



# A SUSTAINABLE BANKING SECTOR IN SCANDINAVIA

— Proposals for green  
banking regulations  
in Scandinavia and  
the EU

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# ! THE ROAD TO A SUSTAINABLE BANKING SECTOR

**T**he changing climate calls for green transition in all parts of society. The Scandinavian countries are often highlighted as the progressive frontrunners on the green agenda. Unfortunately, this does not hold true when it comes to the financial sector. In Scandinavia, the big banks are not taking on their share of the responsibility for the climate – and the politicians have not included the financial sector in their environmental policies. This is unfortunate as **the significance of the banks in the green transition is tremendous**. This applies especially in Scandinavia where the banking sector is one of the most extensive in relation to the size of the real economy.

**Right now, the banks' lending contributes to exacerbating the climate crisis.** When they lend billions to coal, oil and gas companies, they finance the increased CO<sub>2</sub> emissions. Cutting out fossil fuels all at once is not realistic, but when the banks finance companies which keep searching for new oil and gas reserves, they are acting in direct opposition to climate science. The International Energy Agency's conclusion is clear: The search for and extraction of new fossil-fuel reserves is out of the question if the Paris Agreement is to be met.

**Political regulation of the banks' climate-damaging lending is therefore necessary.** The Scandinavian governments can and must take the lead and introduce ambitious measures. They are in a position to set a high bar for others to follow.

**C**limate regulation of the banks solves two challenges. On the one hand, we oppose the climate crisis when we reduce lending to oil, coal and gas. On the other, we handle great financial risks. Banks with substantial loans and investments in the oil, coal, and gas industries will lose money in step with fossil fuels becoming increasingly bad business. This will lead to financial instability, and **according to the latest IPCC report, the financial risks in connection with the climate crisis are severely underestimated**. IPCC therefore call for politicians to intervene. Not just for the sake of the environment, but also for the sake of the banking sector itself.

**Therefore, ActionAid Denmark presents three proposals for green banking regulation in this report.** The report is the first of its kind in a Scandinavian context, but it is based on the comprehensive international literature. It demonstrates that it is possible to impose climate regulation on the banking sector in a manner which is in line with the principles of modern banking regulation. We propose:

**1) Making climate plans mandatory for banks.** All big banks must have a plan for how they are going to comply with the Paris Agreement and the recommendations from the International Energy Agency's Net Zero Emission scenario. This will bring the banks on-board with the green transition *and* level the playing field between them.

**2) Introducing higher capital requirements for oil, coal, and gas.** Capital requirements means that the banks must have saved money for a rainy day when they provide loans. Fossil fuels are not only the greatest cause of global warming – they are also becoming increasingly high-risk, financially speaking. The capital requirements must therefore be raised. This must be done at the EU level, and Sweden and Denmark, in particular, can play an important role by pushing for high capital requirements for oil, coal, and gas.

**3) Imposing caps on the banks' lending to oil, coal, and gas.** The financing of damaging activities must be limited politically. This also applies to oil, coal, and gas. Therefore, politicians must impose caps on how big a share of a bank's lending may be going into fossil fuels.

With these tools, we can minimise the financial risks of the climate crisis, increase the speed of the green transition and demonstrate climate leadership to the world. The Scandinavian countries can create global change by showing the way on our home turf. This must of course also apply to the role of the financial sector in the green transition. **Sweden, Norway and Denmark are in a position – today – to become green standard bearers by imposing ambitious and responsible climate regulations on the banks. This report demonstrates how.**

# INDHOLD

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**A Sustainable Banking Sector in Scandinavia** — *Proposals for green banking regulation in Denmark and the EU*

Modified and translated version of the report: *En bæredygtig banksektor — Forslag til grøn bankregulering i Danmark og EU*.

