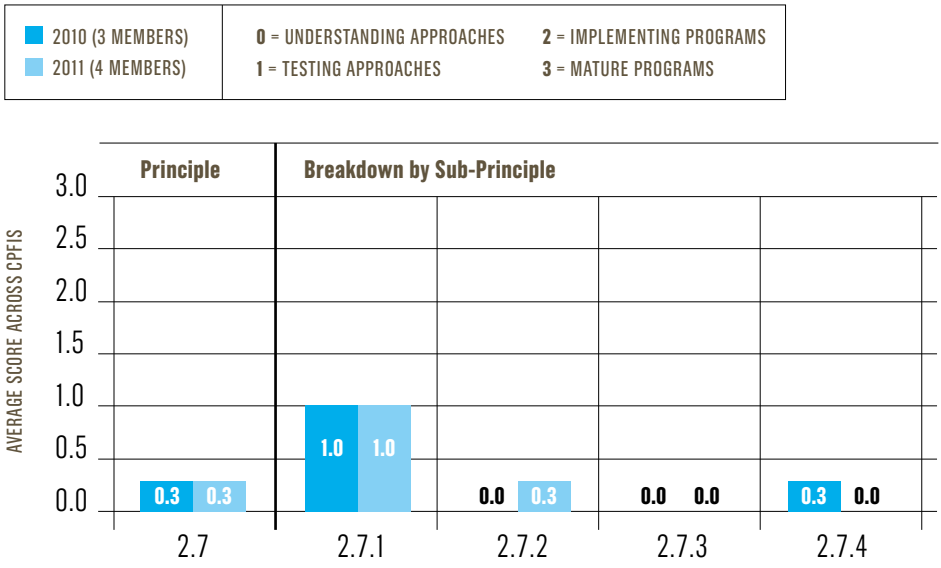
Principle 2.7.1: Seek opportunities to reduce project-related GHG emissions in a manner appropriate to the nature and scale of project operations and impacts.

Principle 2.7.2: Quantify and disclose direct GHG emissions and indirect GHG emissions associated with the off-site production of power used by the project.

Principle 2.7.3: Monitor and report GHG emissions annually in accordance with internationally recognized methodologies.

Principle 2.7.4: Evaluate technically and financially feasible options to reduce or offset project-related GHG emissions during the design and operation of the project.

Figure 8.
Principle performance across the CPFIs[15]



PROGRESS

In last year's Progress Review, project finance achieved the lowest performance score across all principles. This performance remains similar in 2011.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: Last year the Progress Review recommended increased monitoring and disclosure of carbon emissions from carbon-intensive projects and to work with project sponsors to identify ways to reduce emissions. Although, the CPFIs appear to show a commitment to monitoring emissions, barriers such as client confidentiality and a lack of guidance within the Equator Principles[16] continue to hinder progress in this area. Limited public disclosure was seen on client engagement.

EMISSIONS REDUCTION: CPFIs who have also adopted the Equator Principles undertake some form of environmental and social due diligence for project finance lending. However, only

16 'The Equator Principles are a set of voluntary financial industry standards for managing social and environmental issues in project financing. More information can be found at: www.equator-principles.com.

a couple of the institutions publicly evidence that climate change impacts are considered as part of this process. For example, at Crédit Agricole, the due diligence process includes a review of the environmental impact assessment, the environmental management plans, and independent engineer reports which include climate change risks.

For all institutions it is still very difficult to ascertain how clients are being engaged to reduce emissions through implementation of effective emissions reduction plans, during both design and operational phases. The International Finance Corporation (IFC) Performance Standards underlying the Equator Principles currently contain little guidance, meaning that CPFIs are left with the sub-optimal option of taking voluntary, bilateral approaches to address climate risks in project financing. This may change in the future, however, as part of the IFC's current review of its Sustainability Framework.

EMISSIONS DISCLOSURE: Through the Progress Review interviews, it was clear that institutions remain engaged on the monitoring of emissions and are working with their clients to identify effective ways to report the data and progress externally. Some CPFIs indicated that they have already developed methodologies for collecting absolute emissions and emissions intensity data from project finance transactions for internal reporting purposes. Nevertheless, many CPFIs expressed concern that it would not be appropriate to publish emissions if their clients do not disclose their own data, and questioned what benefit emissions data had without a better understanding of the context.

PENDING EP STRATEGIC REVIEW: During the interviews conducted as part of the Progress Review, a number of institutions confirmed they are currently looking to the Strategic Review of the Equator Principles, due to be completed in 2011, to provide more stringent reporting requirements. The Strategic Review is designed to assess progress to date and identify future challenges and opportunities and will be completed following the revision of the IFC Performance Standards.

