CARBON CAPITAL

HOW THE CITY BANKROLLS CLIMATE CHANGE

The City of London is at the heart of the UK financial sector. It's where shares are traded, corporate lending is arranged, and all manner of bets are made on the future price of commodities like oil. Through the Corporation of London, it maintains a powerful lobby for lower business taxes and fewer regulations. And while the UK finance sector is keen to talk up its green credentials, in reality it is bankrolling a global fossil fuels boom, driven on by high oil prices, a dash for gas in electricity supplies, and soaring global demand for coal.

City of London,
Capital of Climate Change

Fossil fuel companies raise money through a mix of equity and debt. Large companies usually raise equity by selling shares, and the London Stock Exchange is one of the world's leading share trading venues. The money mostly comes from ordinary people, but we have little say in the decision of fund managers to invest our pensions, insurance revenues and savings in extractive industries.

Debt financing is mainly arranged by banks, and London is also one of the world's main banking hubs. It hosts the global headquarters of HSBC and Barclays, and the Europe, Middle East and Africa (EMEA) operations of every leading US investment bank. Between them they arrange bonds and loans that channel billions of pounds per year into new fossil fuel extraction.

Speculation on the future price of oil is a lucrative business too, with London recently surpassing New York as the world's oil trading capital.

The financial sector views fossil fuels as a reliable bet, and is betting on the UK government doing little to curb our oil, gas and coal addiction. With tax breaks of over £1 billion to North Sea oil, and new carbon reporting rules that don't even ask financiers to count the impact of their investments, it has not been disappointed.[1]

This booklet looks at how the City of London organises the fossil fuel investments for destructive fossil fuel projects that are leading to runaway climate change, and asks what we can do to stop it. Its aim is to inform campaigners and equip them to take action.

Shares

The London Stock Exchange is at the heart of the UK finance industry. It is a club where investors trade shares, each representing a small slice of the ownership of a company.

Traders choose their investments from long lists of companies (called 'indexes'), a bit like lottery players choosing numbers from a card. The FTSE100 is the most important of these lists, and contains 100 companies that account for four-fifths of the shares traded in London. Shell and BP are the largest and third-largest companies on this list.[2]

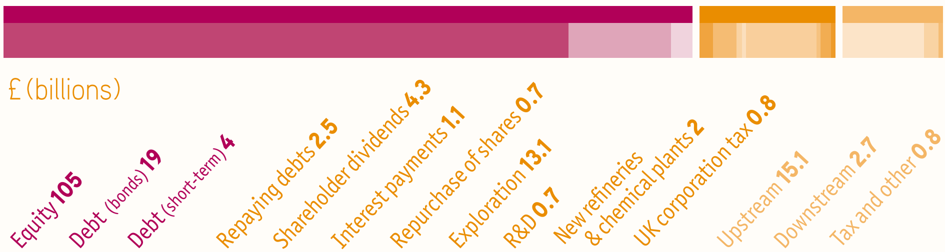
The fossil fuel shares listed on the stock exchange are worth (as of December 2012) approximately £900 billion, around 25 per cent of all of the shares listed there. Around £680 billion of this is invested in oil and gas, approximately £185 billion in coal, with much of the rest in power companies. By way of comparison, the value of shares in 'alternative' (i.e. renewable) energy companies is around £5 billion.

The value of fossil fuel company shares is mostly based on estimates of how much oil, gas or coal they will be able to extract from their network of wells, mines and prospective sites. Exploiting all of these reserves would release enough carbon dioxide to cook the planet several times over. In fact, just 30 companies listed on the London Stock Exchange hold more 'unburned carbon' than the CO_2 emissions of the whole world for the past six years.[3] That's around 470 times larger than the UK's annual emissions.[4]

Oil, gas and coal companies trading in the City control some of the world's most damaging fossil fuel projects. These include an Australian coal mining boom (spearheaded by BHP Billiton, Anglo American, Rio Tinto and Xtrata), Shell's investments in the massively destructive North American tar sands, and offshore drilling by Shell and BP in the Gulf of Mexico, the Arctic and Angola.

