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Fossil Fuel Financing

Why and how policymakers should combat oil & gas expansion financed by UK banks

Russia's devastating invasion of Ukraine and the ongoing volatility of gas prices have exposed the fragility of fossil fuel economies. In the words of Fatih Birol, Executive Director of the International Energy Agency (IEA), we face an "historic turning point" in how European countries source their energy. Decisions policymakers make today will cement the future of our energy mix in the medium- and long-term. **Now more than ever the focus must be on sustainable finance to support the roll-out of renewable sources to replace fossil fuels.**

But UK banks continue to finance fossil fuels at an alarming rate, despite the latest climate science, and there is a risk that the energy crisis will be used as an excuse to continue on this trend[i]. The commitments[ii] by the Net Zero Banking Alliance (NZBA) are a step in the right direction but currently lack the ambition required to lead us to a climate-secure world. Equally, the UK Government is sending mixed signals, on the one hand pledging ambitious emission reductions targets and on the other, supporting new oil & gas (O&G) fields. The IEA has made it clear the two are incompatible[iii] – even in the current geopolitical context it is more stringent climate policy, not O&G expansion, which is needed.

We propose a set of meaningful actions policymakers can take to accelerate action by the UK banking sector and to support the Government's ambition to restore energy price stability and create the world's first Net Zero-aligned Financial Centre.

This briefing outlines the following:

- Current rates of O&G financing by UK banks;
- The need for increased ambition amongst NZBA members and the UK Government;
- Why increased fossil fuel production is not the answer to stabilising energy prices; and
- What policymakers can do to direct private finance away from unsustainable activities.

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Oil & gas expansion is incompatible with climate targets

The world's most influential energy body has closed the door to new O&G fields. The International Energy Agency (IEA) said in May 2021 that there is no room for new O&G fields in its pathway for the global energy sector to achieve net zero CO2 emissions by 2050[iv]. Even despite the UK and the EU's decision to transition away from Russian gas, that IEA has restated this fact.

But the O&G sector shows no willingness to stop expanding its capacity. Most O&G companies are still expanding production. Their projected growth is significant, with sanctioning of new projects forecasted to be around US$150 billion in 2022.

The nature of the expansion pipeline is also a cause of great concern. Half of planned expansion comes from 'unconventional' sources (e.g. shale and Arctic O&G), which have higher financial and environmental costs[v].

Despite IEA warnings, British banks continue to finance new fossil fuel projects

If the City of London were a country, its financed emissions would make it the ninth largest polluter in the world. The emissions it funds makes the UK financial sector a bigger polluter than Germany or Canada[vi].

Recent research by our Banking Standards Team shows that European banks have financed upstream O&G expanders with over US$400 billion since 2016[vii]. **Two of the UK's four largest banks are leading the way – HSBC comes top followed by Barclays in terms of finance provided. These two UK banks are responsible for a quarter of all financing within Europe. Between 2016-2021, HSBC and Barclays provided US$107.44 billion to 50 oil & gas expanders.**

Trends suggest UK and European banks show no sign of stopping – on average, financing in 2021 remains consistent with pre-pandemic levels.

The Net-Zero Banking Alliance is a start, but needs to go further

Launched in April 2021, the Net-Zero Banking Alliance (NZBA) is the banking element of Glasgow Financial Alliance for Net Zero (GFANZ). The NZBA is industry-led and convened by the UN Environment Programme Finance Initiative.

NZBA say they 'bring together banks from a broad set of countries that are committed to aligning their lending and investment portfolios with net-zero emissions by 2050. Combining near-term action with accountability, this ambitious commitment sees banks setting an intermediate target for 2030 or sooner, using robust, science-based guidelines.'

However, despite this:

- There are **no accountability mechanisms in place;**
- NZBA members have committed to set emission reduction targets for their energy portfolios, but **the alliance's guidelines are silent on the need for bank's policies to cover fossil fuel expansion;**
- NZBA **members include banks providing billions to expanding O&G**. Since the launch of NZBA, members in scope of ShareAction's analysis provided at least US$33 billion in financing to the top 50 upstream O&G expanders.

Banks can't make credible net-zero claims without a commitment to stop financing new fossil fuel fields in line with credible 1.5C pathways.

The UK Government must lead by example

Financial institutions look for policy signals when assessing risk. If the message to banks from the IEA is to stop developing new O&G fields, then the Government must set the same tone.

But the Government is supporting O&G expansion. It has given the green light to new O&G fields in the North Sea[viii] and continues to subsidise the O&G industry with public funds[ix]. Legal NGO ClientEarth announced in January that they are taking the Government to court over their inadequate net-zero plans. They argue that its current policies will not reduce emissions enough to meet its legally binding carbon budgets[x].

