The Changing Environment of Banks *

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Due to their intermediary role in the economy, banks hold a unique position with regard to sustainable development. This intermediary role is both quantitative and qualitative. Due to their efficient credit approval systems, banks are well equipped to weigh risks and attach a price to these risks. Through such price differentiation, banks can foster sustainability. Banks can also develop more sustainable products, such as environmental or ethical investment funds. In addition, there is great scope for banks to improve their internal environmental performance. This paper examines the development of environmental concern in banks, their environmental impact, their role in the economy and the driving forces for more proactive policies toward sustainable development. A typology is presented categorising four stages of attitudes toward environmental problems: defensive, preventative, offensive and sustainable banking. The paper illustrates that governmental policy is an important factor in designing the context that shapes some, but not all, of the actions taken by the banking sector. An overview of the match between Dutch environmental policy and the role of the banking sector is presented. Finally, some conclusions are drawn with regard to the possible future role of banks towards sustainability.

- Sustainable banking
- Economic system
- Stakeholders
- Banks' environmental impact
- Risks
- New financial products
- Price differentiation

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SUSTAINABLE COMPANIES WILL NEED TO CONSIDER THEIR LONG-TERM STRATEGIES more seriously in business decisions. In fact, the very existence of many companies will depend either on the continued availability of certain natural resources or their ability to adapt and reinvent themselves.

So how is the banking sector responding to the new challenges that sustainability presents? Basically, it has responded far more slowly than other sectors. Bankers generally consider themselves to be in a relatively environmentally friendly industry (in terms of emissions and pollution). However, given their potential exposure to risk, they have been surprisingly slow to examine the environmental performance of their clients. A stated reason for this is still that such an examination would 'require interference' with a client's activities. Empirical research from 1990 concluded that (European) banks were not interested in their own environmental situation nor that of their clients (*Tomorrow* 1993).

This situation is now changing. There is growing awareness in the financial sector that environment brings risks (such as a customer's soil degradation) and opportunities (such as environmental investment funds). On the risk side, there has been an enormous raising of concern in the United States since the late 1980s. Banks could, under CERCLA,[1] be held directly responsible for the environmental pollution of clients and obliged to pay remediation costs. Some banks even went bankrupt under this scheme. Due to these developments, American banks became the first to consider their environmental policies, particularly with regard to credit risks. European banks were not exposed to these liabilities and only began to develop policies toward environmental issues during the mid-1990s. The focus here was less on risk assessment and more on the development of new products such as environmentally friendly investment funds.

Both risk and opportunity are now becoming established elements in banking policies towards the environment. Empirical research on the environmental activities of banks by the United Nations Environment Programme (UNEP) in 1995 stated that 80% of the respondents made some kind of assessment of environmental risks (UNEP 1995). An investigation from 1997 concluded that many banks have set up environmental departments and are developing environmentally friendly products (Ganzi and Tanner 1997). In Asia, South America and Eastern Europe, change is also under way, mostly through the influence of environmental standards from multilateral development banks, such as The World Bank, the International Finance Corporation (IFC), the Andean Development Corporation (ADC) and the European Bank for Reconstruction and Development (EBRD).[2] Strong evidence that sustainability has reached the mainstream financial community was provided by the launch of the 'Dow Jones Sustainability Group Index' in September 1999 (DJSGI 1999). For the first time, a mainstream global index is tracking the performance of the leading sustainability-driven companies worldwide.[3]

The role of banks in contributing toward sustainable development is potentially enormous, because of their intermediary role in an economy. It is exactly this intermediary role that has attracted the interest of governments and institutions such as the EU and UNEP in their environmental activities (UNEP 1997; European Commission DG XI 1998). Banks transform money in terms of duration, scale, spatial location and risk and have an

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1 To cover the costs of Superfund (especially soil contamination), the US government initiated the 'Comprehensive Environmental Response, Compensation and Liability Act' (CERCLA) in 1980. In the 'US versus Fleet Factors Corporation' case, a bank was held responsible for the environmental pollution of its client. The outcome of this trial sent an immense shockwave through the US (and international) banking community. For details of this trial, see Bryce 1992.

2 For The World Bank, see http://www.worldbank.org; for the IFC, see http://www.ifc.org/enviro. See also ADC 1998 and EBRD 1995.

3 See *International Herald Tribune* 1999 or http://www.sustainability-index.com.

important impact on the economic development of nations. This influence is of a quantitative, but also of a qualitative, nature, because banks can influence the pace and direction of economic growth.

