EDINBURGH
INVESTMENT TRUST

Are the banks going green?

JAMES DE UPHAUGH, MANAGER OF THE EDINBURGH INVESTMENT TRUST

UK-listed banks have spent many years wearing a metaphorical hairshirt following on from the global financial crisis – most people would say deservedly so.

Yet not only has the tide turned financially, with regulators now happier to sanction increased dividend flow and share buy backs as the financial performance of banks has substantially improved, but a closer look reveals notable positive changes to banks' Environmental, Social and Governance (ESG) signatures.

While we look to structure the Edinburgh Investment Trust's portfolio with a number of different themes (as we recognise that at any point in time a theme waxes and wanes), a key theme for EIT is what we call "ESG rehabilitation": the concept that a company can move from being judged by stakeholders and broader society as a bad actor to a good actor.

Banks – a rehabilitation?

Have banks been rehabilitated from the unenviable position they held post the financial crisis? Certainly, we believe this is the case for much of the banking sector today. During the pandemic banks arguably demonstrated social purpose through the widespread and expedited provision of SME loans to companies in need, helping many to stay afloat, while also freezing mortgage and loan repayments for those struggling to meet their financial commitments.

Today, one of the key roles banks have to play is in financing the energy transition that is essential for the world to achieve net zero and successfully tackle climate change. Banks such as Standard Chartered and HSBC with a broad geographical footprint are well placed to capitalise on the growth of sustainable finance.

Shifting the geographical emphasis

It is widely agreed that there is an urgent need to shift the emphasis around where we spend money to focus on prioritising decarbonisation globally if we are to stand a chance of achieving net zero. Many developed countries are already on the journey in terms of implementing carbon reduction strategies or climate change initiatives. But the focus now needs to be further afield to make the most difference.

We believe there is a clear need to spend more in Asia and Africa – not least because the incremental return is far higher for a dollar spent in Lahore than London, coming as it does from a far lower base and therefore having more impact.

As a comparison, it is possible to see every day how our electricity is made up at any time by viewing data available through the National Grid here. This shows that while fossil fuels still make up around a third of UK power, it is rare that coal is part of the mix – instead it is mainly gas. Around a third of UK power comes from renewables, with nuclear and biomass accounting for close to 20%.

In contrast, around 70% of energy consumed in India in 2022 came from coal. According to Statista, India accounted for 12.4% of global goal consumption in 2022, although this was dwarfed by China, which accounted for 54.8%. This highlights the need for ongoing investment to move to more environmentally sustainable technologies.

The good news is that figures from Bloomberg[1] show that investment in decarbonisation has now passed the $1 trillion mark, with the Asia Pacific region receiving nearly 60% of overall investment in the global energy transition in 2022. This equates to year-on-year growth in excess of 50%.

Yet in order to achieve the target of achieving net zero emissions by 2030, it is estimated that there would need to be an average of at least $3.5 trillion dollars invested globally every year – of which more than half would need to be in Asia.[2]

The trick is how to do this. To finance this effectively, a mix of funding from private and public and supranational organisations is required, with groups getting together and leveraging the finance to make it work.

Banks such as Standard Chartered and HSBC – both of whom we invest in through EIT – have the reach to do this. Standard Chartered, in particular, has an unparalleled network in its heartland countries in Asia, Africa and the Middle East. The energy transition that the world needs to accelerate is going to need a huge amount of finance directed to its regional heartlands. Standard Chartered is ideally placed to continue to organise and lead-manage a good share of this finance – and in turn generative attractive returns for shareholders.

Investors are increasingly likely to value streams of income from sustainable finance and therefore banks could represent an opportunity worth considering.

In many ways Standard Chartered is a parable for much of the UK equity market – cheap as it is but even cheaper if you appreciate its medium-term role in sustainable finance.

HSBC and Standard Chartered are far from the only banks looking at sustainability as a way to both grow, meet environmental objectives and grow investment returns. Other banks such as NatWest and Lloyds offer green mortgages, or discounted loan rates for homeowners making green improvements to their properties. However, we believe that HSBC and Standard Chartered provide a nice combination of an area where they are differentiated – thanks to their geographical reach – and as a result should be able to generate attractive streams of income that investors will alight on as being high quality.

The rehabilitation journey looks to be well underway.

[1]BloombergNEF, Energy Transition Investment Trends 2023.

[2]Energy Transitions Commission, *Financing the Transition: How to Make the Money Flow for a Net Zero Economy*, 2023.

[3].Top coal consuming countries worldwide 2022 | Statista

For a comprehensive list of common financial words and terms, see our glossary at: http://www.edinburgh-investment-trust.co.uk/glossary

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