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Green finance? Why global banks are pledging billions to fight climate change

By Simon Wilde

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Banking giant HSBC has pledged $100bn (£76bn) to "fight climate change", to be spent on sustainable finance and investment over the next eight years. It also commits to increasing its own use of renewable energy and to reducing its funding of coal projects.

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HSBC is following a growing trend among investment banks which includes a $200bn funding commitment from JP Morgan Chase, the acquisition of the UK's Green Investment Bank by Macquarie, and exits from coal lending by Deutsche Bank, Credit Agricole and others.

I know a fair bit about such deals as I have been an energy investment banker for 25 years and now assess the sector in my research at the University of Bath and Imperial College. So how significant are these moves and what might their impact be?

1. Huge capital is needed for green transition

Undoubtedly the move to a green economy requires significant investment, over and above today's levels. For 2016-2030, the OECD estimates an additional $600bn infrastructure investment per year is needed to meet Paris Agreement climate goals, across energy, transportation and other sectors.

As part of this transition, green energy investment is already growing rapidly: the United Nations reports doubling of clean energy asset finance over the past decade, with $1,657bn being raised in total 2007-2016, much of it from bank lending. So $300bn over the next decade from HSBC and JP Morgan, while significant, will not in itself be game-changing. It does, however, reflect the continued growth that we have seen for some time, driven by the declining cost of renewable power and broadly supportive government policies.

Banks are also encouraging the growth of the "green bond" market, where companies and governments raise money specifically for environmentally positive projects such as new wind farms, solar technology or more energy efficient housing – with the money ring-fenced and externally monitored. The green bond market remains small, at less than 2% of annual global bond issuance. However volumes are growing rapidly and observers including the OECD see this market as important to climate finance. HSBC and other banks have been active in green bonds, issuing their own bonds and helping others access the market.

2. It’s not just bank lending that is important

There are concerns that bank lending may decline over time due to regulatory changes such as the Basel III framework, which requires banks to decrease their leverage and keep more capital in reserve. Governments are therefore also encouraging greater investment directly by large institutional investors such as pension or life insurance funds. Increasing equity and debt investment into a better structured pipeline of clean energy projects is a challenge for policymakers and financiers alike.

Likewise, much climate-related investment is needed in emerging markets or for high-risk early-stage innovation and development. For example MIT last year highlighted the decline in clean-tech venture capital funding, despite increased lending and investment for the deployment of existing technologies. It may be that continued overall commercial bank lending for “safe bets” (such as British wind farms that use established technology) does little to support these more difficult areas.

3. What’s in it for the banks?

Some question banks’ motivation: pressure group Banking on Climate Change points out that the world’s largest banks lent $290bn to coal, liquid natural gas and environmentally sensitive oil projects in 2014-16, with JP Morgan the third-largest lender and HSBC at number eight. Announcing green finance packages is one way of deflecting criticism for such activities.

Likewise, the risk of climate change litigation is rising, with Columbia Law School pointing to the tripling of climate cases since 2014. A recent action against the Commonwealth Bank of Australia highlights the potential for banks to be sued. In the face of litigation, now withdrawn, CBA acknowledged climate change as a significant risk, published a climate policy for the first time and withdrew from lending to a controversial coal project. Actions like those announced by HSBC this week, can be seen in the context of avoiding similar issues.

That said, HSBC and others may well be following growing demand from their own – particularly younger – customers for sustainability-related products. All successful organisations need to adapt to changes in customer preferences, and any generational shift in environmental views requires banks – like other companies – to adjust their marketing approach.

So what are we to conclude from these moves?

Increased green lending by commercial banks, while not the whole answer, is to be welcomed. Continuing to finance the growing deployment of increasingly low-cost renewable energy contributes positively to climate change action. In the face of increasing scrutiny of potential negative contribution by lenders – in the coal sector for example – it’s understandable that banks want to be able to trumpet their green credentials.

More is needed – from governments, development agencies, long-term investors and banks alike – but recent moves by HSBC and others are a step forward. It will be interesting to look back from 2020 at the relative levels of investment actually delivered to both renewables and more carbon-intensive sectors.

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