SHELL PLC

Capital Spending Profits



CAPITAL: Total capital, 2011. Short-term borrowing comes through selling "commercial paper" (like bonds, but issued for less than a year) to brokers and dealers. Shell has a $5.2 (£3.2) billion credit facility with a consortium of banks, but did not draw on this at all in 2011.

SPENDING: This is a sample of some major items of expenditure. It does not account for all of the money the company spent in 2011. R&D is Research&Development, a programme mainly focussed on extracting more oil and liquifying gas to make it more easy to trade.

PROFITS: Upstream includes sales of oil derivatives (average price: $111). Downstream includes petrochemicals, aviation and corporate fuel sales, and petrol stations. "Tax and other" suggests that Shell made more in tax credits and subsidies than it paid in corporate tax globally.

All figures from Shell Annual Report, 2011. Converted $ to £ as at 31/12/11

People in the world's poorest countries are already feeling the worst effects of climate change, while many are also faced with and resisting the spread of extractive industries. Shell's long history in Nigeria shows how transnational corporations, politicians and security firms strike it rich when oil is discovered, while poor people are denied their livelihoods. An offshore oil boom in the Gulf of Guinea threatens to spread this 'oil curse' from Nigeria to nearby countries, with London-based Tullow Oil spearheading production in Ghana and Shell exploring in Benin and Gabon.

Many of the smaller companies pioneering oil exploration, gas fracking and mining also thrive in the City, where the Alternative Investment Market (AIM) provides them with a platform to find investors. For example, the main activity of AIM-listed GCM Resources is to develop the huge and controversial Phulbari open-pit coal mine in Bangladesh, which has met with stiff resistance from the local population that would be forcibly displaced by the project. The project is entirely funded by £40 million worth of shares sold in London.[5]

The City is not simply the financial heart of fossil fuel extraction that takes place elsewhere, but also joins the dots between these sites and the tax havens that channel large swathes of corporate profits. It is where the accountants, lawyers and bankers do the real work of setting up and running offshore shell companies. A quarter of the 30,000 subsidiaries run by FTSE100 companies are registered in tax havens.[6] For example, BP runs a major Algerian gas project from Jersey, self-insures its off-shore drilling in Guernsey, and operates oil tankers from the Isle of Man and Bermuda.

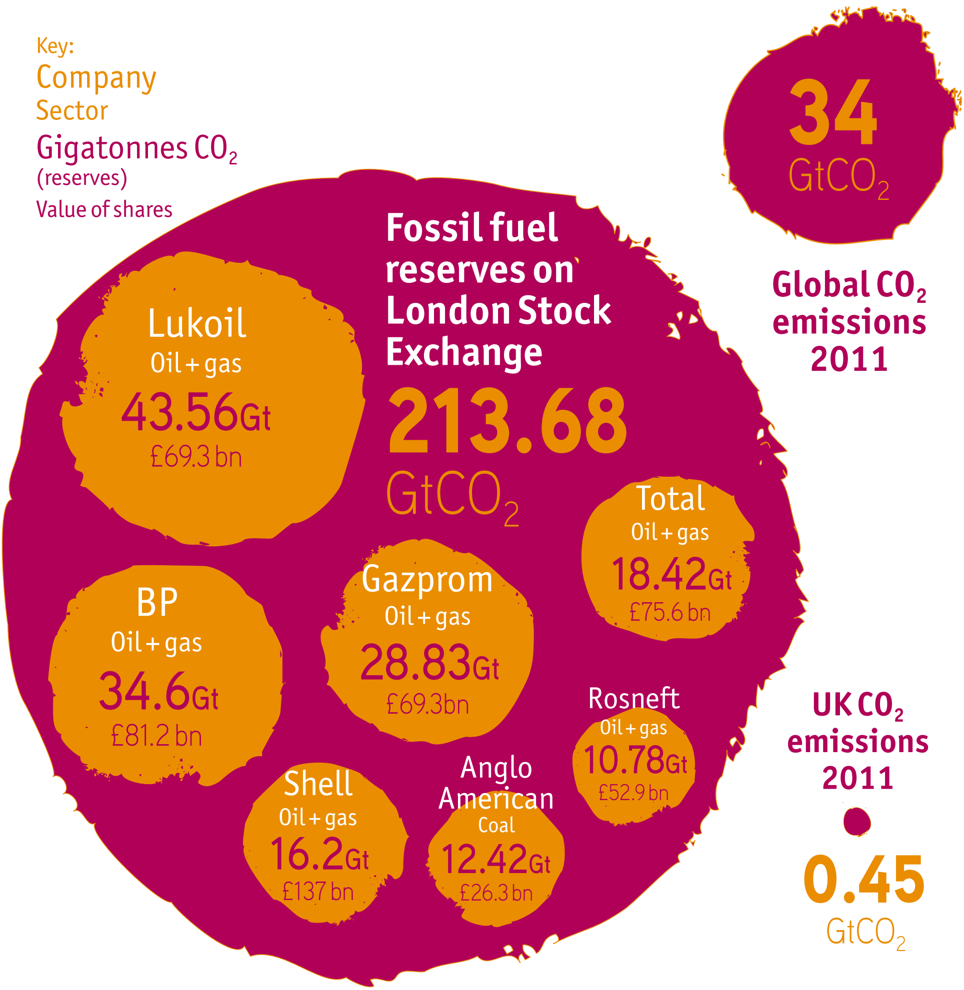
Beyond Renewables?