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# ! INTRODUCTION

**T**he severity of the climate crisis is evident, and the burning of fossil fuels – oil, gas, and coal – is by far the greatest source of greenhouse gas emissions, historically as well as presently.<sup>1</sup> A vast part of the global carbon budget has already been spent,<sup>2</sup> and more than half the earth's oil and gas reserves and practically all coal reserves must remain in the ground if we are to stand any chance of meeting the Paris Agreement target of 1.5°.<sup>3</sup> In 2021, the International Energy Agency (IEA) presented its *Net Zero 2050* scenario with a clear conclusion: If we are to stand any chance of living up to the Paris Agreement, we cannot initiate new developments of fossil-fuel reserves.<sup>4</sup> We have more than enough in the current fossil-fuel reserves that are already developed. So according to the IEA, any exploration, development and extraction of new oil wells, new gas fields, new fossil-fuel power plants or new coal mines – should be excluded.<sup>x</sup>

## THE FINANCE SECTOR AND THE CLIMATE CRISIS

With its enormous societal impact, the financial sector is a crucial piece of the climate puzzle. As environmental researcher Bill McKibben puts it: "money is the oxygen on which the fire of global warming burns".<sup>5</sup> The Paris Agreement's article 2 thus contains the objective of "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."<sup>6</sup> With this focus in mind, banks are particularly important financial institutions. As society's credit providers, the banks not only finance in the world as it is; their financing contributes highly to shaping our future society. This applies especially in Scandinavia, which is a region with a relatively extensive banking sector.

There is a great need to direct finance flows *into* green projects, and many investors have already discovered how this can benefit the planet as well as the returns. However, the need to direct the financial flows *away from* fossil fuels – the main cause of the climate crisis – is just as great. A

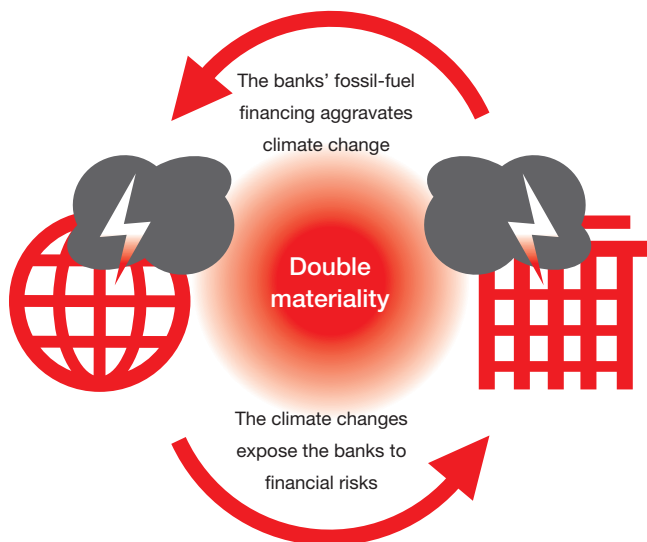
survey from 2021 shows that 10 great Nordic banks have financed fossil fuels with 67 billion US dollars in the period 2016-2020.<sup>7</sup> If we zoom in on the significant financing of fossil-fuel *expansion* which is strongly discouraged by the IEA, the NGO ShareAction demonstrated in 2022 that Danske Bank and Nordea (the only Scandinavian banks included in the survey) financed fossil-fuel expansion with more than 4.1 and 3.5 billion US dollars, respectively, in 2016-2021.<sup>8</sup> Despite the urgent need to stop fossil-fuel expansion and phase out existing fossil-fuel projects, the banking sector is moving in the wrong direction.

## ENVIRONMENTAL RISKS EQUAL FINANCIAL RISKS

The finance sector impacts the climate when the financing of fossil fuels contributes to increasing global warming. But the climate also reversely affects the finance sector. As it is, the climate changes entail significant *climate-financial risks* to the banks (and other financial institutions). For example, banks with great fossil-fuel lending risk incurring extensive financial losses when the politicians introduce stricter climate policies which make it more costly to emit CO<sub>2</sub>. Similarly, the banks risk losing money on their fossil-fuel assets as fossil fuels grow increasingly less competitive compared to sustainable energy. Banks with loans to fossil fuel companies and activities thus run the risk of their assets *stranding* – meaning their assets will have lost a significant part of their value.<sup>9</sup> The latest IPCC report indicates that even a limitation of the climate changes to a rise in temperature of 2° will result in stranded assets worth trillions of US dollars – and if the Paris Agreement objective of 1.5° is achieved, it is expected to result in an amount which is "significantly higher" than this already enormous financial loss.<sup>10</sup>

