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Socially Responsible Investment is Also Financially Responsible—But Banks Need Regulation Too

Leah S. Horowitz, University of Wisconsin-Madison

The recent banking crisis, starting with the collapse of Silicon Valley Bank in March 2023, led many to ask what went wrong: What could banks have done differently, and what should regulators' role be? My research and expertise lead me to believe we must seize this moment to scrutinize banks' investment choices, and why they sometimes make ethically and/or financially unsound decisions. Understanding these "whys" is critical for the creation of better banking policy and roadmaps for how banks, activists, and government can work together.

Socially Responsible Investment (SRI) involves screening investments according to criteria based in ethical considerations. It goes hand-in-hand with divestment (withdrawing investment) from unethical projects. Some politicians claim that SRI caused the recent bank crises; economists, on the other hand, blame a lack of regulation. Indeed, SRI is often actually a good business move. For instance, studies show that investment in renewable energy (solar, wind) is more profitable than investment in fossil fuels (coal, oil, natural gas). Divestment from fossil fuels, and related infrastructure, is also a smart financial decision; as the world turns away from these climate change-causing energy sources, those resources may become "stranded assets" that can never be exploited.

My recent research on the #DefundDAPL movement points to the value of SRI, but also shows why banks—even those trying to do the right thing—will never adjust their investment portfolios adequately without regulation.

The #DefundDAPL Movement's Moral Arguments were Not Enough

#DefundDAPL encouraged investors to divest from the Dakota Access Pipeline (DAPL), an oil pipeline running a half-mile from the Standing Rock Sioux Reservation in North Dakota. Their aim was to avoid the environmental, social, and cultural harms that often result from industrial projects near Indigenous communities. Bank employees who were responsible for assisting their institutions in doing "the right thing" for people and the environment were receptive to activists and their arguments, but lacked the power to change bank policy; the people with that power were not interested in engaging with activists.

Reputational Concerns were Not Enough—Unless Profits were Affected

Activists also tried to pressure banks through reputational threats. Banks tried to say that they were not responsible for the abuses of Indigenous rights at Standing Rock, but activists wrote reports, went to the media, and used websites and social media to raise awareness of the fact that banks were lending or investing money that made the construction of DAPL possible. Individual banks had different cultures, and bank CEOs and staff members had moral values, all of which influenced how the banks responded to pressure from the activists. But my research clearly showed that banks were most likely to take that pressure seriously when they worried that the threats to their reputations could hurt their profits. Wealthy investors questioning banks' ethics were far more likely to get bank leaders' attention than activist groups. For some banks, though, projected profits from lending money for DAPL trumped potential reputational harm.

Profit Concerns Trump All

Banks divest from projects when they are not profitable anymore, like coal. So activists tried to convince banks that investing in the pipeline was financially risky. For one thing, #DefundDAPL was succeeding in getting people and cities to close their bank accounts with DAPL-lending banks. But this was not always possible:

Seattle wanted to divest its $3 billion investment from Wells Fargo, but could not find a non-fossil-fuel-lending bank with the capacity to handle a large city account.

Ultimately, partly because of the #NoDAPL activism, and partly because of federally-imposed delays in response to litigation, the company building DAPL, Energy Transfer, did lose money—possibly billions of dollars. This worried the company so much that they (unsuccessfully) sued several environmental organizations; but because investors kept investing with them, Energy Transfer bounced back.

The Importance of Place-Based Relationships

Banks worried about fossil fuel divestment in part because they had long-standing relationships with fossil fuel companies based in loyalty and trust, sometimes through personal connections due to close geographical proximity. Also, oil and gas extraction were important to the economies of the United States and Canada, which was not the case in Europe, so North American banks were under a lot more pressure to keep loaning money to fossil fuel projects than were their European counterparts.

New Screening Options

On their own, banks do not always think it is worth the effort to discern whether and how a project is bad for the environment or for human rights. But these calculations are changing as banks increasingly understand that Indigenous-led movements and lawsuits can lower returns on investments. Investors are beginning to seek out companies that consider sustainability, and banks are starting to find ways to choose projects that do not damage the environment and respect human rights.

One organization that helps banks screen projects is the Equator Principles Association, a framework created by and for financial institutions to identify and manage projects' environmental and social risks. However, that organization's prescription for ethical lending did not stop investment in DAPL: Of the 17 banks loaning money for the pipeline, 13 had signed on to the Equator Principles. So, in May 2017, 10 major banks wrote an open letter to the Equator Principles Association detailing their concerns about the reputational damage that DAPL had caused, both to the banks and to the Equator Principles themselves. Over the next two years, the Equator Principles Association edited the Principles to make them stronger on human rights, climate change, Indigenous Peoples, and biodiversity. But a rule that projects in wealthy countries like the United States only had to follow local laws—which is what had allowed banks to sign on to the Principles while still investing in DAPL—was left standing.

"Herding" Behavior Slows Change, as Banks Fear Becoming Outliers

Some banks decided on their own not to invest in harmful projects like oil drilling in the Arctic National Wildlife Refuge, possibly because they wanted to avoid the reputational damage they witnessed their DAPL-investing peers endure. One bank, BNP Paribas, even decided in 2017 to stop loaning money for shale oil, shale gas, and tar sands projects, although it did continue funding other fossil fuels; BNP Paribas cited both environmental and return-on-investment concerns in their reasoning.

Even more than lost profits and reputational risks, though, banks feared decisions that made them outliers among their peers; due to what are known as "herding" tendencies, no institution wanted to be either the first or the last to chart a new course regarding fossil fuel project lending. For instance, a representative of BNP Paribas said that the bank had expected other banks to follow them and divest from shale oil, shale gas, and tar sands projects, but that effect never materialized; subsequently, BNP Paribas executives worried they would lose profitable opportunities to their competitors who were still lending to those types of projects.

Conclusions

#DefundDAPL activism made a difference, but ultimately the pipeline was still built and banks are continuing to lend money for other pipelines. Therefore, this research suggests that—despite a burgeoning SRI movement—in the absence of government regulation, banks may not be able, in the short term, to avoid loaning money to projects that damage the environment, harm people, and are poor investment choices in the long term.

Read more in Leah S. Horowitz, "The Double Movement and the Triple-Helix: Divestment, Decommodification, and the Dakota Access Pipeline." *Environment and Planning A: Economy and Space* (forthcoming).