Renewable energy barely registers on the radar of City investors. A mere handful of small wind and solar companies are listed on the London Stock Exchange, and fund managers trading in renewable energy stocks is so insignificant that it fails to register in statistics or most analysts' reports. Shell and BP – who once claimed to be moving 'beyond petroleum' - have sold most of their (small) wind and solar businesses. That leaves Scottish Southern Energy (spending £850 million per year, mostly on wind farms) as the only major FTSE100 renewables investor.[7] In contrast, in California, China, Denmark, Germany and Spain the renewables sector has taken root from a mix of favourable regulation, including feed-in tariffs and other subsidies that include small-scale producers, renewables targets and infant industry protection. All of these measures are anathema to the fossil fuelled 'free market' lobbying by the City of London Corporation, the financial centre's powerful lobbying group.

The carbon bubble

Oil, coal and gas on the Stock Exchange

The 'carbon bubble' is the amount of CO_2 that will be released into the atmosphere if all of the 'proven reserves' owned by the largest oil, gas and coal companies are extracted and burnt. The emissions figures shown here are based on Carbon Tracker Initiative, Unburnable Carbon (2011). Rosneft acquired BP's Russian operations in October 2012, but this change is not yet reflected in the figures. UK and global emissions comparisons are from the UK Department for Energy and Climate Change, and PBL Netherlands Environmental Assessment Agency (2012). Market capitalisation figures from London Stock Exchange, 31 December 2012.



Who owns the City?

Most of the money invested in the City of London comes from ordinary people's pension funds, insurance premiums and bank savings. Pension funds account alone have £1.5 trillion invested in a mix of shares, bonds (company borrowing), currency and commodities like oil. All told, the City's fund managers invested over £5 trillion at the end of 2011, almost three times the size of the UK's Gross Domestic Product (GDP).[8]

Investment does not automatically result in control. People whose money ends up in fossil fuel extraction have no say on how it is spent. For example, no pension products currently on offer in the UK (even 'ethical' ones) exclude fossil fuels from their portfolio.

More surprisingly, perhaps, fund managers have limited control too. Most of the big 'institutional investors' feel that they might be better off sending their cat for a 'random walk' over a copy of the *Financial Times* than giving their fund managers free rein.[9] Instead of picking big winners from the lottery list of shares listed on the City's exchanges, funds are instructed to buy small stakes in many companies, restrict purchases to certain sectors, or (in the case of 'index funds') invest in accordance with the sectoral balance of the whole market. Beyond that, fund managers' only goal is to make a profit, irrespective of the social and environmental damage caused along the way. With their tight leash and amoral standpoint, fund managers act more like sociopathic robot dogs than cats on a random walk.

SEEK PROFITS.
MUST PROFIT.