The risk is not drawn from thin air; In June 2020, BP devalued their assets by 17.5 billion US dollars due to an adjustment of their forecasts concerning the long-term prices on fossil fuels.<sup>11</sup> The same summer, French Total incurred a loss of 6.5 billion US dollars to their activities in Canadian bituminous sand.<sup>12</sup> Losses like these will become more and more frequent, and the latest IPCC report states that this type of risk is "greatly underestimated by financial institutions and markets".<sup>13</sup> The great financial risks to the individual banks as well as to the

**X)** This report uses the definition of fossil-fuel expansion for fossil-fuel companies from the environmental organisation Urgewalds Global Oil & Gas Exit List and Global Coal Exit List. At the project level, we refer to the IEA, which excludes projects which have not been "approved for development" as of 2021 (IEA (2021) *Net Zero by 2050 - A Roadmap for the Global Energy Sector*).



**Fig. 1. The principle of double materiality**

financial system as a whole which stem from climate change are broadly recognised by, among others, the central banks in Sweden, Norway and Denmark,<sup>14</sup> the European Central Bank (ECB)<sup>15</sup> and many others.<sup>16</sup>

This two-way street – the fossil-fuel banks being detrimental to climate change while climate change adversely affects the banks’ finances (climate-financial risks) – makes up the EU principle of *double materiality*. This principle is a cornerstone in the EU’s strategy concerning sustainable finances. This means that climate-financial regulation must consider the climate as well as the financial sustainability of the banks.

### THE NEED FOR EFFECTIVE REGULATION

Even though the finance sector is exposed to quite significant climate-financial risks, the politicians and regulatory authorities have yet to introduce the necessary regulation. In the EU, lately the focus has been on “sustainable finance”. This not only impacts EU members Sweden and Denmark, but also Norway where the banking regulation follows EU regulations closely.<sup>17</sup> However, the problem with the EU measures is that they lack sufficient ambition. For example, the EU Commission has introduced or is in the process of introducing a number of measures: the green taxonomy,<sup>18</sup> the disclosure framework,<sup>19</sup> the reporting directive,<sup>20</sup> the benchmark regulation,<sup>21</sup> and the green bond standard.<sup>22</sup> And even though the EU is one of the most active players in the field, this trend is global.<sup>23</sup>

These are positive initiatives. Regulation to increase green financing is all well and good, but it is problematic that very little regulation exists, which will reduce fossil-fuel financing. Green credit and investments are becoming increasingly common, but no green measures can mitigate the climate crisis if we do not simultaneously

limit the use of fossil fuels fast and effectively. To do so, the banks’ lending must be regulated as this is a crucial channel for the financing of fossil fuels. A lacking aspect of the regulatory measures in existence so far is that they are aimed more at the investment market than the banks’ lending.<sup>24</sup> Therefore, regulation of lending is the primary focus of this report’s proposals for regulation.

It is thus crucial to have regulation aimed at lending and fossil fuels and not just regulation aimed at investments and green activities. Unfortunately, the risks associated with fossil-fuel loans have until now mainly been dealt with in terms of transparency, stress tests and classifications. In the long term, this may provide a basis for more ambitious measures, but on their own, these measures do not counter the climate-financial risks. Transparency and classifications alone do not move the billions away from fossil fuels sufficiently fast as long as money can still be made from oil, gas and coal. We therefore need regulation which more directly impacts the financing. And this would not be ground-breaking. On the contrary, this is exactly the approach behind the rightly strict regulation designed to counter for example financial white-washing and terrorist funding. In this report, Action-Aid Denmark therefore presents three regulatory ways to limit the financing of coal, oil, and gas.

# Proposal 1 MANDATORY CLIMATE PLANS

**B**anks are institutions with great significance to the society around them. It is thus an untenable situation that it is up to the individual bank to decide whether or not it wants to have a climate plan and, if so, how ambitious it should be. It must thus be a requirement for all banks of a certain size to have a climate plan for how they intend to live up to the Paris Agreement. This will also level the playing field between the banks.

