Increased environmental awareness: turning it into business opportunities

by Susan McGeachie and Sarah Parkinson

In the world of Lord Nicolas Stern, a former adviser to the British government on the economics of climate change and development, and a former chief economist of the World Bank, "Banks are about managing risks and financing opportunities."[1] While Canadian banks have shown progress in managing environmental risk, they now need to become more actively involved in environmental product and service opportunities in order to harness public awareness of environmental issues and to position themselves for pending climate change regulation.

[1] "Big Banks Ranked on Climate Change Practices," Environment News Service, January 11, 2008.

The issue of the environment is no longer only at the doorstep of every Canadian bank; it now has a foot firmly in the door. Over the past 12 months, growing public awareness of environmental issues has raised the topic's ranking on the corporate agenda. While Canadian banks have shown progress in addressing stakeholder concerns with respect to the environment, such as in-house emissions tracking, risk management or green procurement, related product and service offers remain an area of growth in Canada. Moving forward, products and services that address heightened public awareness of environmental issues will need to continue to be an integral component of each bank's sustainability strategy. Emerging best practices of global leaders provide a number of innovative ideas and climate change solutions from which to draw inspiration.

Without a doubt, the "hot" environmental issue in Canada right now is climate change. Climate change presents an unprecedented and multidimensional issue for Canadian banks. At this stage in Canada's climate change "journey," a primary consideration for banks is the state of public opinion. A poll conducted by the Strategic Counsel in December 2007 found that of all threats facing the world today, climate change topped Canadians' lists (36%) more than any other[2]. Last fall, data from the Environmental Monitor research program revealed that two thirds of Canadians rated climate change as a very serious problem, up from 57% the year before[3]. These results are representative of the upward trends in public opinion noted in other polls conducted in Canada last year.

Heightened public concern and awareness on any issue poses a threat to a bank's reputation, brand and customer loyalty, especially if that issue affects a number of customer segments. To that point, of particular interest to Canadian banks is an Angus Reid poll conducted in March 2007, which found that environmental concern in Canada, unlike past social revolutions, is not driven only by the young; it concerns Canadians of all ages, particularly those over 50[4]. These customers may increasingly not only be concerned about the reputation of the institution they deal with, but also interested in differentiating between the products and services they buy.

To date, only a modest number of products and services that focus on addressing the growing public concern for the environment have been launched by Canadian banks in the retail banking space. The current scope of environmentally-friendly products includes the ability to receive bank statements electronically, rebates on switching home or business electricity to alternative energy sources and "green" retail mortgages. These products and service offerings are presently not targeted at specific customer segments, but instead are aimed at customer preferences across all segments. Moving forward, banks will need to focus on innovation to both seize opportunities (e.g. develop segment-specific offerings) and to minimize reputational risk. Product offers that demonstrate concern for the environment, are transparent to the end user and don't come at a premium price, are the ones most likely to succeed.

European banks have a head start on incorporating climate change mitigation elements into retail banking products. This has been driven, in part, by the fact that in the past, concern for the environment in Europe has surpassed that in North America; it has also been driven by existing environmental regulation across the region. A select few European banks have recently appealed to strong customer awareness regarding climate change and the environment with specific credit card products. Credit card products offer an interesting case study. Unlike mortgages, credit cards are used by a large majority of the public. These products are also backed by large marketing campaigns that can effectively reach the public and speak to current opinion.

Barclays and Rabobank have trailblazed environmental credit card offers in the retail banking space. With it's recently launched Barclaycard Breathe credit card, the bank will

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[2] CTV.ca, December 10, 2007.
[3] "Climate change alarms Canadians, poll finds", The Gazette, September 5, 2007.
[4] "How deep a shade of green", Toronto Star, March 30, 2007.

donate an impressive 50% of net profits to projects that tackle climate change. Structured slightly differently, Rabobank's Climate Credit Card offsets carbon dioxide emissions generated by customer purchases of products and services by procuring carbon dioxide emission rights (offsets) to renewable energy projects, both domestic and in developing countries. Boosting credibility, both banks' solutions are administered by independent third parties. With each card, there is a direct and relevant link between how an individual uses the card and the resulting contribution to the environment.