The specialist 'asset management' firms Black Rock and Capital Group own the largest stakes in oil companies trading in the City of London, followed by Legal & General (L&G). These companies manage pensions schemes for private companies, local authorities, healthcare trusts, universities and trade unions, as well as acting as 'wealth managers' for millionaires. In the case of Shell, for example, around £8.5 billion (6.5 per cent) is controlled by the Capital Group, £8.2 billion (6 per cent) by BlackRock, and £4.8 billion (3.5 per cent) by L&G.[10] This money, in turn, is dispersed across dozens of smaller funds, which range in size from tens of millions to a couple of billion.

BlackRock's Charishare fund is a typical example. Charities, non-profit foundations, universities, private schools and churches have bought into the fund in amounts ranging from £1,000 to several million. As of 2011, Charishare had £460 million to invest in companies listed on the London Stock Exchange. Just over 20 per cent of the money was held in oil and gas company shares (including £33 million in Shell) and a further 10.5 per cent was invested in mining stocks (including a £14 million stake in Rio Tinto).[11] These proportions are slightly higher than the stock market as a whole, reflecting the fact that fund managers see fossil fuels as a safe bet.

Fossil fuel investment is woven deep into the fabric of the UK finance sector, with well over a thousand funds investing in these companies.

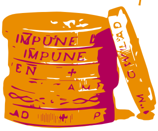
Hedge Funds

Hedge Funds are investment vehicles whose main purpose is to make the very rich even richer, although around a quarter of their money also comes from ordinary people's pension funds. Hedge funds own a small proportion of oil and gas companies, but buy and sell their shares much more frequently than institutional investors, accounting for between a third and half of all trading in shares.[12] They are also heavily involved in speculating on the future price of oil. Monopoly fans will be unsurprised to learn that many of London's leading hedge funds operate from properties in Mayfair, although some of the largest funds are also run directly by investment banks.

Six steps to dirty energy

1. Most of the money in London's stock markets comes from ordinary people's pension fund contributions, savings accounts and insurance policies invested in shares (this is equity).

Ordinary people's money



59% UK

12% Other EU

23.5% US

6.5% Rest of the world

Equity

2. Ordinary people don't control this money. Most of it is invested by fund managers working for mutual funds, or directly for the pension and insurance companies.