At the Earth Summit in 1992, the 'UNEP Financial Initiative on the Environment and Sustainable Development' was established in order to initiate a constructive dialogue between UNEP and financial institutions. The financial sector incorporates a broad set of institutions, which includes commercial banks, investment banks, venture capitalists, asset managers, multilateral development banks and rating agencies. The mission statement of this initiative declares:

> This initiative, which operates under the auspices of the United Nations Environment Programme, promotes the integration of environmental considerations into all aspects of the financial sectors' operation and services. A secondary objective of the initiative is to foster private sector investment in environmentally sound technologies and services (UNEP 1999 or http://www.unep.ch/eteu/envr-fin.htm).

The initiative ultimately resulted in a statement by banks (the 'UNEP Statement by Banks on the Environment and Sustainable Development' in 1992) and by insurance companies ('Insurance Industry Initiative for the Environment, in association with UNEP' in 1995). At the beginning of November 1999, approximately 160 banks and approximately 85 insurance companies had signed the respective statements.

This paper explores the role of banks in the progress toward sustainable development. First, we map out the role of banks in a macroeconomic system by looking at their products in general. We then analyse the environmental impacts of banking, before describing the driving forces on banks to take environmental action. In the following section we present a typology of the actions that banks are taking. We then examine the role of governments in establishing a role for banks in achieving sustainable development, with particular regard to the experience of the Netherlands. Finally, we provide some conclusions about the current dynamic and likely changing role of banks in the future.
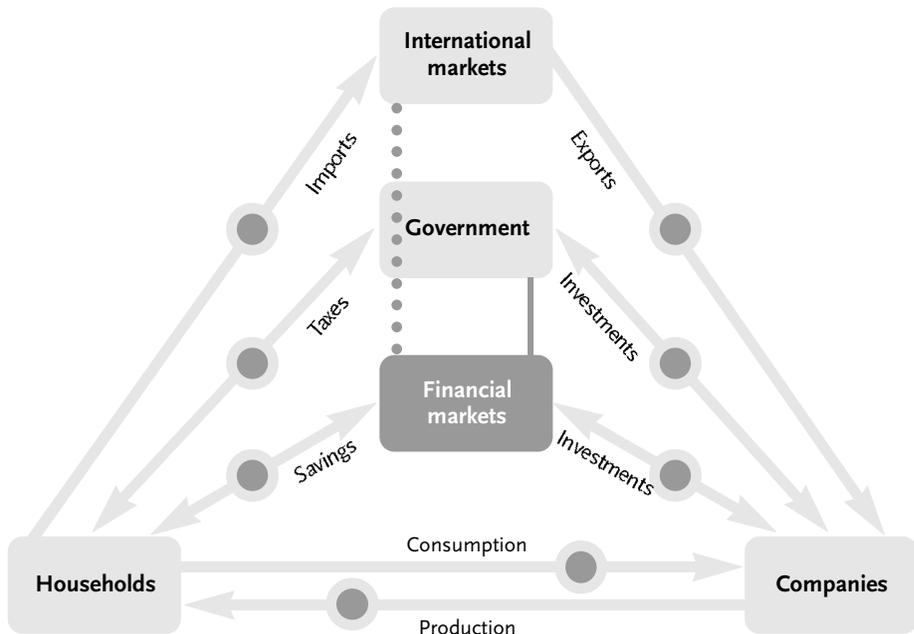
1 The role of banks

Banks have an important role in an economy: they are intermediaries between people with shortages and surpluses of capital. Their products include savings, lending, investment, mediation and advice, payments, guarantees, and ownership and trust of real estate. These core activities generate two principal sources of income: interest earnings and provision earnings. In the first case, a bank is working on its own behalf and risk; and in the second case on behalf of and at the risk of its clients. It is usual to distinguish between different banking departments such as investment banking, commercial banking, corporate banking, private banking, trade finance, electronic banking, securities, financing and loans, savings and so on. Some banks specialise in one or more of these areas. Universal banks usually cover all activities.

Figure 1 represents the typical cyclical process of a macroeconomic system. In this simplistic model one can clearly see at which points in an economy banks are present and have influence (represented by the shaded areas). The arrows represent money flows. Households pay taxes, consume and import goods and save money. Companies produce, invest and export goods and receive investments. Governments receive taxes, pay subsidies and invest. Through the international markets, goods (imports and exports) are traded. Surpluses and shortages of the government, the international markets, companies and households are dealt with by financial transactions through the financial markets. The importance

Figure 1: THE ROLE OF THE FINANCIAL MARKETS IN AN ECONOMIC SYSTEM
Source: Jeucken 1988

of the financial markets is evident. In many countries, banks are the most important financial intermediaries in an economy.[4] The traditional intermediary role has consisted mainly of bridging savings and investments. Today, it more usually consists of bringing together people with shortages and people with surpluses of capital. The traditional profits of banks have largely consisted of interest earnings. Today, and due to this shift, more than half the profits of banks are often generated through provision earnings. Securitisation and investment banking are important examples of this shift, which is of some importance with regard to sustainability because it involves the increasingly direct influence of clients on the investments that banks make.