More and more banks, internationally as well as nationally, have developed climate plans during recent years. The trend has been amplified by the establishment of international networks for financial institutions such as Net Zero Banking Alliance.<sup>25</sup> Even though several of the banks' climate plans contain positive measures, the voluntary plans have proven inadequate.<sup>26</sup> For example, the plans do not address the fossil-fuel expansion which is emphasised by the IEA as crucial to meeting the Paris Agreement objectives. Likewise, the ECB's Frank Elderson has pointed out the problematic issue that some banks promise to be CO<sub>2</sub> neutral by 2050 without having a plan for reduction of CO<sub>2</sub>-intensive industries in 2030.<sup>27</sup>

It is therefore necessary with political action which makes it obligatory to live up to the environmental objectives of the Paris Agreement and which levels the playing field between the banks. To the banks that have already taken ambitious strides in terms of environmental issues, the regulative burden of this proposal will be limited. To banks that still have one foot on the brake, this will be a necessary and effective step. Obligatory environmental plans for the banks are already emerging. The ECB has come out in favour of the proposal, and the British government said in 2021 that it wants to make *net zero* transition plans obligatory for financial institutions.<sup>28</sup> The EU Commission proposal for a new directive on sustainability reporting contains requirements for financial institutions to draw up transition plans,<sup>29</sup> and the president of the French central bank has suggested that capital requirements be tied to the banks' transitions plans.<sup>30</sup> These are all positive measures. The Scandinavian countries should jump on board this green wave, and the Scandinavian governments may even take the lead and set an international example.

For the current proposals come up short in certain areas, and Sweden, Norway and Denmark can do better.

First, we need plans which consider both the financial risks to the banks and their role in climate-damaging activities. It is important to consider how the climate affects the banks' business as well as how the banks' activities impact the climate. And the consequences to the banks which do not live up to their plans must be tangible and uniform. The British government's proposal suffers from this problem as it leaves it up to the market to assess and sanction the adequacy of a bank's transition plan.<sup>31</sup> As mentioned, there are already many bank transition plans which do not at all live up to the Paris Agreement objective to keep the temperature increase at 1.5°. It is therefore essential that society imposes certain requirements for what makes a good transition plan – just as it is the case with the national objective of 70% reduction by 2030.

Second, the Scandinavian countries can set an example by setting higher standards for the level of ambition contained in a climate plan. The Commission proposal for a new directive on sustainability reporting<sup>32</sup> considers the principle of double materiality, but the requirements for what a transition entails are too unambitious in this directive. In the words of ECB board member Frank Elderson, it is problematic that the directive "leaves their [the transition plans'] content and timing to the discretion of each bank, without stipulating any clear metrics, milestones or targets."<sup>33</sup> Scandinavia thus has both great potential and the legal opportunity to be first movers.<sup>34</sup> Therefore, Action-Aid Denmark in line with a number of international players proposes:

**The national parliaments in Scandinavia must introduce legislation which makes it obligatory for all Scandinavian banks of a certain size to draw up and publish a climate plan for how the bank intends to bring its activities in line with the Paris Agreement objective of 1.5° and the IEA's Net Zero 2050 scenario.**



**The bank's environmental plan must (as a minimum):**

- Set the goal to meet the IEA's recommendations and stop new lending to companies involved in fossil-fuel expansion immediately after the law takes effect.
- Set a *net zero* target for the financed absolute emissions<sup>X</sup> for all the bank's activities no later than 2050 in accordance with the IEA's *Net Zero 2050* scenario.<sup>35</sup>
- Set five-year targets which render possible their fulfilment of the 2050 target.
- Submit annual reports to the national financial supervisory authority.
- Cover *scope 1, 2 and 3* of the bank's and its clients' emissions.
- Avoid relying on negative emission technologies or offsetting to a greater or lesser extent.
- Encompass all the bank's activities, including lending, investments and underwriting.
- Describe how the bank intends to implement the climate objectives in its governance structures, internal capacity in the environmental area, policies for salary bonuses and lobbying activities.
- Aim to reduce their financing of high-emission activities in the OECD faster than in the world in general due to the greater historic responsibility for the climate crisis as well as a greater financial capacity to implement green transition in the global North.

development internationally. This is a role the Scandinavian countries can and should play successfully.

There are two benefits to this proposal: first, it will force the banks to take into sufficient consideration the climate-financial risks, and second, it will make the banks carry their fair share of the responsibility for the green transition. The proposal will thus raise the bar and push for green

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X) Financed emissions should be calculated based on the Partnership for Carbon Accounting Financials' method. As we are dealing with absolute emissions, objectives concerning emission intensity may not replace them, but at the most be used in supplement.