Rich people's money
Mainly from US and EU

Insurance

Banking

Pensions

Mutual funds
Unit trusts and investment trusts

3. Fund managers invest heavily in oil and gas companies shares.

Personal shareholdings

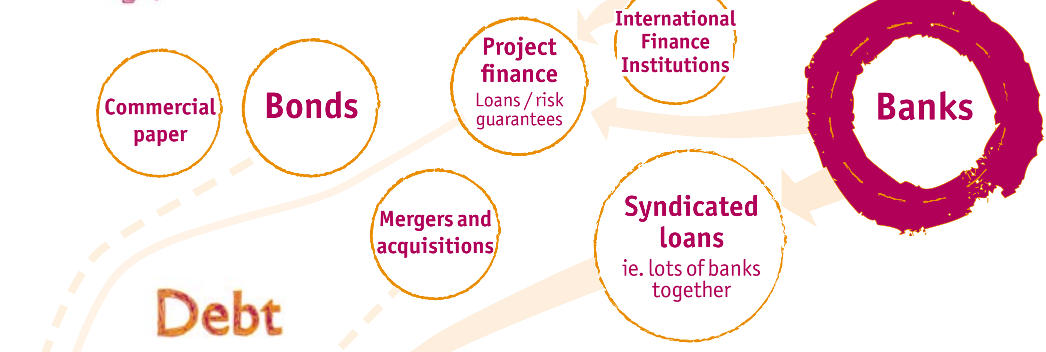
Executive share options

Hedge funds

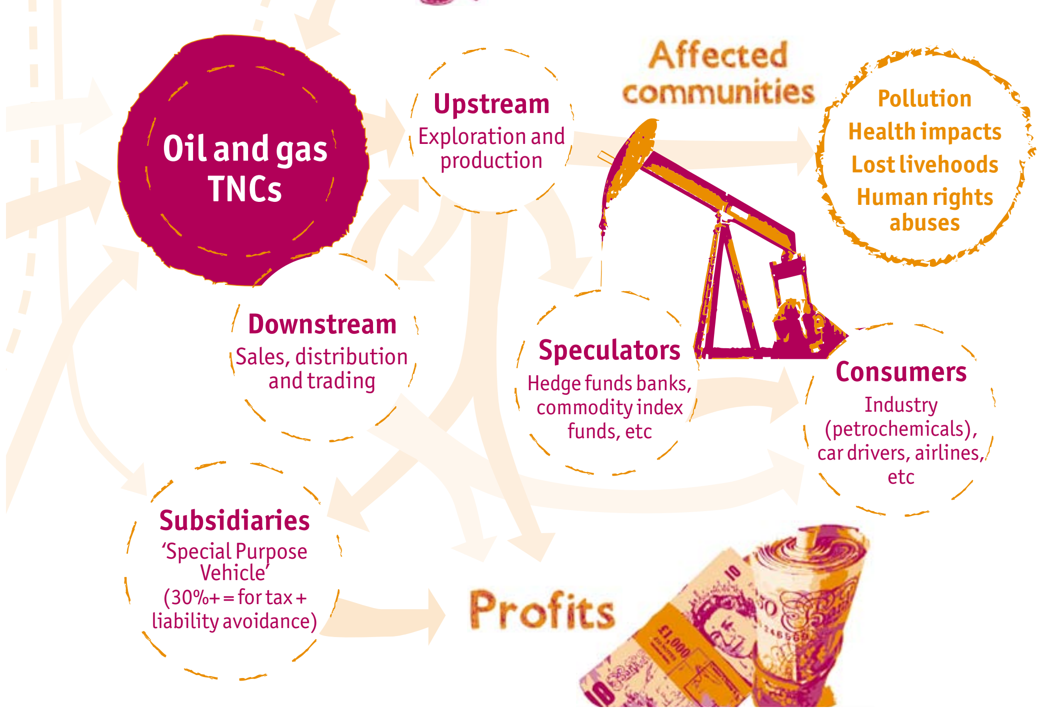
Sovereign wealth funds

London stock exchange

4. Equity investments enable companies to borrow even more money. This debt mostly comes in the form of bonds (long-term), commercial paper (short-term) and syndicated loans (from consortiums of banks).



5. The debt and equity investments are used to fund the extraction of oil and gas, destroying the livelihoods, health and environment of communities across the globe.



6. Oil production costs vary considerably but almost all existing fields are profitable when a barrel of oil sells at £70, the average price in 2012. Some of the profits are returned to shareholders, banks (as fees and interest), fund managers and directors (in the form of bonuses). The rest are used for even more oil exploration and production.

Banks

The UK's leading banks like to present themselves as corporate leaders in addressing climate change, but their fossil fuel lending tells a different story.

Big companies, including oil, gas and mining multinationals, often borrow money by issuing *corporate bonds*. These are I-owe-you slips handed out by the companies themselves, but 'underwritten' by the main banks. That means the banks draw up the paperwork, sell the bonds and, if insufficient buyers are found, buy them up for re-sale at a later date. Bonds are often issued for five to ten year periods, but companies also make short-term promises to pay back money in less than a year's time. These are called *commercial paper* and, like bonds, they provide a cheap alternative to conventional bank loans. In both cases, investment banks make most of the arrangements and are amongst the main traders.

Syndicated loans, as the name implies, are provided by a group of banks acting together. The size of these loans is directly related to the equity of the company which, in turn, is largely determined by projections about how much oil, gas or coal they are likely to extract from the territory that they have access to. Syndicated loans can run to billions of pounds. Other corporate loans take the form of *project finance*, which mainly funds the construction of new infrastructure like pipelines, roads or power stations.

Bond issues and corporate loans account for 88 per cent of bank financing for coal-fired power plants and coal mining globally, with a further 11 per cent derived from these banks' asset management activities (mostly, holding coal company shares). Only 1 per cent of financing is provided in the form of project finance.[13]

Fossil fuel financing:

Figures represent value of fossil fuel bond and share issues underwritten by each bank between 2010-2.
They do not include money lent to dirty energy companies as corporate loans or project finance.