As a financial intermediary between market players, a bank has four important functions:

▶ First, it transforms money by scale. The money surpluses of one person are mostly not the same as the shortages of another person.

▶ Second, banks transform money by duration. Creditors may have short-term surpluses of money, while debtors mostly have a long-term need for money.

▶ Third, banks transform money by spatial location (place). For example, a bank brings money from a creditor in New York to a debtor in London.

▶ Finally, banks act as assessors of risk. As a rule, banks are better equipped to value the risks of various investments than individual investors who have surpluses available. In addition, through their larger scale, banks are more able to spread the risks.

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4 This is true for continental Europe, Japan and most of the developing countries. In countries such as the US and the UK, the importance of banks is much smaller. The share of banks in the financing of the American economy consisted of 80% in 1970. By 1990 this had gone down to only 20% (Albert 1991).

This last function in particular is of importance with regard to the achievement of a sustainable society. Banks have extensive and efficient credit assessment systems and because of this they have a comparative advantage in knowledge (regarding sector-specific information, legislation and market developments). Through this knowledge of environmental and financial risks, banks fulfil an important role in reducing the information asymmetry between market parties. A bank will attach a price to this reduction of uncertainty (through, for example, its interest rates). So tariff differentiation for sustainability can be justified from a risk standpoint: clients with high environmental risks will pay a higher interest rate. The possibilities for tariff differentiation will be even larger if banks can attract cheaper money—by paying less interest for their own funding because of the relatively high quality and lower risk of their credit portfolio. This tariff differentiation by banks will stimulate the internalisation of environmental costs in market prices. In this sense, banks are a natural partner of governments.

A sustainable bank may well go a qualitative step further and contribute to sustainability on ideological grounds as well as on risk assessment grounds. Through their intermediary role, banks may be able to support progress toward sustainability by society as a whole—for example, by adopting a 'carrot-and-stick' approach, where environmental front-runners will pay less interest than the market price for borrowing capital, while environmental laggards will pay a much higher interest rate. This may result, at least initially, in a loss of profitability, but certainly doesn't require a loss of continuity.

The question is if, or to what degree, banks are willing to take such steps. Schmidheiny and Zorraquín's book, *Financing Change* (1996), asks the fundamental question whether banks are a driving force or a hindering force for sustainability:

> Do the financial markets encourage a short-termist, profits-only mentality that ignores much human and environmental reality? Or are they simply tools that reflect human concerns, and so will eventually reflect disquiet over poverty and the degradation of nature by rewarding companies that treat people and the environment in a responsible manner? (Schmidheiny and Zorraquín 1996: xxi).

Schmidheiny and Zorraquín conclude (based on interviews throughout the financial sector) that banks are not hindering the achievement of sustainability. We believe that this conclusion may be flawed. Intuitively, banks have a hindering role in the achievement of sustainable development. First, they prefer short-term payback periods, while many investments necessary for achieving sustainability must be long term. Second, investments that take account of environmental side-effects usually have a lower rate of return, while financial markets usually look for investments with the highest rate of return. It is therefore the case that sustainable investments are unlikely to find sufficient funding within the current financial markets.

In an economic paradigm of profit and benefit maximisation, companies and households will not take account of the environmental side-effects of their economic decisions as long as the environment is not represented in the prices on which they base these decisions. There will always exist an alternative investment that will yield a higher profit or benefit than an investment that takes into account all environmental side-effects. For example, an investment in a factory that legally pollutes heavily (and passes the cost burden onto society at large) will—*ceteris paribus*—have a higher rate of return than a factory that has invested in expensive technologies to combat that pollution. Banks will often reward the first company with a lower cost of capital or request for collateral. In the long run, an investment in the second factory would have been a better investment for the bank (and society at large), but, by the time the first factory is confronted by tougher legislation, greatly increased costs and even threats to its licence to operate, the bank has made its profit and pulled its money out of the factory (*ceteris paribus*).

If Schmidheiny and Zorraquín are right after all, then the 'highest return effect', as outlined above, has to be overcome by far stricter environmental legislation and enforcement or dynamic environment-related market developments. An alternative reason for banks not to hinder progress toward sustainable development is stakeholder pressure—such as NGOs, shareholders and employees—to act 'sustainably' (see section 3).

2 The environmental impacts of banking

To understand the environmental impacts of banks, one has to make a distinction between internal and external issues.[5] Internal issues are related to the business processes within banks, while external issues are connected to the bank's products.

