

UK Parliament Environmental Audit Committee

9th March 2010 meeting on UKFI and the low carbon transition

Written evidence submission from the Royal Bank of Scotland Group

Executive Summary

- RBS welcomes the opportunity to contribute to this enquiry on the role we can play in financing the transition to a low carbon society.
- We support the ongoing international negotiations to put in place a binding global framework to address climate change by capping annual emissions at a level deemed to be acceptable by the Intergovernmental Panel on Climate Change. We believe that climate change can only be addressed by concerted multi-stakeholder action, involving national governments, local authorities, NGOs, businesses and consumers.
- Through our existing business, we provide a wide variety of services in support of low carbon sectors and RBS has historically been the leading UK bank in arranging finance for renewable power projects globally. Our appetite in this sector remains strong, as demonstrated by our participation in the recently announced £1.4billion EIB wind power lending scheme.
- Due to the higher credit risks involved, we are generally unable to lend to clients and low-carbon technologies at the experimental or earliest stages of development. However, we would welcome further discussion with the UK Government on how the finance sector could mitigate or share these credit risks with other parties.
- As a major bank to the energy sector, we have a broad range of clients whose operations are currently focussed on hydrocarbon extraction and power generation. Given the current energy dependency of the UK and other countries on hydrocarbons, and the current technology, planning consent and other limitations on the realistic projected growth rate of viable alternatives, we do not believe that RBS should unilaterally scale back its involvement with these clients, but instead should engage with the energy sector to support the development of cleaner technologies and increased investment in renewable energy.
- Whilst we recognise that UKFI can play a role in tackling these issues, we believe that focussing additional initiatives through UKFI risks being ineffectual by excluding the rest of the financial services industry and by only being a short term arrangement or policy.

Introduction

The Environmental Audit Committee's objective for this enquiry is to "examine what scope exists for UK Financial Investments to support the transition to a low-carbon economy within the rules that govern what it does, what could be done if these rules were changed and what would need to happen to make this possible" (Clerk of Committee Announcement, 4 February).

To assist the Committee with this enquiry, this submission provides:

1. A brief overview of RBS businesses.
2. Information about RBS' current work to address environmental challenges and opportunities through the RBS Environment Programme.
3. Information on reporting and disclosure and RBS' ratings with sustainable investment indices.
4. Commentary on the options for further support of the low carbon transition.

Section 1: Overview of RBS business

The RBS group is a large international banking and financial services company, headquartered in Edinburgh. The Group operates in the United Kingdom, Europe, the Americas and Asia, serving more than 40 million customers worldwide, including 25 million in the UK.

RBS Group's banking network in the UK includes a comprehensive range of services for personal customers including current accounts, mortgages, loans, savings and investments. Through our corporate and commercial arms, RBS caters for small, medium and large enterprises and can provide the full range of finance, investment and advisory services for these organisations as well as asset finance services through Lombard. RBS is also the UK's second largest insurance provider, offering home, motor, travel and pet insurance through brands such as Direct Line, Churchill and NIG. Finally, through its Global Banking and Markets division, RBS offers an extensive range of investment banking services including risk management, debt advisory, debt capital markets, interest rate, currency, credit, equities, foreign exchange, commodities, treasury and investment products, M&A and advisory services.

Section 2: The RBS Environment Programme

2.1 RBS position on climate change and the transition to a low carbon economy

RBS supports a binding international legal framework to address climate change. Such a framework would help give renewable energy developers, and by extension banks, the confidence to make long term investment decisions. With or without a framework, only co-ordinated multi-stakeholder action will be sufficient to bring about the structural changes that are required to stabilise carbon dioxide emissions at the 450 ppm level recommended by the IPCC. To communicate our support for binding international targets to policymakers, RBS was a signatory of the *Copenhagen Communiqué*, an open letter from businesses co-ordinated by the Prince of Wales' Corporate Leaders Group on Climate Change.

Alongside collaborative initiatives such as this, we also proactively engage with NGOs and other organisations to discuss environmental issues. We hold several meetings per year with environmental groups and take part in multilateral round-table discussions and consultations on the solutions to the climate change challenge.

In July 2008 we organised the UK Low Carbon Economy Summit in London in partnership with the UK Government at which Prime Minister Gordon Brown addressed a large audience on the decarbonisation of the economy. We have also taken part in a number of UK

Government consultations and are currently one of the sponsors of a Royal Society of Edinburgh enquiry into mitigation of climate change.