## Proposal 2 FOSSIL-FUEL CAPITAL REQUIREMENTS

**T**he purpose of the capital requirements is to protect the banks from financial risks, but they do not take into consideration the significant risks presented by the climate changes and lending to fossil-fuel companies. Scandinavian politicians should push to change this in the EU. It is not necessary to fundamentally change the regulation on capital requirements. Fossil fuels should merely be re-categorised as very risky assets.

### THE CURRENT CAPITAL REQUIREMENTS

The capital requirements for the banks are pivotal in the regulation of banks. They are based on the recommendations of the Basel committee.<sup>36</sup> The Basel committee works with three pillars of financial regulation, and Pillars I and II both concern capital requirements. Pillar I outlines rules for the general capital requirements, which are, in the case of Sweden and Denmark, regulated through the EU.<sup>x</sup> Norway also follows EU regulations in this area despite their non-member status. Pillar II of the Basel committee outlines rules for determining supplementary bank-specific capital requirements which may be decided by national financial supervisory authorities.<sup>xx</sup>

The purpose of capital requirements is to ensure that the banks always have capital adequacy to resist unexpected losses to their assets and to stay solvent. The banks are therefore subject to a requirement that they must always have a capital adequacy of 8% (in concurrence with other capital requirements such as non-risk-weighted liquidity requirements and extra capital buffers).<sup>xxx</sup> This means that a bank must have \$8 in equity to cover every loan of \$100. But the equity requirements are adjusted based on the risk of assets. Bank with \$100 in high-risk assets must therefore have more capital than banks with \$100 in low-risk assets. In practice, this is considered by weighting the risk of the assets. If an asset's risk

is weighted at 100%, the original capital requirement of 8% remains (i.e. \$8 capital per \$100 asset). But if an asset's risk is weighted at, for example, 200%, the bank must instead hold 16% capital as coverage (8% 200% = 16 %).

### CAPITAL REQUIREMENTS AND CLIMATE-FINANCIAL RISKS

The risk-based approach to capital requirements is extremely sensible. However, the problem is that, at the moment, the significant climate-financial risks of fossil-fuel assets are not included in the considerations as climate impact is not incorporated into the banks' capital requirements. To solve this problem, the risk weight of fossil-fuel assets must be increased. This is standard practice for risky assets. For example, lending to "speculative immovable property financing and to investment in private equity" is already subject to a weighted risk of 150% in EU's CRR,<sup>37</sup> and given the climate-financial risks of the climate crisis, it is hard to argue that the risk of stranded assets is less significant for fossil fuels than for private equity or immovable property. Likewise, assets already exist which are considered so risky that they require full capital adequacy. This applies to assets within securitisation exposures<sup>38</sup> and certain holding companies,<sup>39</sup> and it is in development for cryptoassets.<sup>40</sup>

The underestimation of climate-financial risks in the current capital requirements has made its way to the agenda in recent years. In 2021, the EU Commission presented a proposal for revision of the CRR<sup>41</sup> and the CRD (Capital Requirement Directive)<sup>42</sup> which contained, among other items, the implementation of ESG risks. The regulatory process is ongoing, and Sweden and Denmark are in a position to play important roles by pushing for the amendment to be as ambitious as possible. Furthermore, the European Banking Authority (EBA) has been tasked with exploring the opportunity to incorporate environmental considerations into the capital requirements,<sup>43</sup> and the European Central Bank (ECB) is also looking into this.<sup>44</sup> With the right political pressure, this could lead to capital requirements which consider the climate crisis; and Sweden and Denmark should work to this effect. Therefore, ActionAid Denmark proposes to incorporate climate considerations into the capital requirements in the following two ways:

**X)** The EU-specific capital requirements are primarily regulated by the CRR (Capital Requirements Regulation) which was introduced in 2013 and revised in 2019 (CRR2).

**XX)** This is done on the basis of the overall direction set by the Basel and EU regulations, namely the EBA's Supervisory Review and Evaluation Process Guidelines.

**XXX)** The equity is first and foremost comprised of transferred revenue and share capital, and Article 92 of the CRR stipulates that 4.5% of the capital requirement must be met by capital of the highest quality, the so-called Common Equity Tier-1 capital.