Internal

Internally, banks are a relatively clean sector. The environmental burden of their energy, water and paper use is not comparable to many other sectors of the economy. However, the size of the banking sector overall is large enough to make the environmental impact significant. A research study among Dutch banks in 1995 reported that waste was perceived as the biggest single environmental issue faced by banks (SME Milieuadviseurs 1995). In addition, three-quarters of the banks interviewed claimed to be working on energy efficiency. In the Netherlands, banks used approximately 550 million kWh of electricity and 72 million m^3 of natural gas in 1996. The financial sector has also made a voluntary agreement with the Dutch government to cut its energy use by 25% from a 1995 baseline by 2006 (Jeucken 1998).

The potential energy savings of banks are huge, as can be seen by the achievements of the more proactive companies. Between 1990 and 1993, UBS reduced its energy use by 25% (UBS 1999). Between 1991 and 1995, NatWest saved approximately US$50 million in energy costs (NatWest Group 1998). The measures were taken not because of legislative pressure but because they were cost-effective. Some banks are also now using renewables, particularly solar energy (for example, some of the branches of the Rabobank Group). Other initiatives include the more efficient use of water and transport policies and the development of more environmentally benign credit cards. One of the leaders in such practices is the Co-operative Bank in the UK, who introduced the first biodegradable credit card in 1997—an affinity card that supports Greenpeace.[6]

Credit Suisse has developed an instrument to measure the environmental impacts of its bank which concluded that energy use is by far its most serious impact, accounting for 90% of all cumulative pollution within the organisation.[7] UBS came to a similar conclusion on the basis of its so-called 'Environmental Performance Evaluation'.[8] Other environmental reports from banks also concur that energy is the most significant aspect.[9]

However, the measurement of environmental performance and comparison of that performance between banks remains difficult. To address this, VfU (1998) has developed a methodology to standardise the measurement of environmental pollution within banks.

5 Labelled 'operating' and 'product' ecology by the VfU (1998) and the Schweizerische Bankiervereinigung (1997). See also e.g. the environmental report of UBS (1999) or Credit Suisse (CSG 1998).

6 http://www.co-operativebank.co.uk/greenpeace.html

7 The so-called 'Environmental Performance Indicators'. See http://www.csg.ch.

8 See UBS 1999. The methodology identifies business travel and paper consumption together as the second most relevant environmental issues.

9 See e.g. http://www.natwest.com; http://www.ing.com; http://www.bankamerica.com.

Parameter	LLB	LG	BLB	Allianz	CSG	UBS
Electricity consumption (kWh/employee/year)	2,886	4,627	4,816	4,110	7,500	7,300
Heat consumption (kWh/m²)	n.a.	n.a.	n.a.	n.a.	98	104
Water consumption (m³/employee/year)	145	98	100	76	119	94
Total paper consumption (kg/employee/year)	120	113	120	258	240	252
Copier paper consumption (pages/employee/year)	3,997	3,895	5,200	7,200	8,850	10,600
Computer hardware (numbers/employee/year)	0.5	0.2	0.3	1.03	n.a.	n.a.
Business travel (km/employee/year)	321	1,040	1,500	3,700	1,700	3,000
CO$_2$ emissions (kg/employee)	n.a.	n.a.	n.a.	n.a.	2,850	2,800

Table 1: INTERNAL ENVIRONMENTAL BURDEN OF GERMAN/SWISS BANKS
Source: European Commission DG XI (for LBB, LG, BLB and Allianz; 1996 figures);
CSG 1998 (1996 figures); UBS 1999 (1998 figures)

Table 1 presents the environmental impact of six German/Swiss-based financial institutions who have reported (partly) using this VfU methodology: three German banks (Landesbank Berlin [LBB], Landesgirokasse [LG], Bayerisches Landesbank [BLB]); a major insurance company (Allianz); and two Swiss banks (the Credit Suisse Group [CSG] and UBS).[10] The relative figures make it possible to compare the eco-efficiency of these institutions. Unfortunately, the tool does not take into account the size or specific operations of organisations, which leads to some anomalies. For example, smaller banks are obviously likely to use less paper, while multinational banks will incur a much larger score for (transcontinental) business travel. The VfU methodology certainly needs to be improved, but is a positive development towards standardised measurement of internal environmental performance in the banking community.

External

Here we consider the environmental impact of banks' products. The problem with this is that, contrary to other sectors in the economy, the products of the banks themselves do not pollute. Rather, it is the users of these products who impact on the environment. This makes it very hard to estimate the environmental impact of banks' external activities. In addition, to date, banks feel that external environmental care would require interference in their clients' activities. This is one reason why banks have been reluctant to promote environmental care on the external side of their business (even when they are likely to be exposed to risk). However, in recent years, by developing a selection of products from which a client can choose, banks have tried to cope with this dilemma.