2.2 Governance and Policy

Within RBS, environmental issues are overseen by the Environment Working Group (EWG), an executive-led forum with representation from across the company that meets four times per year. The EWG reports into the Board-level Group Corporate Sustainability Committee (GCSC) chaired by our most senior Independent Director, Sir Sandy Crombie. The GCSC is comprised of some of the most senior executives in the organisation, and has a remit to oversee the full range of sustainable business issues including fair banking, diversity and environmental impacts. The EWG and GCSC have the ability to set overall strategy for the Group.

RBS has had a Group Environment Policy in place since 1997 and this policy was most recently updated in 2009. We have also adopted a number of external principles and are adopters of the Equator Principles for Project Finance, the UN Global Compact, and the UN Environment Programme for Financial Institutions.

2.3 Development of environmentally tailored products and services

2.3.1 Financing for renewable energy

Our financing of renewable power projects and clients operating in this area is perhaps the most obvious example of our pro-active engagement with the low-carbon transition. Within Structured Finance, RBS has a specialist renewables team who are actively engaged with governments and other key stakeholders to ensure that this sector makes the necessary contribution to the long-term transition to sustainable energy sources.

Because of our strength in this area, RBS was recently confirmed as one of three banks participating in a wind financing scheme backed by the European Investment Bank (EIB). The scheme will make up to £1.4 billion available to qualifying onshore wind power projects over the next three years and its introduction was supported by HM Treasury and the Department of Energy and Climate Change. The EIB will provide up to £700 million for up to 50% of total eligible project costs, with the remainder coming from a mix of sponsor equity and commercial debt from the participating banks (RBS alongside Lloyds Banking Group and BNP Paribas Fortis). The loans will be available to eligible onshore wind projects with a total project cost of between £20m and £100m. RBS is extremely pleased to have been selected to take part in this initiative, a decision which was based on our expertise and strength in this field.

Our Lombard asset financing businesses is also increasingly active in the smaller renewable energy market, and has recently been involved in a deal to retain wind turbine manufacturing capabilities in Scotland.

In the three years prior to 2009, RBS was typically arranging c.US\$1.5 billion worth of renewable energy transactions per year, and in 2006 was ranked as the world's leading arranger of finance for the renewable energy sector by Environmental Finance magazine. To put this in context, RBS has been amongst the industry leaders globally in this respect during a period when no other UK bank has been consistently in the top 15 list. RBS designed the financing techniques for many of the market's earliest transactions and continues to innovate.

With regard to the different renewable energy technologies available, RBS is best positioned to assist with the more 'proven' projects where risks are lower and cash-flows more robust and predictable. This means our current focus is predominantly on on-shore and off-shore wind, offshore transmission, selected biomass technologies, and certain solar PV projects.

Technologies that are still largely at the developmental stage, such as wave and tidal power, some geothermal applications and some types of solar, represent a higher credit risk. These projects are therefore typically more suited to equity investors who will demand higher returns to compensate for the additional risks that they are taking. RBS does not typically offer this

type of finance and is unlikely to in the future due to the higher risks involved. However, to the extent that any of the emerging technologies becomes more proven, and with appropriate regulatory support, it is probable that senior debt might begin to become available for it.

Another related technology which at present falls into this higher risk category is carbon capture and sequestration (CCS). The technology remains unproven on a commercial scale however we are monitoring developments closely and engage in discussions with clients over potential funding solutions. In March 2007 we provided grant funding for a project with BG Group and Scottish Power to evaluate the potential of using CO₂/flue-gas injection in Scotland as a way of enhancing methane recovery and storing CO₂ within coal beds.

2.3.2 Financing for energy efficiency

Alongside renewable power, energy efficiency represents another important part of the transition to a low carbon economy. Advances in energy efficiency tend, however, to be more incremental and less capital intensive than renewable power developments, so we find there is currently less need for large scale financial products as with renewable power.

We are, however, working to develop innovative financing mechanisms for large organisations such as local authorities that will allow them to install the necessary energy efficiency technologies without initial capital expenditure. This will be achieved by essentially securing the loan against future savings to utility bills.

We have also investigated the potential to provide tailored loans to homeowners and landlords to install energy efficiency measures. At present, however, the various grant mechanisms available and access to conventional bank loans mean we are not actively pursuing this area. This also appears to be the approach taken by most other UK banks.