The UK's three main high-street banks are amongst the world's leading coal funders. Between 2005 and 2011, Barclays' coal financing was worth at least £9.6 billion, compared to £9.2 billion for taxpayer-owned Royal Bank of Scotland (RBS), and £3.7 billion for HSBC, according to a study by Banktrack. JP Morgan and Citigroup, the world leaders in bankrolling coal, also run their Europe, Middle East and Africa (EMEA) operations from London.[14]

Barclays, HSBC and RBS have also ploughed significant sums into oil and gas extraction. No complete figures are publicly available, but a 2010 investigation by campaign group Platform found that the three banks had 'underwritten' (arranged) loans and bonds worth over £31 billion just to companies operating in Canada's tar sands.[15]

Bond issues and corporate loan syndicates arranged in the City of London and underwritten by British banks are also at the heart of oil and gas exploration and production from Africa. The Total group, which already sources 28 per cent of its oil and gas from the continent, is expanding its 'ultra-deepwater' exploration across West Africa from Angola to the Ivory Coast. The company currently has £19 billion in bonds to fund these and other projects globally, most of which are arranged by Citigroup from London, and underwritten by a consortium that includes HSBC, RBS and LloydsTSB. It has a further £9 billion in 'current' debt, which includes commercial paper (similar to short term bonds) and bank loans. By comparison, Total's equity (the combined value of its shares) is worth just short of £60 billion.[16]

Mergers and acquisitions

The riskier bets in the oil and gas sector are often taken by small companies. If they strike oil, part or all of the resulting field, or even the whole company, is bought up and developed by multinationals. Political risks or payouts for oil spills can also result in sales of established fields or subsidiaries to free up money for new exploration – as is the case with BP, which is currently undergoing a major reorganisation. Investment banks are key players in these 'mergers and acquisitions' (M&A), which see around $200 billion (£130 billion) in assets change hands each year.[17] Banks earn a significant share of their revenue by offering strategic advice, legal and financial support for these deals.

Commodities

North Sea oil reserves are starting to run dry – the UK government even blamed declining production for tipping the country back into a recession – but the trade in North Sea oil is booming. In 2012, over £11 trillion of North Sea oil (aka. Brent Crude) was bought, sold and speculated on.[18] That's more than 10 times the size of UK GDP, the combined value of all of the goods and services produced in the country in one year.

OIL FUTURES, 2012:

£11 trillion

UK GDP, 2012:

£1.5 trillion

Brent Crude is now the world's most heavily traded commodity, with London's ICE Futures market the venue of choice for international dealers who bet on whether barrels of oil that have not yet been produced ('oil derivatives') will rise or fall in value. Banks, hedge funds, pensions funds and insurance companies account for a growing share of this market, even though they have no interest in using the oil itself. More specialist commodities traders, like FTSE100-listed Glencore, mix speculation with a refineries, transport and storage business. When prices fall sharply, these companies even pay for dozens of super tankers to be moored around the British coast, waiting for prices to rise.

Increased speculation leads to a more volatile oil price. This has major effects on food and energy prices. One of the main reasons for this is that a lot of oil trading is conducted by 'commodity index funds,' which buy and sell based on a basket of commodities (corn, wheat, cattle, etc.). As the world's most traded commodity, oil is usually also the largest item in an index fund's basket – a fluctuating price wreaks havoc on the cost of food, and farmers' ability to plan what they plant. The world's poorest people, who usually spend more than half their income on food, suffer the most.

Carbon trading

The European Climate Exchange, located in the City of London, is where most of the world's carbon allowances ('permits to pollute') are traded. These are meant to put a price on carbon, encouraging industry to reduce greenhouse gas emissions, but corporate lobbying and recession has resulted in a massive oversupply of permits and prices have collapsed. The EU Emissions Trading System (ETS) was lobbied for and pioneered by BP, while Shell made the first 'futures' trade of an EU ETS allowance in 2003. They remain big players, as do the trading desks of 'big six' energy companies like EDF. Major banks like JP Morgan, Deutsche Bank and Barclays are the other large players in the carbon market. The European Climate Exchange is run by Intercontinental Exchange (ICE), which also runs London's main oil and gas futures exchanges.