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10 CSG has followed the lines of VfU in its environmental report 1997/98. UBS also published aggregate figures according to the VfU guidelines. It does not follow the guidelines, but publishes the figures to make comparison between banks possible. For other banks, it is not possible to extract the figures to the standardised VfU form.

One could take one of two extreme standpoints on the environmental impact of banks' products. On the one hand, all pollution caused by companies who are financed by banks is the responsibility of banks. It is easy to make an estimate of the environmental impact in this sense: it would equate to almost the aggregate pollution of the whole economy in many countries. On the other hand, as the products of banks do not pollute, the users of those products—the clients—should take sole responsibility for the pollution they create. Of course, both standpoints are absurd. The truth lies somewhere in the middle—as CERCLA has demonstrated in the US—but still remains almost impossible to quantify.

3 Driving forces to take action

There are both internal and external driving forces for banks to integrate sustainability within their day-to-day business and corporate policies. Internal driving forces are likely to emanate from employees, shareholders and the board of directors. External driving forces result from pressures from governments, customers, competitors, NGOs and society at large (the public). Whether banks are made liable for the environmental pollution of their clients or not, the risks of customers are also the banks' risks. If the continuity of a customer is threatened by new environmental legislation, the continuity of the bank will also be affected.[11]

However, driving forces derive not only from the need to minimise exposure to risk. There are also opportunities to be gained from moves towards sustainability—particularly with regard to new business. For example, ABN–AMRO and UBS have a growing interest in market developments for wind energy. Traditional forms of finance may be sufficient, but banks are also being challenged to develop new products that fulfil the specific needs of customers. The growing market for sustainable investment funds, such as the Storebrand Scudder Environmental Value Fund (WBCSD 1997) or the UBS Eco Performance portfolios (UBS 1999), is a good example of this trend. The growing importance and number of such funds illustrates that competitive pressures are driving more banks to diversify their product range in response to market demand.

Governmental policy is another major driving force for banks, particularly with regard to internal aspects. To date, banks have reacted cautiously to government attempts to legislate on their external side and are unwilling to become the enforcers of government policies (see section 5). Other driving forces include the changing expectations of society, media, suppliers, other financial institutions (such as rating agencies and The World Bank), employees, boards of directors, shareholders and various kinds of NGO such as Greenpeace and the World Business Council for Sustainable Development (WBCSD). Figure 2 presents an overview of the internal (the middle circle) and external (the outer circle) stakeholders of banks.

4 Actions taken by banks

To understand the actions that banks are taking towards sustainability, we have identified four stages or attitudes. Although each bank will normally go through all of these

11 Of course, a distinction has to be made between the environmental risks of private and business clients. Furthermore, clients may have conflicting interests; large banks in particular will need to pick the best of both sides—for example, support organic farmers while still financing more intensive agriculture: a problem that faces the Rabobank Group in the Netherlands.
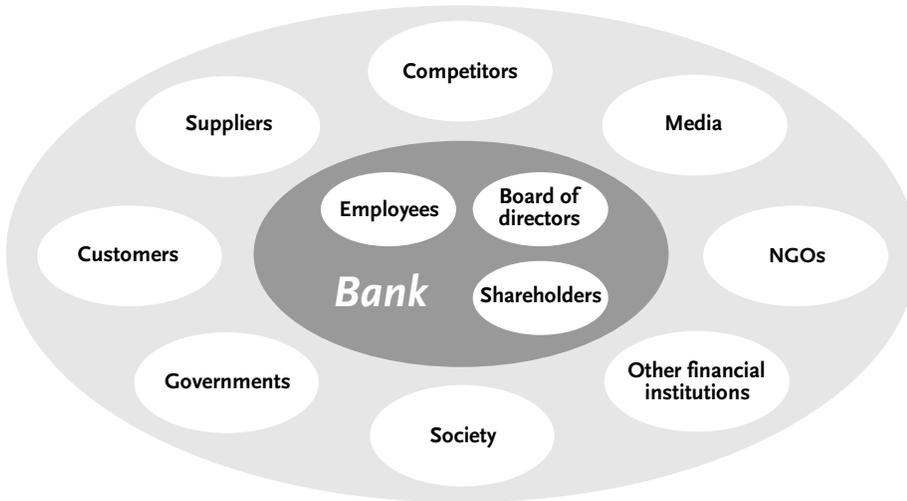
The inner circle represents the bank and its internal stakeholders;
*the outer circle contains the external stakeholders.*