Reward credit cards have traditionally been used to drive customer acquisition and loyalty. Furthermore, the premise of the reward credit card is to offer relevant and tangible incentives (e.g. air travel, cash dividends or groceries) to customers for transaction use. Customer acquisition and loyalty continue to be key elements of these "green" card offers. However, it is the intangible aspects of the incentives and the end-to-end environmental strategy that make these cards innovative. The principal "reward" to a customer is not an item or service, but a sense of satisfaction at having contributed to climate change mitigation. The rewards are complimented by a holistic focus on the environment, are transparent and, as highlighted above as best practice, do not come at an extra cost to the customer. In the case of Barclaycard, the actual card is made from environmentally-friendly materials and customers receive special discounts and offers on public transit and greener goods. Marketing materials, statements and other maintenance services are only available online. For banks, hitting the customer's sweet spot of goodwill is, to quote a leading credit card payment processor, "priceless." It is this type of innovation and positioning Canadian banks need to develop and explore with their own products.

Regulations are another primary consideration for Canadian banks. Both the federal government and the provinces are in the process of expanding regulatory frameworks to address climate change. While the details of the federal plan have been announced and are due to be enforced starting in 2010, the likelihood that this proposed framework will one day become legislation remains uncertain. The probability, however, that some form of federal regulation will be enacted is far more certain. Regulations are bound to have a material impact on customer opinion and behaviour, as well as on the business practices of corporate clients and the banks themselves. Shifting behaviour and business practices are agents of opportunity and thus it is in the banks' best interest to be prepared for such events. The absence of a regulated carbon market in Canada today is partially responsible for creating a gap between Canadian banks and their global counterparts with respect to activity in the regulated and voluntary emissions markets.

European financial institutions have gained experience in emissions trading due to the fact the European Union Emissions Trading Scheme (EU ETS) commenced operation on January 1, 2005. Deutsche Bank and Barclays Capital, the first banks with emissions trading desks in Europe and the UK, respectively, are among the leaders. The most established of the US financial services firms are Goldman Sachs, Morgan Stanley and Merrill Lynch. Again, experience is due to trading activity on the EU ETS. What is most relevant to the Canadian banks, however, is the growing evidence of early mover advantage for these players due to their involvement in developing the market and in serving clients.

Being one of the first to build trading capacity has translated into the top (largest) intermediary position in the carbon market for Barclays Capital. When one considers that the emissions market is now worth $30 billion and is predicted to grow to $1 trillion in the next decade, being prepared to take advantage of such market growth is a compelling argument[5]. To date, few Canadian banks have even made public mention of positioning themselves for the realization of a regulated emissions trading market in Canada.

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[5] "Carbon trading: Where green is green", International Herald Tribune, June 20, 2007.

The evolution of Morgan Stanley's activities in the carbon market commenced with the launch of its carbon and emissions trading platform in 2004 and most recently took shape in the form of the Morgan Stanley Carbon Bank, announced in August 2007. Addressing a growing need in the market place, the new initiative will offer services for clients looking to become carbon neutral. To build integrated carbon auditing and offsetting services in the voluntary market, Morgan Stanley has formed a partnership with Det Norske Veritas, a leading provider of emissions data certification. The expertise of Morgan Stanley's Commodities Group will be used to procure and cancel emission credits generated in accordance with Kyoto Protocols from various sources. A portion of the credits will be sourced from Morgan Stanley's own direct investments in emission reduction projects and through its 38 percent stake in MGM International, which is currently financing 34 Clean Development Mechanism (CDM) projects worldwide[6].

Morgan Stanley Carbon Bank is a compelling case study for Canadian banks as it demonstrates how a financial services organization may leverage relationships and expertise gained through involvement in the regulated carbon market to create an innovative service for clients outside that market. It highlights the role that Canadian banks could play in bringing verification standards, similar to Morgan Stanley's partnership with Det Norske Veritas, to Canada's voluntary market, which in turn could boost overall market activity and opportunity.

In Canada, the first bank to seek opportunity in the emissions markets or launch a truly innovative product or service to address climate change or other environmental concerns has yet to emerge. For now, the story of the Canadian banks and the environment is largely unwritten. Canadian banks need only look to the emerging best practices of the global leaders to help navigate through growing external pressures and harness the opportunities that lie ahead. If they do not, global leaders will continue to press forward, widening the gap with Canadian banks. The story written under that scenario may be one that Canadian banks are reluctant to hear.

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[6] http://www.cdmpipeline.org