2.3.3 Business and commercial banking

Environmental issues are becoming a major strategic driver for many of our business and commercial customers. We offer paperless banking options and have also developed a specific service for our small and medium-sized enterprise (SME) customers that is an extension of our 'Business Mentor' service. Business Mentor Environmental provides businesses with expertise, advice and tools from our qualified environmental consultants to help them address environmental issues in their businesses.

2.3.4 Public and not-for-profit sectors

RBS is the leading relationship bank to UK Local Authorities, has banking relationships with over 60% of the higher education sector and is also the largest charity banker in the UK. An example of our work in engaging with these clients on climate issues is the creation of the UK's first structured finance solution for Energy Performance contracts in partnership with the London Development Agency and Greater London Authority. The resultant Building Energy Efficiency Programme was launched in December and provides a model for large scale energy efficiency retrofits to public buildings. In partnership with the LDA and the GLA, RBS has also led the development of the London Green Fund model, which will provide a source of finance to a wide range of smaller scale environmental projects and businesses in London.

RBS also holds a leading market share in the funding of regeneration projects and investment in areas of inner city deprivation. By making use of existing 'brown field' or high-density inner city sites, these developments ease pressure on surrounding 'green field' sites and reduce traffic congestion and emissions caused by commuting.

2.3.5 Personal customers

We have several initiatives in this area. To reduce the impact of our conventional banking services, we have so far encouraged c. 6 million of our UK customers to switch to paperless banking and in the US have launched our Citizens Bank GreenSense account. This account rewards customers 10 cents for every paperless transaction they make and so far over 65 million paper transactions have been avoided.

In 2008/09 we launched our Green Edition Combi-Saver Products for personal investors, which produces returns linked to the RBS Green Index - a 'basket' of green technology and renewable energy companies. These products were very popular, with over £500million taken in deposits, and we have gone on to develop more eco-themed investment products.

In 2008 we launched a pilot Solar Mortgage product in Northern Ireland through Ulster Bank in partnership with a leading solar panel installer, Solar Century. The product enabled homeowners to incorporate the cost of a discounted solar PV installation into their mortgage, effectively borrowing at a very low rate. Unfortunately the product was not successful, partly due to a sharp decline in Northern Ireland's property market. Our subsequent research showed that homeowners who were considering solar panels often either had the money already or preferred to arrange their own installation and take out a conventional loan for part of the cost. We are however continuing to research ways of further developing an offer of this sort, particularly in light of the micro-renewables feed-in tariff.

2.3.6 Reducing the environmental impact of our own operations

Because of our size, the environmental impacts from our properties – primarily caused by energy consumption, travel, water and paper use - are significant. In the UK and Ireland, we currently procure 92.2% of our contracted electricity from renewable sources and our standard office paper has 80% recycled content. We have many other initiatives in this area, although as this is not within the scope of the EAC's investigation, we would direct interested parties to the sustainability pages of our website for more information.

2.4 Dealing with environmental risks in our lending and client relationships

2.4.1 Our wider role as an energy financier

RBS provides financial services to several of the world's leading energy companies, many of whom have operations that are predominantly fossil-fuel based. Fossil fuels still account for at least 80% of total global energy provision and the rapid growth of alternative sources of energy will take at least a decade to start replacing fossil fuels on a large scale. Many of these clients are themselves also major investors in renewables, although this part of their business is often on a smaller scale than their fossil fuel and/or nuclear operations at present.

The majority of the financing we provide to such companies is in the form of general corporate credit facilities that are not tied to any particular project or operation. Much like the provision of an overdraft facility to a personal customer, such credit facilities are negotiated on the basis of a client's ability to pay the money back and the overall strength of their business. We have policies and procedures in place which aim to ensure that we only provide services to companies whose activities meet all relevant standards applicable to their business and area operations. We will also take steps to proactively engage relevant clients on specific Environmental, Social and Ethical (ESE) issues should they arise.

The provision of financing tied to a specific project, such as an individual power station is dealt with by our structured finance teams using agreed processes and procedures to assess environmental and social risk factors alongside legal and financial issues. RBS was one of the ten initial signatories of the Equator Principles, which were launched in 2003 and are the leading voluntary social and environmental risk assessment mechanism for project finance transactions.

