ESG Now Podcast

"BNP's 'Duty of Care' and a Lonely Start for Germany's Female Execs"

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Bentley Kaplan:

Hello and welcome to the weekly edition of ESG Now, the show that explores how the environment of society and corporate governance affects and are affected by our economy. I'm Bentley Kaplan, your host for this episode.

And on today's show, we are going to get into two stories. First, we'll get to the bottom of a lawsuit that's being brought against BNP Paribas, asking that the bank ceases its financing of fossil fuels. And then, we'll take a look at efforts by German regulators to poke a hole in the executive glass ceiling by effectively passing a quota that requires all large German companies to have female representation on their management boards. It may sound like a mouthful, but it is well worth the airtime. Thanks for sticking around. Let's do this.

We spend a lot of time on this show talking about how environmental, or social, or governance factors, are important for different companies. And these factors can vary depending on the products that they make, the industries that they're in, or the geographies they operate in or make their sales. Sometimes we're talking about purely financial risks, like how a construction company that's not on top of its safety risks might have a serious mishap, which means having to shut down operations for a few days, and that event ties directly into a company's bottom line. And sometimes we're talking about a company's externalities. Or its impacts on society or the environment, like say how it relies on the cocoa value chain to make chocolate and how that matters because cocoa production is a key driver of modern slavery and child labor.

But sometimes it's harder to draw the line between these two different things. Sometimes a company's externalities have a specific and direct link to its bottom line, and that's what this first story is all about. So in late February this year, three NGOs filed a lawsuit against the French multinational bank, BNP Paribas. And the lawsuit calls for the bank to essentially stop financing fossil fuels altogether. And as you can imagine, there's a lot to unpack here. So to find out more about this lawsuit, what it tells us about BNP, and what it could mean for investors, I called up a fresh face on the podcast, Guilherme de Melo Silva, who is based in our London office and covers the financial sector. First, Guilherme, put the lawsuit into context for me.

Guilherme de Melo Silva:

This became the first, possibly the first, case of NGOs using the courts to push a commercial bank towards a faster low carbon transition. This law is based on a 2017 Duty of Care law in France, different from many other environmental laws. This one covers the firm's own activities, but also its relationship with all business partners, supply chain and clients, which is certainly challenging for companies like banks where the impact is indirect. BNP has all the required reports, maps, et cetera, but campaigners argue that the banks climate goals and credit policies still contain gaps and loopholes that allow it to continue expanding fossil fuel financing. And by doing that, generating global negative environmental impacts.

Bentley Kaplan:

Okay, so there is something unique here. Since 2017, France has had something called the Duty of Care law. And in basic terms, this law requires that large French companies put together a plan for mapping their risks related to negative impacts on human rights and the environment, and then measures that would prevent that impact from happening. That means not just due diligence, but also monitoring systems and mitigation efforts. And the scope of this law is bold, covering not just a company's own activities, but its supply chain and commercial partners, not only in France, but globally.

The NGOs that have brought this lawsuit against BNP are basically saying that the bank's financing of fossil fuels goes against the company's duty of care. A company that has found to have not fulfilled its duty of care can face fines of up to 10 million euros and be held liable for any resulting losses. And it's this consequence that could see a company's external impacts, in this case, the emissions it finances, also have consequences for its bottom line.

Now, the law itself is relatively untested in this context. The only other lawsuit against a company like this was brought against Total Energies over the company's drilling and pipeline activities in Uganda. The case was ultimately dismissed earlier this year, but it might have left the question of company responsibility in the minds of several stakeholders, especially for investors that might be looking ahead at any future lawsuits that challenge companies on their duty of care. And that's a challenge that's being put to BNP as we're recording this.

So next, I wanted to get a sense of where BNP stands in terms of how much financing it has put behind fossil fuels and whether that's changed over the past few years. Because even outside of France's duty of care law, investors and regulators will be looking increasingly at the exposure of different banks to fossil fuel lending, or more broadly, their financed emissions, how much they've invested in emissions-intensive activities or assets.

Guilherme de Melo Silva:

BNP has engaged in a number of sectoral initiatives related to climate, such as being a member of PCAF, the Partnership for Carbon Accounting Financials. That is the gold standard in terms of financed emissions reporting, and is also a member of the Net Zero Banking Alliance, which is led by United Nations and was actually one of the founders of this initiative.

The bank has also implemented a number of climate-related management practices involving governance, reporting, targets, procedures, et cetera. BNP has a 2025 net zero targets for oil and gas, energy and automotive sectors, and plans its coal exit by 2040 worldwide. Last year the bank reported more low carbon than fossil fuel energy production, in a proportion of 28 against 24 billion euros respectively. It is a small percentage considering the huge portfolio of BNP Paribas, which is the second largest bank in Europe, but it's of course a significant absolute number considering the size of the fossil fuel sector.

According to some databases, BNP financed more than 165 billion dollars for fossil fuels between 2016 and 2022. And according to our methodology to estimate financed emissions or emissions generated by the investments and loans the bank offers, covering loans, equity investments, and assets under management, BNP generated over 142 million tons of CO2 in 2021, which is the highest level among European peers according to our methodology.