The Climate Group has established a Clean Energy Working Group to collectively work on this challenging area and understand how guidance may be applied to new coal-fired power stations. If this approach is useful for the CPFIs, guidance for other carbon intensive sectors may be developed.

FOCUS FOR ACTION

During last year's Progress Review, CPFIs were encouraged to make more information publicly available on how they are engaging with clients in carbon-intensive projects. It also recommended collaboration with organizations such as the Equator Principles Association and the International Finance Corporation to drive progress in this area. The 2011 Progress Review has shown that continued focus on these actions is required.

CPFIs need to work around challenges associated with client confidentiality and public disclosure of GHG emissions data. The Equator Principles Strategic Review should provide some guidance on this. However, if the institutions decide that the requirements of Principle 2.7 are misaligned with the intended focus, then amendments to the Principle should be made in order to stimulate meaningful action. Either way, improvements in reporting on carbon emissions financed and mitigation strategies adopted should be the objective of the Principle.

Once the Equator Principles Strategic Review is completed, the CPFIs should incorporate any clarification on reporting requirements into their policies and processes. This will help ensure that climate change impacts and potential reduction plans are considered at the early stages in project evaluation and design. In the meantime, the CPFIs should at least ensure that emissions are being monitored through the life of loans and that total emissions financed are (internally) reported.

SECTION 3: BROADER ENGAGEMENT WITH STAKEHOLDERS

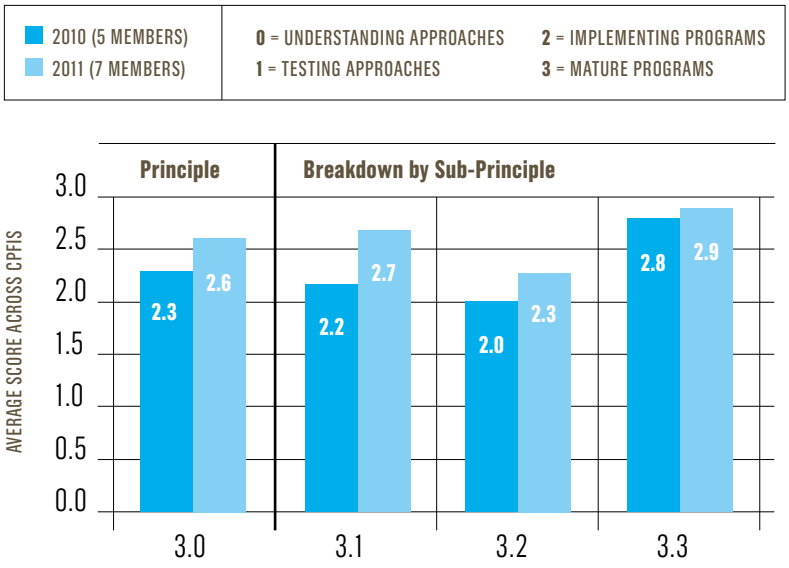
3.0 We will engage others to support the growth of a low carbon economy, where consistent with our corporate policies on public engagement.

Principle 3.1: We will disseminate information through our network of customers, suppliers, staff, and other stakeholders to raise awareness about climate change and the opportunities for reducing GHG emissions.

Principle 3.2: We will engage our significant suppliers on climate change issues and work with them to enable us to reduce GHG emissions throughout our supply chain.

Principle 3.3: We recognize that tackling climate change cannot be solved through voluntary action alone and we support the adoption of effective and efficient regulation and policy to reduce GHG emissions. Such support may include engaging policy makers and/or key stakeholders on an individual basis or through relevant industry and multi-stakeholder initiatives.

Figure 9.
Principle performance across the CPFIs[15]



PROGRESS

All CPFIs continue to show significant progress in the engagement of stakeholders. This reflects a strong commitment to continue to enhance the way information is shared with various stakeholder groups.

PROGRESS ON LAST YEAR'S FOCUS FOR ACTION: Last year the Progress Review recommended providing tailored information on climate change and emissions reduction options to each stakeholder group. Although the CPFIs continue to show increased

engagement of stakeholders, they could disclose with greater clarity on what they can do to inform and support each stakeholder group. This information would raise awareness of the support the organizations provide to stakeholders such as suppliers and customers, and also demonstrate to investors, government, and NGOs that the institutions are playing a role in emissions reduction beyond the boundaries of their own organizations.