### **1) Increase the capital requirements from 8% to 12% for existing fossil-fuel exposure.**

To increase the capital requirements from 8% to 12%, the weighted risk must be increased to 150% for fossil-fuel assets (assets in fossil-fuel companies and projects). This must apply in cases where the exposure is related to extraction of fossil-fuel reserves approved for development prior to 2022 or the operation of existing fossil-fuel power plants.

### **2) Increase the capital requirements from 8% to 100% for new fossil-fuel exposure.**

To increase the capital requirements to requirements for full capital adequacy (100%), the weighted risk must be raised. As 8% 1250% = 100%, the risk weight must be increased to 1250% for exposure to fossil fuel companies, activities, reserves and fossil fuel power plants that engage in exploration, extraction or exploitation of new coal, oil, and gas resources or development of new fossil fuel powerplants.

Assets' weighted risk is calculated either using a standard method determined by the legislators or by using the banks' internal models which must meet certain requirements.<sup>45</sup> The increased fossil-fuel risk weights proposed here must, in addition to being implemented in the standard method determined by law, also be introduced as minimum requirements for the banks' internal models.

### **WHY INCREASE THE CAPITAL REQUIREMENT FROM 8% TO 12% FOR EXISTING FOSSIL-FUEL EXPOSURE?**

It is not realistic completely to cease the use of fossil fuels immediately. A certain level of fossil-fuel use must be accepted while the green transition is completed. But as the global fossil-fuel reserves by far exceed the amount

of fossil fuels which can responsibly be burnt, it cannot be contested that fossil-fuel assets have a high risk of becoming stranded. The EU's Capital Requirement Regulation (Article 128 of the CRR2) states that assets "that are associated with particularly high risks" must be weighted at 150% – and as previously explained, a risk weight of 150% is the method in which the capital requirement is set at 12%. Fossil-fuel assets fit directly under this wording due to the significant risk of stranding. The increased risk weight of fossil-fuel assets can thus be changed in the EU even today, and it is in accordance with the risk-based approach of the Basel recommendations.<sup>46</sup>

### **WHY DEMAND FULL CAPITAL ADEQUACY FOR NEW FOSSIL-FUEL EXPOSURE?**

While the burning of parts of the existing global fossil-fuel reserves cannot be entirely avoided, the situation is different for new fossil fuels. In 2021, the International Energy Agency presented a crystal clear conclusion: If we are to stand a chance of meeting the Paris Agreement target of 1.5°, there is no room for new fossil fuels. The current developed fossil-fuel reserves already spend the global CO2 budget. Climate considerations thus leave no room for new oil or gas fields, new coal mines or new fossil-fuel power plants. Therefore, new fossil-fuel exposure is not only at great risk of becoming stranded assets; they must in fact become stranded assets.

In light of this considerable risk, the responsible solution is that the banks must have full capital adequacy when financing activities and companies connected to new fossil-fuel exposure – every dime lent to new fossil-fuel exposure must have a corresponding dime in equity, i.e. a capital adequacy requirement of 100%.<sup>X</sup> As explained, the technical reason is that 1250% multiplied by the capital requirement of 8% equals 100%. Complete capital adequacy is the requirement today for, among others, securitisation exposures and certain holding companies. The amendment simply entails inserting a new clause in Article 128 of the CCR.<sup>47</sup>

X) Lending to companies engaged in fossil-fuel expansion must be weighted at 1250% in line with project loans to fossil-fuel expansion projects. If only project loans are subject to the increased risk weight, the capital requirement can be avoided by redirecting the funds of the fossil-fuel company, which will neither deal with the environmental-financial risks nor be in accordance with the recommendations from the IEA. The calibration of such company loans can be carried out in two ways.

### **WHY SHOULD THE CAPITAL REQUIREMENTS BE CHANGED AT THE EU LEVEL AND NOT THE NATIONAL LEVEL?**

Even if capital requirements are determined both through the EU and nationally, climate considerations should be implemented under the EU-regulated Pillar I requirements, not the nationally regulated Pillar II requirements. This is because Pillar I capital requirements are where general financial risks are priced, such as environmental-financial risks.<sup>48</sup> As environmental-financial risks do not apply nationally in one EU member state, but have an effect across borders, there is no legal base for increasing the capital requirements only in one EU country through either Article 458 of the CRR or Article 133 of the CRD.<sup>49</sup> It is therefore the assessment of the Danish Financial Supervisory Authority at this point in time, that it is not possible to introduce purely national environmental capital requirements in Denmark alone,<sup>50</sup> and the same most likely applies in Sweden. As Norway is not a member of the EU, the extent to which they can push for increased capital requirements is thus limited. However, this is not the case for the two other proposals in this report; Norwegian politicians could lead by example and introduce them today.