What we can do

Oil, gas and mining companies are not going to clean up their act voluntarily. But there is plenty that we can do to press for a financial system that could help to make fossil fuels extinct. There are many approaches to this objective. A few of them are listed here.

Demand transparency.

At present, it is impossible to calculate the true carbon footprint of the UK financial sector. From April 2013, new 'mandatory carbon reporting' rules apply to companies listed on the London Stock Exchange, but these will not force bankers and fund managers to reveal the true extent of their financed emissions: the carbon emitted as a result of their investment or lending activity. Barclays will have to count the carbon impact of their light bulbs, but not the billions they are pouring into fossil fuels. The new rules won't apply at all to the shadow banking sector, which includes hedge funds. Join WDM in calling on the government to extend mandatory carbon reporting to account for all financed emissions.

www.wdm.org.uk/take-action

Move your money.

Everyone with a bank account can make individual ethical choices about what to do with our money, but we only win by acting together. It's worth moving your money to credit unions, building societies or ethical banks, but check the small print to make sure they don't really invest in oil, gas and coal. Unless you are a multi-billionaire, moving your money is unlikely to bring down any banks or fossil fuel companies. But it can help to create a more diverse and sustainable financial system – alternatives that are vital if we are to convince policy-makers to turn their back on the City.

www.moveyourmoney.org.uk

Show solidarity.

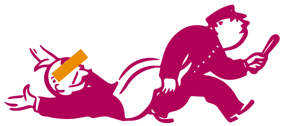
Join WDM and its allies in working to support communities resisting fossil fuel projects. For example, protests and shareholder activism at company Annual General Meetings in the UK can shine a light on abuses in the global south. Such actions don't only make executives squirm: by damaging corporate reputations, they can help scare off investors, make examples of the worst corporate offenders, and ultimately change how companies behave.

www.wdm.org.uk/carbon-capital

Change the rules.

Companies won't really change unless the rules governing them change, which means we need to push the British government and the EU to change course. Even small proposals can help, such as 'publish what you pay' rules to force extractive industries on the London Stock Exchange to disclose their payments to foreign governments, which could help campaigners in Southern countries to track unfair deals and government kickbacks.

www.publishwhatyoupay.org



End impunity.

Fossil fuel firms and their executives should be liable for the environmental and human rights abuses committed under their watch. In January 2013, a legal case brought by Friends of the Earth showed that Shell could be held liable in a Dutch court for environmental damage caused by a Nigerian subsidiary. Our legal system needs to recognise that it has similar responsibilities in holding UK-based multinationals to account.

www.stopcorporateimpunity.org

Set a better example.

The British government could set an example by forcing through cleaner lending policies at the bailed-out banks such as RBS and Lloyds TSB. RBS is now 82 percent owned by the UK public, and yet it continues to be a major bankroller of dirty energy. It's time the UK government told RBS to stop gambling with the atmosphere - the stakes are too high.

www.platformlondon.org/oil-the-arts/fossil-fuel-finance

Reboot the system.

As Naomi Klein reminds us, 'With the fossil-fuel industry, wrecking the planet is their business model.' Fund managers have huge sums of money locked into fossil fuels, and the profitability of their investments relies on their continued extraction. This system will continue to perpetuate itself until we say stop. There is ample evidence that the fossil fuel multinationals don't have the capacity to lead a transition to fossil fuels, and that City investors' interests are so closely wrapped up in these companies that they will be the last to move away from them. That means our priority should be to reduce the role of capital markets and asset managers in investing our money in the first place.

'With the fossil-fuel industry, wrecking the planet is their business model. It's what they do.'

Naomi Klein

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Justice for the world's poor

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The World Development Movement campaigns against the root causes of poverty. Working in solidarity with activists around the world, we oppose injustice and challenge the policies and institutions which keep people poor.

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