DISSEMINATING INFORMATION: The CPFIs are drawing upon a range of different programs and initiatives to engage customers, suppliers, and other stakeholders on climate change. For example, Swiss Re sponsored the BELL project in China in which 2,000 students from 22 universities took part in on-site inspections, interactive events, and presentations given by senior business executives on environmental topics including energy saving. HSBC's Eco-Schools Initiative, which aims to develop a global network of schools that actively tackle climate change issues and champion energy efficiency in local communities, is now in its second year and running in 18 countries around the world.

WORKING WITH SIGNIFICANT SUPPLIERS TO REDUCE SUPPLY-CHAIN EMISSIONS: Information publicly disclosed by the CPFIs on their efforts to reduce supply-chain emissions remains limited, though from the Progress Review interviews it was apparent that all CPFIs have taken some action. The majority have developed, or are developing, procurement criteria to identify suppliers with poor environmental and social performance that could potentially impact the institution and its value chain. HSBC's UK purchasing team chairs the Financial Services Corporate Responsibility Group, which aims to raise standards of responsible procurement across the Financial Services sector by sharing good practice, educating members, and improving consistency in supply-chain sustainability standards.

SUPPORTING POLICYMAKING: All the CPFIs have been active in supporting the development of climate change regulation and policy, through engaging national governments and participation in industry initiatives and strategic partnerships. HSBC's Climate Change Centre of Excellence has produced reports on climate science, policy and markets, including a series of reports on the implications of the Copenhagen climate conference.

FOCUS FOR ACTION

The CPFIs are encouraged to build stakeholder engagement initiatives into longer-term climate change strategy, with defined objectives, resources, and metrics. CPFIs should work with suppliers to identify 'quick wins' to reduce emissions in the supply chain. In exchange for upfront investment to maximize these opportunities, often through delivering improved efficiencies, suppliers may agree to share savings with the institution. The CPFIs could consider formalizing medium to long-term arrangements with suppliers where funding is provided for a guaranteed share of savings. Internally the institutions should look to incorporate climate change concerns into procurement policies and supplier-selection criteria to reduce their own exposure to climate change risks.

The institutions should look to continue their support and engagement of governments at all levels (local, regional, and national) as well as international processes such as the UNFCCC. In particular, the institutions have a wealth of research, cross-industry knowledge, and international perspectives which can be used to advise policy makers. The CPFIs, in conjunction with organizations like the World Economic Forum, could play a formative role in developing public-private partnerships to accelerate and leverage the "fast start funding" pledged to developing countries to help them adapt to climate change. This will go some way to improving engagement of the finance sector with the UNFCCC process, and ensuring that the private sector is involved at the design stage of climate finance mechanisms.

ANNEX I

Methodology for PwC review

The process undertaken as part of the Progress Review is described below.

SOURCES OF INFORMATION

- Company-issued information in the public domain: at present, adopting institutions do not communicate progress against the Principles through a standalone report. We therefore assessed implementation based upon information issued by the adopting institution, which was found within the public domain. Sources included:
  - Responses to Carbon Disclosure Project requests;
  - Company Sustainability Reports; and
  - Company websites
- Interviews: Following this initial data review, individual interviews were also conducted with each institution to address any information gaps, to ensure we had not misinterpreted information and to clarify remaining questions. On occasion, interviews were conducted with several individuals from one institution to ensure information provided for each of the Principles was as comprehensive and accurate as possible.

DEFINITION ON LEVELS OF IMPLEMENTATION

In reviewing institutions' activity against the Principles, we based our assessment of progress upon four distinct implementation levels, as set out in the table below. These levels, and their descriptions, were agreed with the CPFI Group in advance.

LEVELS OF IMPLEMENTATION	SCORE	DESCRIPTION
Not Applicable	-	Institution is not involved in the specific business activity defined by the Principle.
Understanding Approaches	0	Institution is at an early stage of understanding the issue and determining the best approach to be taken.
Testing Approaches	1	Institution has developed approaches and is testing them across a limited part of the institution and/or product/service range.
Implementing Programs	2	Institution has agreed to an approach and is rolling it out across the relevant business areas.
Mature Programs	3	Institution has fully implemented the approach and is using results and findings to the advantage of the business, its clients and customers.

Image: Lighting of the iconic skyline of the highrise buildings in central on Hong Kong island, overlooking Victoria Harbour. Photo by Jiri Rezac.

Progress against the Principles has been assessed on a Sub-Principle-by-Sub-Principle basis and presented for the whole CPFI Group. Summary graphs are presented in the main part of the Report. A full overview of results for each Sub-Principle is presented in Annex III.

CASE STUDIES

The content of each text box was agreed in advance with the relevant adopting institution.