## Proposal 3 FOSSIL-FUEL CREDIT CEILINGS

**T**he most effective way to avoid the banks' lending activities which are detrimental to society is to introduce credit ceilings to specific sectors.<sup>X</sup> This also applies to climate-damaging lending activities. Limits should thus be set on how big a part of the banks' lending activities may be going into fossil-fuel companies and projects.

All proposals in this report have the same purpose: To deal with the banks' climate-financial risks and get the banks on board the green transition and out of climate-damaging activities. There are several ways to go about this. Capital requirements make fossil-fuel lending more expensive as they increase the capital costs for the banks when they have to hold more capital, while climate plans limit fossil-fuel lending through general planning compatible with the Paris Agreement. We are thus dealing with legislation which changes the framework for the banks' financing of coal, oil and gas. The situation is different with credit ceilings. Here, a regulatory amendment will directly limit the extent of the banks' lending to coal, oil and gas. The climate crisis is a serious threat, and this type of resolute action is thus necessary, and there is a regulatory possibility to act nationally.<sup>51</sup> ActionAid Denmark therefore proposes to:

**Limit the banks' lending to fossil fuels by introducing a ceiling on how big a share of the banks' total credit may fund companies and projects in the fossil-fuel sector.**

X) Schoenmaker & Tilburg (2016) calls quantitative credit limits a "very powerful" instrument (p. 9), and D'Orazio & Popoyan (2019) write in continuation hereof that "credit limits could be the most appropriate regulatory instrument to deal with material climate-related risks" (p. 19).

XX) It should be noted that a bank could, in principle, increase its total credit to an extent where fossil-fuel financing would make up a decreasing share despite an overall increase, which is why this proposal is technically based on a CO<sub>2</sub>e intensity target, which would normally be problematic. However, if the credit ceiling is set sufficiently low, the risk that the fossil-fuel banks will actually be able to increase or merely maintain their existing level of fossil-fuel lending will be eliminated.

XXX) It has therefore been suggested to introduce fossil-fuel concentration limits (by e.g. Center for American Progress (2021), Climate Safe Lending Network (2021) and D'Orazio & Popoyan (2019)). This would have the same positive effect as a credit ceiling, but as it only pertains to the banks' capital adequacy, there is a risk it will interfere with EU regulation, which is why the proposed credit ceiling is a more feasible path at the national level.

A credit ceiling should be stated as the relation

$$\frac{\text{fossil-fuel assets}}{\text{total assets}}$$

If, for example, the ceiling is set at 1%, a bank with total assets of \$200 billion may maximum have assets in the fossil-fuel sector worth \$2 billion. The specific level for the credit ceiling should be determined as part of the legislative process, but it should of course be low enough to have an actual impact on the limitation of fossil-fuel financing.<sup>XX</sup> A credit ceiling may also be set at 0%, which is the same as a total ban on any lending to the sectors and activities concerned. But it will also be possible to start at a higher level and then adjust it downward over time on the road to the complete phaseout of lending to fossil fuels. Likewise, a credit ceiling of 0% may be implemented in sub-sectors of the fossil-fuel industry, for example coal or fossil-fuel expansion. To avoid any severe market disturbances, the ceiling could be implemented during a brief introduction period.<sup>52</sup>

The proposal of a fossil-fuel credit ceiling is a continuation of former Western credit policies and increasing political and academic support as well as related regulatory initiatives. Like credit ceilings, the banks' concentration limits set upper boundaries for certain types of lending. The concentration limits impose a ceiling of 25% of the bank's core capital on the bank's exposure to new clients and/or groups of inter-connected clients.<sup>53</sup> A fossil-fuel credit ceiling is thus not far from a fossil-fuel concentration limit, only the regulation of the fossil-fuel credits is calculated relative to the total asset instead of relative to the equity.<sup>XXX</sup>

