Banking and the fight against climate change

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The fight against climate change is one of the greatest challenges currently facing mankind. From the socio-economic point of view, the panorama is alarming. Experts warn that a sustained increase in the average temperature on Earth would have serious effects for millions of people, such as destroying their means of livelihood and their assets to mention just two. This would lead to increased poverty and unemployment, which in turn would lead to social conflict and mass migration of the people affected.

After several failed attempts, the international community finally succeeded in mobilising to respond to the crisis. At the Paris Climate Conference (COP21), held in 2015, 195 nations undertook to reduce their emissions of greenhouse gases, which cause global warming, and to intensify efforts to mitigate and adapt to climate change. The challenge is immense, since it implies going from an economy based on the use of fossil fuels, the negative externalities of which have a high cost to society, to an economy based on principles of sustainability. It is estimates that around US$700 billion will be needed every year until 2030 to cover the infrastructure needs compatible with sustainable economic growth. Given that the public sector's ability to cover this demand is limited, the participation of the private sector is of vital importance. In this context, private financing plays a crucial role.

The opportunities for the banking industry are numerous. In the next few years hundreds of billions of dollars will be channelled into projects involving energy from renewable sources, electric vehicles and energy efficiency. Between 2010 and 2016, investment in energy from renewable sources averaged around US$263 billion a year. The major part of these resources were channelled into the large-scale production of electricity from wind and solar power. n 2015, investments aimed at achieving efficient consumption of energy for lighting, heating systems and air conditioning, construction, transport and household appliances amounted to around US$221 billion. In the transport sector, the majority of automotive companies now have one or more hybrid or entirely electric models. Although these vehicles represent barely 1% of new car sales, technological advances in the development of batteries in the next few years are expected to encourage large-scale buying.

The role of banks in the fight against climate change is not confined to major projects. At the individual level, the drive to consume and invest sustainably has intensified, especially in the developed countries and among young adults, who are prepared to pay more for products and services of environmentally responsible companies. This has led to the development of financial products adapted to the new "green" trends. Prominent among them are: investment options focusing on companies with low environmental impact, mortgage loans that finance improvements in the use of energy in the home, credit cards that reward sustainable consumption and reduced interest rates on loans to acquire electric cars.

The banking industry is not exempt from risks associated with climate change. Extreme weather events such as "super-storms" or "mega-droughts" endanger the physical integrity of its branches, data centres, head office and personnel. Apart from this, environmental regulation, deriving from the efforts to mitigate and adapt to climate change, may affect the value of loan portfolios that include companies with high levels of greenhouse gas emissions or whose inventories consist mainly of stocks of fossil energy. Also, in this age of social media, the financing of projects considered harmful to the environment may unleash reputational crises that are difficult to resolve.

Nevertheless, with appropriate management of the risks associated with global warming and an effective strategy for identifying the most profitable projects, financing the sustainable economy could bring about a virtuous cycle between the pursuit of the common good and the generation of value for financial institutions, shareholders and customers.