Figure 2: A BANK'S INTERNAL AND EXTERNAL STAKEHOLDERS
Source: Based on Jeucken 1998

stages, some banks will probably never reach the holistic final stage which will continue to evolve as stakeholder expectations change. Also, some banks, mostly niche players, will skip the first and second stage. This model is depicted in Figure 3. Each outer layer contains the previous layer (with the exception of the first layer, 'defensive banking'). In other words, sustainable banking will contain the characteristics of both preventative and offensive banking.[12] In principle, banks develop from the inner layer (defensive) to

Figure 3: A TYPOLOGY OF BANKING AND SUSTAINABLE DEVELOPMENT
Source: Jeucken 1998

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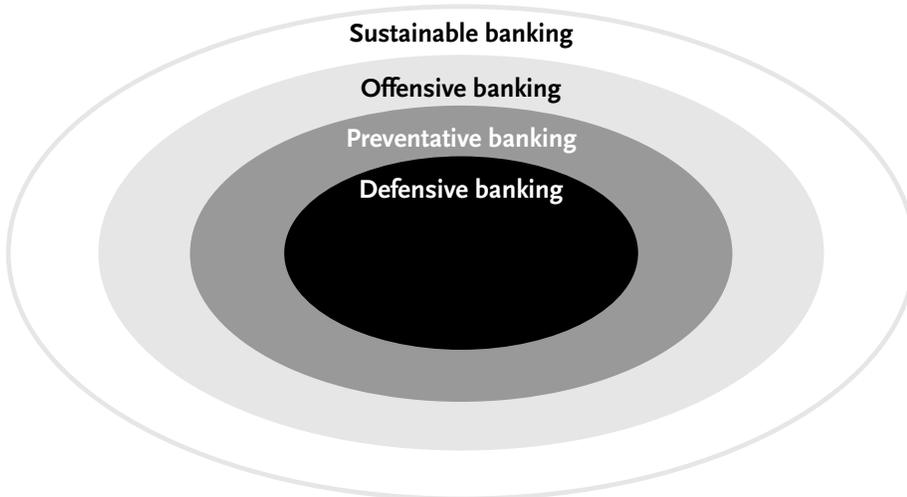
12 Note that the terms 'defensive', 'preventative' and 'offensive' are defined in relation to environmental issues.

the outer layer (ultimately sustainable). Although the model will be used in relation to banks as a whole, it can also be used with regard to the differing stage developments of departments within banks. Because the general aim is to determine at which stage one can classify a bank as a whole entity, this differentiation between departments does not invalidate the model. This differentiation will be of use from a standpoint of strategic management within companies or banks.

The first stage is **defensive banking**. In this stage, a bank is non-active and may even try to delay or oppose new environmental legislation, because it may damage the interests of the bank directly or indirectly (through damage to the profitability of customers). Opportunities from cost savings through initiatives such as energy efficiency are not taken up. Environmental management is seen as an avoidable cost. Very few banks in the North can said to be at this stage today, but certainly some departments of banks or niche players—particularly within investment banking—still show symptoms of this attitude.

The second stage is **preventative banking**. This stage diverges from the previous stage, because potential environmental cost savings and eco-efficiencies are actively taken up. Preventative banking is in some ways inevitable because government and NGOs will directly or indirectly put constraints on the activities of banks, through legislation, social pressure or jurisprudence. Preventative banks will integrate the potential revenues, costs and risks into their day-to-day business. However, banks at this stage will only consider their internal processes such as environmental management and credit risk assessment. The National Westminster Bank has, for instance, cut back drastically on energy costs through energy efficiency. Another example is the reduction of credit risk by integrating environmental issues in the credit risk assessment processes (for example, UBS, Bank of America, Deutsche Bank and ING Group). UBS is also integrating environmental issues into its investment banking branch (Warburg Dillon Read). This so-called 'Global Environmental Risk Policy' for investment banking activities was implemented in February 1999 (UBS 1999) and is the first such initiative by a major bank. Although the nature of this initiative is preventative, it will only be found in banks who are also offensively oriented (as shown below, UBS is also very active in the offensive stage).

Banks in the third stage of **offensive banking** consider their external activities in addition to the internal. In other words, they are also developing and marketing environmentally friendly products. Examples include the development of environmental investment funds (such as the Storebrand Scudder Environmental Value Fund and the Eco Performance portfolios of UBS), the financing of sustainable energy (such as the so-called Solaris Project, a collaboration between Greenpeace and the Rabobank Group [Rabobank International 1998]) and the signing of the UNEP Banking Charter (by organisations such as Bank Austria, UBS, Kenya Commercial Bank Group and Salomon Inc.[13]). Banks will also report on their environmental activities (see, for example, the environmental reports of the Bank of America, UBS, Credit Suisse, ABN-AMRO and Barclays Bank). The attitude can be labelled as proactive, creative and innovative. Offensive banks are continuously looking for win–win solutions. The problem is that, as long as negative environmental costs are not completely integrated into the price system, win–win solutions will not lead to sustainability.