Increasing fossil fuel financing is not the answer to rising energy prices

The Department for Business, Energy and Industrial Strategy has stated that domestic O&G infrastructure is necessary to improve energy security and prices[xi], but this is not the case:

- The IEA emphasises that **it is the insufficiency of current clean energy policies that is exacerbating pricing challenges.** Fatih Birol stated that "Much stronger investment in low-carbon energy technologies [...] is the way out of this impasse. But this needs to happen quickly, or global energy markets will face a turbulent and volatile period ahead."[xii]
- The UK largely uses gas for its energy needs. Tessa Khan, Director of Uplift and international climate change lawyer, notes **"75% of the resource in the 30 new North Sea fields up for approval in the next 3 years is oil and the UK EXPORTS 80% of its oil. These projects [...] won't lower bills or provide energy security."**[xiii] According to Uplift, the recently approved

Abigail field off the East coast of Scotland will cost many millions to develop but will only produce enough gas to meet UK demand for roughly a day and a half, or 34 hours. Abigail's oil is also likely to be exported so will not provide UK households with affordable energy.[xiv]

- Dr Simon Evans, of the climate and energy website Carbon Brief, states **there are 649 individual onshore wind and solar projects that have already been granted planning permission** but are not yet built because of the lack of Government support to bring them to the market. He has calculated that **if these projects were built, they would generate more energy than the total amount generated by all the Russian gas the UK currently imports annually.**[xv]

FACT: it can take up to 25 years from initial exploration until a new fossil fuel project is running, meaning exploration for new O&G fields today could mean fossil fuel production only begins in those sites as late as 2047 – 3 years before we are meant to achieve net-zero. Projects receiving a Final Investment Decision (FID) today might not produce O&G until 2032[xvi]. By 2035, the UK has pledged to reduce emissions by 78% compared to 1990 levels. As Chris Stark, CEO of the UK's Climate Change Committee has said, new investment in fossil fuels "will take too long to ramp up". By contrast a wind farm can be built in 10-30 months[xvii], offering a cleaner, more practical solution to tackling the energy crisis.

Source: Economic and Private Sector PEAKS.[xii]

The focus should be on transitioning away from fossil fuels to meet climate targets and protect energy security

The Government has taken welcome steps to accelerate private sector decarbonisation, and it must continue on this path. At COP26, the Chancellor announced that London will become the world's first 'Net Zero-aligned Financial Centre'. This will be achieved by companies and financial institutions publishing net-zero transition plans. Grand promises of achieving net-zero by 2050, without a verifiable plan of how to get there, have become commonplace. Some of the world's biggest businesses are failing to live up to net-zero emissions targets, with research suggesting they are on track to only cut their carbon emissions by 40% rather than 100%[xviii]. **Enforcing net-zero transition plans on a mandatory basis should address this accountability gap, ensuring that all UK businesses and banks also have short and medium-term strategies in place to decarbonise in line with credible 1.5C pathways.**

Transparent disclosure of data is the first step to apply pressure on companies and financial institutions to decarbonise, but it is not the only way to achieve this. In fact, some research suggests that disclosure alone is not sufficient to enact positive change[xix]. **Government should go a step further and provide sector-by-sector guidance on credible decarbonisation strategies.** For example, Government should make clear that O&G transition plans must include a commitment to cease expansion today to be credibly in line with 1.5C. This will create a soft accountability mechanism, sending a strong message to industry laggards that they must keep up with Government ambition to avoid more stringent regulation. It will also empower investors with a comparative tool with which to scrutinise financial institutions' plans.

How policymakers can drive meaningful change:

1. Respond to the energy crisis with calls for increased sustainable finance

Political, social and environmental risks are great when relying on fossil fuels for energy resources, as proven by the recent gas price hikes and the Ukrainian conflict. Analysis by Carbon Brief, Uplift and the IEA shows that decarbonising our energy sector presents an opportunity to improve our chances of reaching net-zero whilst also increasing energy increasing security and affordability.[xx]

We recommend policymakers amplify the message that increasing renewable energy financing – not fossil fuel financing – is needed to improve security and lower energy prices.

2. Say no to new oil and gas fields to provide the finance sector with long-term policy signals

The UK Government has been supportive of new O&G fields in the North Sea, such as the recently approved Abigail Field, despite climate scientists' warnings and evidence that this will not stabilise domestic gas prices. For the banking sector to phase out their financing of new oil and gas projects, the Government needs to set the tone and say no to new O&G fields.

We recommend policymakers write to the Secretary of State for BEIS, Rt Hon Kwasi Kwarteng,

urging him to follow scientific guidance and put an end to all new UK O&G projects immediately.

3. Scrutinise finance sector net-zero transition plans

Net-zero transition plans are the first step to addressing the accountability gap present in banks' financing strategies, but carry significant risks of greenwashing if plans are not robust.

We recommend policymakers ensure that:

- Finance sector transition **plans lead to absolute emissions reductions, implement financing restrictions in relation to oil and gas expansion, and phase down fossil fuels on timelines aligned with 1.5C pathways;**
- Publishing plans is **strictly mandatory, rather than 'comply or explain'**;
- O&G companies and the **UK's major banks are brought before Select Committees annually to explain why their transition plans are adequate**.

4. Advocate for measures beyond disclosure

Research suggests that disclosure alone is not sufficient to enact positive change by financial institutions[xxi]. **We recommend policymakers call for finance sector pathway guidance from the Government, to provide a steer on what 'best practice' decarbonisation strategies look like.** This would give investors a clear idea of how far away banks' strategies are from Government-approved progress towards Paris goals.

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To learn more about ShareAction's work and our stance on a range of regulatory issues visit our website.

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