SCORING

In assessing performance, each adopting institution was evaluated according to the four levels of implementation and given a score between 0 and 3. CPFI Group performance as a whole was calculated using the mean average across the CPFIs within the given activity (see Annex III for a breakdown of results).

ANNEX II

Principle relevance to the institutions

Not all Principles are applicable to all the institutions, due to the variations of products and services these institutions offer. CPFIs are not assessed against Principles which are not relevant to them. The table below provides an overview of the CPFIs and the Principles against which they are assessed. [17]

FINANCIAL INSTITUTION								
PRINCIPLE		**BNP Paribas**	**Crédit Agricole**	**F&C Asset Management**	**HSBC**	**Munich Re**	**Standard Chartered Bank**	**Swiss Re**
Managing Operational Emissions	1.1	✓	✓	✓	✓	✓	✓	✓
	1.2	✓	✓	✓	✓	✓	✓	✓
	1.3	✓	✓	✓	✓	✓	✓	✓
	1.4	✓	✓	✓	✓	✓	✓	✓
	1.5	✓	✓	✓	✓	✓	✓	✓
Research Activities	2.1.1	✓	✓	✓	✓	✓	✓	✓
Asset Management	2.2.1	✓	✓	✓	✓	✓		✓
	2.2.2	✓	✓	✓	✓	✓		✓
	2.2.3	✓	✓	✓	✓	✓		✓
Retail Banking	2.3.1	✓	✓		✓		✓	
	2.3.2	✓	✓		✓		✓	
Insurance & Reinsurance	2.4.1	✓	✓		✓	✓		✓
	2.4.2	✓	✓		✓	✓		✓
	2.4.3	✓	✓		✓	✓		✓
Corporate Banking	2.5.1	✓	✓		✓		✓	
	2.5.2	✓	✓		✓		✓	
	2.5.3	✓	✓		✓		✓	
	2.5.4	✓	✓		✓		✓	
Investment Banking & Markets	2.6.1	✓	✓		✓		✓	
	2.6.2	✓	✓		✓			
	2.6.3	✓	✓		✓		✓	
Project Finance	2.7.1	✓	✓		✓		✓	
	2.7.2	✓	✓		✓		✓	
	2.7.3	✓	✓		✓		✓	
	2.7.4	✓	✓		✓		✓	
Broader Stakeholder Engagement	3.1	✓	✓	✓	✓	✓	✓	✓
	3.2	✓	✓	✓	✓	✓	✓	✓
	3.3	✓	✓	✓	✓	✓	✓	✓

17 Although Munich Re is no longer a CPFI, the data presented reflects progress made in 2010 and therefore includes Munich Re's scores.

ANNEX III

Results of review of CPFIs[18]

PRINCIPLE		Understanding Approaches (0)	Testing Approaches (1)	Implementing Programs (2)	Mature Programs (3)	Not Applicable (-)
1.0 - MANAGING OPERATIONAL EMISSIONS						
1.1	We have issued a strategy or position that indicates how we undertake our business in a way that reduces the climate and operational carbon impact of our activities.				••••• ••	
1.2	We have board level commitment for the strategy or position and a named senior executive who has responsibility for implementing it across our organization and for ensuring that decisions taken are consistent with it. This executive has the necessary resources to meet the commitments contained in our strategy or position.				••••• ••	
1.3	We have measured a significant proportion of our operational GFG emissions using an internationally recognized or equivalent domestic standard and we disclose this information.			•••	••••	
1.4	We have issued clear and challenging, yet achievable, targets for making reductions in our operational GHG emissions.		•	••	••••	
1.5	We engage our employees on our commitment to addressing climate change and support them in playing an active role in meeting this commitment.			•••	••••	
2.1 - RESEARCH ACTIVITIES						
2.1.1	We will incorporate climate and carbon issues into our research activities and, where relevant, will utilize the findings to develop products and services that benefit our customers and clients.			•••	••••	

18 Although Munich Re is no longer a CPFI, the data presented reflects progress made in 2010 and therefore includes Munich Re's scores.