In the fourth stage of **sustainable banking**, while win–win solutions are embraced, the corporate philosophy also fosters projects at a higher risk, lower rate of return and longer payback periods. The bank does not look for the highest financial rate of return, but for the highest *sustainable* rate of return, while being profitable in the long run. Such banks require that their shareholders have the same vision and ambition. Unfortunately,

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13 See http://www.unep.ch/eteu/envr-fin.htm.

the current status and demand for sustainability in society is not sufficiently developed to make the goal of sustainable banking possible for large banks. Such policies would result in a loss of profit, as the bulk of their current activities simply could not be financed. At this time, the goal of sustainable banking appears to be feasible only for niche players such as the Triodos Bank in the Netherlands or the Co-operative Bank in the UK.[14]

On an even smaller scale, Debt-for-Nature Swaps (DNS) and micro-credit are interesting examples of elements of sustainable banking (see e.g. *Latin America Weekly Report* 1994; World Bank 1996; OECD 1997). DNS involves exchanging a part of the huge outstanding debt of developing nations for an obligation by that country to put measurably more effort into nature conservation. Another example that contains characteristics of sustainable banking is the initiative of various Swiss banks; and also Den Nordske Bank's directed tariff differentiation (the above-mentioned 'carrot-and-stick' approach).[15] In these cases, banks look not only at environmental risks (a negative driving force) but also at stimulating certain developments in society towards sustainability (a positive driving force). It may mean that a bank will not invest in a financially sound business if it is ecologically unsound. Again, this may mean a loss of profitability (business) or even continuity for the bank— unless all banks were to act on a similar basis. The Swiss initiative is interesting for exactly this reason, as a majority of Swiss banks are involved (but not all—leaving opportunities for 'free-riders'). Another example is the Co-operative Bank in the UK, which has made a pledge to its customers not to invest in socially or environmentally damaging sectors such as tobacco production. Companies who are deemed acceptable are eligible for favourable interest rates, with higher interest rates on savings and lower interest rates on loans. The net earnings/savings for a company can be as high as 30% when compared with standard interest rates.[16] A final example is ASN Bank in the Netherlands which has launched an interest-free fund: investors who want to foster sustainability but do not require any financial return are in this way funding the activities of some (selected by ASN) front-runners in the environmental, social or equity (North–South) field.[17]

5 The role of governments in sustainable banking

As discussed above, the major environmental impacts of banks are not physically related to their production processes and products, but to those of their customers. This has historically created difficulties for policy-makers. However, some governments are now becoming increasingly concerned about the intermediary role banks play, particularly in the achievement of environmental policies.

In the Netherlands, environmental policy has taken a unique course with the establishment of national environmental targets as stipulated originally in the National Environmental Policy Plan (NEPP) (VROM 1989) and the National Policy Plan Plus (NEPP+) (VROM 1990). These policy plans provide environmental targets for several sectors of the Dutch economy: agriculture, industry, transportation and consumers. By examining the progress of Dutch national environmental policy over the last ten years, it is possible to identify different stages in the development of such proactive environmental policies.

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14 See http://www.triodos.nl *or* http://www.co-operativebank.co.uk.

15 See van der Woerd and Vellinga 1997 or http://www.unep.ch/eco.

16 See *Green Futures* 1998 or http://www.co-operativebank.co.uk/ecology.html.

17 This initiative is of particular interest to those who do not wish simply to donate money for certain projects, but want some kind of market control on how their money is being spent and controlled. See http://www.asnbank.nl.

In the NEPP, the banks were not direct players in the design of environmental policy but were confronted with the clean-up costs of their customers. However, these financial burdens did not significantly affect the banking sector as they did not generally result in bankruptcies. As a consequence of compliance with environmental standards, new industrial sectors quickly evolved that specialised in environmental technologies. Banks began to develop special funds that invested in this sector—a side-effect of the environmental policy. Clearly, banks started to become more offensive through the identification of environmental challenges that were accelerated by the governmental policies that promoted environmental technologies.

The following stage, the NEPP+, featured the growing importance of voluntary agreements between industry and governments. Environmental objectives and plans to reach these objectives were formulated in dialogues between large industry groups and government. Once again, banks were not directly involved in this process.