2.4.2 Our risk mitigation processes

RBS is currently in the process of updating its ESE risk policies for the Group, including further development and implementation of ESE sector policy standards and risk decision support tools. These policies are aimed at higher risk industry sectors in which the bank conducts business, such as oil and gas and mining and metals. The ESE Risk Policy Framework to be applied internally will further strengthen the process of ensuring ESE issues are taken into consideration in lending and credit provision decisions.

Training and awareness-raising programmes on the enhanced ESE risk policy framework will be employed once this updating process is complete (Q3-4 2010) to ensure users of the policies and tools can effectively assess and manage these ESE risks for RBS.

Section 3: RBS reporting and disclosure and rating by external benchmarks and indices

3.1 Public reporting and disclosure

RBS has been reporting on our approach to sustainability since 2003, and since 2004 our reports have been externally verified by Deloitte. Our most recent report was accredited to the new AA1000 2008 reporting standard for openness and transparency - the first bank globally to receive this. We have also supported and responded to the Carbon Disclosure Project (CDP) since its inception and over the last 6 months RBS has been involved in a pilot project to develop a new CDP initiative. Our annual submission to the CDP is openly available online and we were included in the CDP's FTSE 350 Leadership Index in 2009.

3.2 RBS rating with external benchmarks and indices

RBS has been included in the Dow Jones Sustainability Index since its inception in 1999, placing us amongst the best performing 15% of companies who take part in the DJSI. This index is used by investors to assess performance on sustainability issues. We have also been consistently included in a range of other indices, such as the FTSE4GOOD in the UK, where we have also been a member since inception in 1999.

Section 4: Options for further support of the low carbon transition

RBS welcomes further dialogue about the role that we can play to support the transition to a low carbon economy. With or without the public stake in RBS via UKFI, this would continue to be an important area of focus for RBS, as it is for our peers in the financial services sector. We are currently financing as many commercially-viable renewable power projects as we can, provided they meet our criteria and our offers are attractive to clients. Our partnership in the £1.4 billion European Investment Bank onshore wind scheme is a clear example of our commitment in this area.

However in our experience the growth of this market for finance is driven by other factors than the perceived availability of bank funding, including planning permission, connections to the grid and the number of active developers. Beyond the commercially-proven renewable energy technologies, we are generally not currently able to invest significantly in technologies at an early stage of development due to the various risks involved such as technology and infrastructure uncertainties, fluctuating energy prices and pending regulatory approvals. These types of hurdles are not insurmountable, but if RBS were to significantly increase its involvement in such projects a solution would need to be found to mitigate the credit risks to us.

This raises a fundamental question about whether RBS should be expected to subsidise the growth and development of a particular sector - and consequently the success of private companies that operate within it. This question is brought into even sharper focus by the financial situation that RBS finds itself in, which has been serious enough to warrant the assistance of the UK Government and the subsequent capital injection and shareholding by UKFI. UKFI's key responsibility is to maximise sustainable value for the taxpayer by reducing its stake in RBS and other banks in a timely and ordered way. In order for that to happen, RBS must return to financial health as soon as is practicable and possible, which to some extent restricts our ability to support other policy objectives. A significant change of our investment mandate would also require approval from RBS's minority shareholders.

The Environmental Audit Committee is considering whether the creation of additional rules for UKFI could help accelerate the transition to a low carbon economy. As one of the world's largest existing financiers of renewable energy generation, RBS would be very willing to support the development of new approaches for funding renewable energy generation and other lower carbon technologies. However, we have some concerns that a UKFI solution would only be a short-term one and would not affect the majority of the finance sector that is not UKFI-owned. This would also introduce a distortion in the market, since not all banks would be operating in a consistent manner.

A more viable alternative may be for the Government to support the development of a sector-wide fund to lend to newly established developers and emerging technologies. The UK Government could potentially provide some form of risk guarantee which would be activated in the event of projects failing in order to address the banks' credit risk concerns with such ventures.

At the domestic and householder level, we believe the Government is already adopting the right approach through the introduction of the feed-in tariff scheme for micro-generation which has worked so effectively in Germany and other countries. This move will transform the attractiveness of micro-renewables for homeowners and importantly puts the emphasis of financial support on actual generation of power rather than just the installation of equipment.

We are already involved in dialogue with Parliamentarians and relevant Government Departments on these and other issues and would welcome further interaction, including a broader debate about mechanisms to incorporate the environmental costs of fossil fuel use into energy prices, and our disclosure of enhanced information to investors and other stakeholders on carbon risks and opportunities.