Direct intervention in the credit allocation, such as credit ceilings, disappeared from the regulatory toolbox in the Western world in the 1980s/90s.<sup>54</sup> But regulation which affected the offered credit to different parts of the economy played a significant role in most Western countries in the decades following WW2 (and today, this type of regulation is still used in major parts of the world<sup>55</sup>).<sup>56</sup> After being out in the cold for a few decades – replaced by a belief that the best thing for the markets is as little outside interference as possible – active credit policies are now back on the agenda. This is due, in part, to the great market flaw that is the climate crisis. A number of scientists have spoken out

in favour of quantitative credit caps as a means to reducing environmental-financial risks.<sup>57</sup> In addition, large players like the ECB<sup>58</sup> and the NGFS<sup>59</sup> have started looking into these types of credit caps. There is no doubt that the growing support for this type of proposal would be strengthened by Scandinavian leadership in the field.

## **! TYPICAL OBJECTIONS**

**“If we impose stricter regulations on the banks, it will make it difficult for them to make money on fossil fuels and they will thus have less funds for green finances.”**

The proposed environmental bank regulation in this report is a means to dealing with the banks’ climate-financial risks to make them more resilient. More resilient banks do not damage the real economy, but an unstable banking sector and losses on fossil-fuel assets do.<sup>60</sup> It is also self-contradictory to continue financing the causes of the climate crisis in order to have sufficient funds to solve the crisis they are creating – especially given the fact that a phase-out of fossil-fuel financing will direct the money into other more sustainable sectors.

**“The fossil-fuel companies in the energy sector are the real problem, not the banks which merely provide credit. The banks will shift automatically in step with the green transition.”**

The idea of banks as neutral credit providers with no influence on the societies they finance is incorrect. As mentioned in the introduction, the banks’ lending decisions contribute to pushing society in one direction or the other. It is therefore important to be serious about the banks’ credit activities, especially during a climate crisis. The fact that banks can influence the surrounding society is also the rationale behind the banks’ voluntary climate plans and policies, which would otherwise be superfluous. The rationale behind regulative measures is the same except they raise the level of ambition and level the playing field.

**“Financial regulation should not be about climate, but about financial risks.”**

As this report has pointed out, climate-financial risks mean that you cannot separate climate and financial risks. Therefore, there is no conflict between the existing supervisory task and the measures which accommodate climate-financial risks. Instead, not dealing with a certain type of financial risks, e.g. climate-financial risks, could be considered failure to perform the supervisory tasks.

**“Climate-financial risks cannot be modelled and quantified, especially due to a lack of underlying data. Regulatory intervention is thus misplaced.”**

First, the modelling and underlying data concerning climate-financial risks have already been significantly improved, for example through the Partnership for Carbon Accounting in Financials. Second, it is a fallacy that a lack of exact risk assessments should justify less action. Climate-financial risks are real and considerable. This is a fact which does not change because the quantification of these risks is a challenge. The approach to climate-financial risks should thus be somewhat precautionary.<sup>61</sup> The precautionary principle is explicitly included in the UN’s Rio declaration on environment and development from 1992, and it states that higher uncertainty concerning risks is not an argument for less risks management, but for more.<sup>62</sup> Today, financial authorities already work with an imperfect degree of accuracy in their regulation of other assets, e.g. in connection with risk-weighted capital requirements.<sup>63</sup> And even the US government has made it explicit that “a lack of perfect information should not be a justification for inaction.”<sup>64</sup>

**“In an internationalised finance sector, the regulation of Scandinavian banks will not have any beneficial climate effect, but merely direct fossil-fuel financing abroad.”**

Even though it is not happening fast enough, at the international level, banks are beginning to cut off funds to fossil-fuel companies. For example, French bank La Banque Postale have announced that they will no longer provide any new financing to fossil-fuel companies. Scandinavian banks must be a part of this wave. And when more and more banks halt their fossil-fuel credit activities, they contribute to increasing the credit costs internationally and demonstrating that the business is unethical. When fossil-fuel projects become more costly and connected with bad publicity, fewer and fewer will be realised. In addition, the Scandinavian countries are in a position to become climate leaders in the area and set a new standard for sound regulation and inspire other countries to act. Scandinavia can demonstrate how regulation can combine financial considerations and climate considerations and move billions away from fossil fuels.



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