However, in the third and current stage, as laid out in the so-called 'Policy Document on Environment and Economy', the environment is no longer the exclusive concern of government and the direct polluter, but also of other business partners and intermediaries such as the financial services sector (VROM 1998). In this stage, the life-cycle approach became integrated into environmental policy. The continuous improvement of products, the use of environmental management systems, and instruments such as environmental reporting were widely implemented by industry. Government strategy was to decrease direct involvement and increase the responsibility of the polluting target groups in reaching objectives. Moreover, financial institutions were directly addressed by Dutch environmental policy for the first time as part of this process. In contrast to the first and second stages, where the environmental policy of the government set the environmental context in which banks operate, this third stage involved the banks as a player in designing environmental policy.

As a consequence, the role of the government in the Netherlands is now to stimulate, facilitate, monitor and actively co-ordinate. To this end, a variety of tools are used: the financial support of environmental sound product development; the development of an environmental information exchange system; financial instruments such as green investment; eco-labelling; exploration of life-cycle methodologies and eco-indicators; green procurement; the stimulation of sustainable consumption; and the introduction of a product-oriented environmental management system.

Because mandatory regulation of extended or shared responsibility on the total environmental impact of products is almost impossible to impose on all market actors, other means have been sought to implement this voluntarily. Banks have been at the heart of this process. For this purpose, the 'Environmental Dialogue between Banks and Governments' was established in April 1999 in the Netherlands in an attempt to stimulate environmental improvements through the development of new financial products and services and through an optimal match between the environmental and fiscal policy of the government. The policy goal is to further explore ways in which banks can stimulate sustainable development. Standardisation of the environmental information provided by companies (indicators), benchmarking between banks, and developing fiscal and financial instruments are cited as main underlying aims. At the first meeting of the 'Environmental Dialogue between Banks and Governments' five observations were made as starting points (VROM 1999):

1. Banks have already taken a number of steps in assuming responsibility with regard to the environment; it is unclear to what extent these activities are to be regarded as niche or mainstream activities.

2. The Dutch government has made a formal request in its Policy Document on Environment and Economy (1998) to banks to play a role in achieving a sustainable development.

3. The stage of policy development regarding the role of banks in the European Commission is at the same level as that of the Dutch environmental policy.

4. At a global level, the financial sector is encouraged to take a role in sustainable development through the UNEP initiative.

5. There have been specific developments related to the introduction of policy instruments such as tradable permits, joint implementation and the clean development mechanisms of the Kyoto Protocol.

It would appear that, even in an environmentally advanced country such as the Netherlands, constructive dialogue between banks and governments has only just begun. However, it is clear that there is considerable scope for the process to advance.

6 The dynamic and changing role of banks

The banking sector has taken some steps to stimulate sustainable development. However, because of the critical role that finance plays, much more needs to be done. International institutions such as UNEP must continue to increase the awareness of banks and hence stimulate new product development. The World Bank must draw attention to the relationship between the environmental impacts of investments and financing decisions. And banks themselves must engage further with their customers, rating agencies, insurance companies, competitors and governmental policy-makers in order to establish:

▶ The role of different actors in achieving sustainable development

▶ The motives of actors for incorporating environmental awareness into their decision-making

▶ The rules of the game for banks (e.g. transparency issues, codes of conduct and legislation)

▶ The products and services banks offer to their customers

▶ The products and services that are offered to banks by the other actors

▶ The stimuli and impediments for the further development and success of the products and services offered by the banks

Ecologic and Delphi International state in their recent report to the European Commission that, if financial institutions are to integrate environmental considerations into their decision-making, they need to be convinced that not only are they profitable in the narrow sense, but they are also sufficiently important to merit their attention (European Commission DG XI 1997). This may be a serious obstacle in the real world, despite the fact that good environmental performance is often linked to good financial performance (WBCSD 1997). For many banks, it is questionable whether this link is strong enough to make the environment a critical feature of investments. It is likely that this link needs to be strengthened by addressing:

▶ The significance of environmental performance to financial risks and returns on investments

► Taxation schemes (e.g. tax credits for good environmental performance)

► The quality of communications by firms to financial institutions about their environmental performance

Currently, there are wide geographic and organisational differences in how banks relate to their stakeholders' concerns about sustainability issues. This is true even within the EU. To gain further insight into the possibilities of the financial sector playing a constructive role in sustainable development, multinational studies need to be performed that adapt the framework according to the specific circumstances in a country. However, focusing only on the financial products and services that financial institutions offer in a country is not sufficient. The interplay between the actors will determine the success of the financial products and services. By comparing the behaviour of financial institutions (the financial products and services they offer and the internal processes of the banks) in conjunction with the context as shaped by the other actors, proposals for all actors can be formulated that contribute to a more constructive role for the financial sector in progressing toward sustainable development.

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