PRINCIPLE		Understanding Approaches (0)	Testing Approaches (1)	Implementing Programs (2)	Mature Programs (3)	Not Applicable (-)
2.2 - ASSET MANAGEMENT						
2.2.1	We will enable our analysts to incorporate carbon and climate risks and opportunities into their research and investment decisions where relevant.		•	• • • •	•	•
2.2.2	We will engage our clients to understand the carbon and climate change risks and opportunities relevant to them and we will develop products and services that support them in managing those risks and exploiting those opportunities.		•	• • •	• •	•
2.2.3	Where consistent with our fiduciary responsibilities, we will engage with the companies our clients invest in to understand how they are minimizing the risks and maximizing the opportunities presented by climate change and climate policy. We will also encourage these companies to improve their governance and disclosure of climate risks and opportunities.	•	• •	• •	•	•
2.3 - RETAIL BANKING						
2.3.1	We will undertake research to understand: 1) The potential impacts of climate change and climate change policy for our customers; 2) The willingness of our customers to address these impacts; 3) The products and services that customers need to address these impacts and the barriers to addressing them; and 4) The approaches needed to raise awareness of how our customers manage their GHG emissions and reduce their carbon footprint.		• • •	•		• • •
2.3.2	Based on our understanding of our customers, we will develop products, services and communication and engagement strategies to enable them to address potential impacts and reduce their carbon footprint.		• •	• •		• • •

PRINCIPLE		Understanding Approaches (0)	Testing Approaches (1)	Implementing Programs (2)	Mature Programs (3)	Not Applicable (-)
2.4 - INSURANCE AND REINSURANCE						
2.4.1	We will develop the necessary knowledge, skills, and tools to assess carbon and climate risks associated with our transactions and the financial implications they have for our business.		•	••	••	••
2.4.2	We will develop risk assessment techniques to assist our clients better understand and respond to climate change.		••	•	••	••
2.4.3	We will develop insurance products and services that encourage our customers to reduce their carbon and climate risks, assist the development and adoption of GHG mitigation technologies and strategies and take advantage of the carbon market.			••	•••	••
2.5 - CORPORATE BANKING						
2.5.1	We will develop and implement a process to consistently assess the financial implications of carbon and climate risks relevant to our clients and will train employees to implement this assessment.		••	•	•	•••
2.5.2	We will consider practical ways to assess the carbon and climate risks of our lending and investment activities. Where a feasible and relevant methodology can be found, we will develop and implement this approach.		•	•••		•••
2.5.3	We will engage our clients to understand the carbon and climate risks and opportunities associated with their business. This might include encouraging them to develop a strategy to manage these risks; to measure and disclose their carbon footprint; and, to set meaningful targets to reduce carbon emissions.		••	••		•••
2.5.4	We will develop financing solutions to facilitate investment in low-carbon technologies and GHG reduction projects.		•	•	••	•••

PRINCIPLE		Understanding Approaches (0)	Testing Approaches (1)	Implementing Programs (2)	Mature Programs (3)	Not Applicable (-)
2.6 - INVESTMENT BANKING AND MARKETS						
2.6.1	**Corporate Advisory** We will develop the knowledge, tools, and skills necessary to advise our clients of the potential financial implications of carbon and climate risks and opportunities associated with their business transactions.		• • •	•		• • •
2.6.2	**Structured Lending & Venture Capital** We will develop viable financing solutions to facilitate investment in low-carbon technologies and GHG reduction projects.			• • •		• • • •
2.6.3	**Trading** We will develop expertise to support emissions trading, weather derivatives, renewable energy credits, and other climate related commodities, and look for ways to play a constructive role in promoting these.		• •	•	•	• • •
2.7 - PROJECT FINANCE						
2.7.1	Seek opportunities to reduce project-related GHG emissions in a manner appropriate to the nature and scale of project operations and impacts.		• • • •			• • •
2.7.2	Quantify and disclose direct GHG emissions and indirect GHG emissions associated with the off-site production of power used by the project.	• • •	•			• • •
2.7.3	Monitor and report GHG emissions annually in accordance with internationally recognized methodologies.	• • • •				• • •
2.7.4	Evaluate technically and financially feasible options to reduce or offset project-related GHG emissions during the design and operation of the project.	• • • •				• • •

PRINCIPLE		Understanding Approaches (0)	Testing Approaches (1)	Implementing Programs (2)	Mature Programs (3)	Not Applicable (-)
3.0 - BROADER ENGAGEMENT WITH STAKEHOLDERS						
3.1	We will disseminate information through our network of customers, suppliers, staff, and other stakeholders to raise awareness about climate change and the opportunities for reducing GHG emissions.			• •	• • • • •	
3.2	We will engage our significant suppliers on climate change issues and work with them to enable us to reduce GHG emissions throughout our supply chain.		•	• • •	• • •	
3.3	We recognize that tackling climate change cannot be solved through voluntary action alone and we support the adoption of effective and efficient regulation and policy to reduce GHG emissions. Such support may include engaging policy makers and/or key stakeholders on an individual basis or through relevant industry and multi-stakeholder initiatives.			•	• • • • • •	

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