Bentley Kaplan:

Okay, so Guilherme has made a couple of critical points here. One, BNP is a huge bank, and that means that even if only a small percentage of its overall lending is geared towards fossil fuels, that ultimately means a big absolute amount, both in terms of dollar value and ultimately greenhouse gas emissions. Second, when we're talking about a bank's financed emissions, it's a complicated process. Standards to estimate or calculate these emissions are emerging and getting better, but it can still be quite difficult for a bank to transform all of its lending and investment activities into raw emissions numbers.

As Guilherme told me, it can be easier to do this when looking specifically at a loan book with known use of proceeds. But when looking at things like corporate finance, or real estate holdings, or assets under management, it gets very murky very quickly.

And for BNP, there are kind of two sides to their story. One is of a global bank that has a relatively big exposure to fossil fuels and emissions-intensive sectors. Between 2016 and 2021, the bank was one of the biggest financiers of fossil fuels globally. But the company has also taken clear steps to cut its funding to fossil fuels and has set targets for reducing its financed emissions for the ever popular net zero by 2050 target. The bank is making a lot of moves that suggest it's trying to lower the risks it would face in a low-carbon transition, or indeed, its contribution to climate change.

But whether or not the company is actually on track with such a target is tied up with the same questions of how a bank can actually measure its total financed emissions. Something that feels close to crystallizing, but is not quite there. So for now, we can hang a question mark on that. But there's a lawsuit on the go. And that doesn't really have a pause button. So I asked Guilherme whether this type of lawsuit is really an oddity for BNP and Total Energies and the French legal system, or if this was in fact a wider risk as climate becomes a more pressing issue for investors and stakeholders.

Guilherme de Melo Silva:

The flagship case related to climate litigation was against Shell. A Dutch court ordered the energy company to cut 45% of its global carbon emissions between 2019 and 2030 to follow science-based references. However, Shell is currently appealing the decision. But I see climate change litigation as a global trend. And may become relevant in many industries including the financial sector. Columbia University and London School of Economics and Political Science both have databases with around 3000 cases each against governments, companies, and individuals worldwide. And the figures almost doubled in the last two years with a special increase in demands related to losses and damages and to poor climate ambitions or demanding strategic shift in public policies and also in companies' business models.

Bentley Kaplan:

Right. Now, for our second story, we're going to skip across the border from France into Germany, because last year in August, Germany's parliament adopted a mandatory gender diversity quota for senior executives at large German companies. And this was a big move, because large German companies actually have two boards, a supervisory board, which is one that oversees company management, and then a management board made up of company executives.

German companies have been very successful in building up the representation of women on their supervisory boards, but this wasn't really the case for management boards, which have remained traditionally male dominated. My colleague, Florian Sommer, looked at data from 34 large German companies covering around 84% of the market cap of the German MSCI ACWI Index constituents to see if and how this law was starting to move the needle for gender diversity in company management.

Florian Sommer:

So maybe the first thing to say is that women remain heavily underrepresented in terms of seats on German management boards. Only 22% of those seats on management boards were held by women as of February. That's quite a clear number.

However, and I think that's important in the context of the quota that we're talking about, there has been a considerable increase in recent years. It's 22% as of February this year, but it was only 13% of those seats in November 2020. And if you look in detail when exactly that increase happened, and how it coincides with some of the key steps in terms of developing and implementing this quota, I think you see some interesting trends here. Essentially, I highlight November 2020 here because that's when the German coalition government at the time agreed on these new gender diversity rules for management boards. If you take that point in time and project it and look at the evolution up until February this year, you see that increase.

Bentley Kaplan:

OK, so, Florian has seen a definite shift. After this quota was approved by German parliament, the proportion of women on management boards started to creep up. And keep in mind that they were doing so from a very low base. Before lawmakers stepped in, only about one in 10 of these management board seats were held by women, and one in two companies had all male management boards. By the time the quota became applicable, then things were starting to move a little more substantially, and as of February, more than 2 out of 10 management board seats are now held by women.

And if you're an investor that wants greater gender diversity in company decision-making, this is good news, even if it required an intervention by the government to kick things off. But I pushed Florian to dig into the data a little further because appointing one female executive to a management board that historically has been all male and would presumably be keeping a lot of these executives in place, doesn't necessarily seem like an automatic transformation. Changing a culture seems like something that might need a little more time. And this disparity between numbers on paper and board dynamics in reality was definitely something that had been on Florian's mind.

Florian Sommer:

Well, I think that depends on the makeup of the specific management board, and also on the tenure of female senior managers. On the question of composition of the management board, we looked at a subset of 34 big German listed companies, and you can really see big differences between them. Some have two female senior managers, some have three, but most of them actually only have one woman on the management board.

You can also go one level deeper and look at tenure of female senior managers, because it sometimes takes time for new board members to be fully integrated into decision making. They may need to get to know the company or the board better. A quarter of our 34 German listed companies only have one female senior manager that has been recently appointed to the management board, so within the last two years. And in those cases, I'd argue you go from a situation of an all-male management board to a male-dominated management board. I think the bottom line is that there has been an important increase in female senior managers in Germany, but you could also see that there's still some way to go to achieve equal participation in board decision-making at the management level. So I'd definitely watch this space.

Bentley Kaplan:

So for Florian, big German companies may have made a promising start to getting more women on management boards. But it is very much just a start. And any given board will have complex and changing dynamics. Being the sole female executive on a board that has been historically staffed by men will not necessarily be an easy prospect. And deftly managing this context will be a challenge in itself, before day-to-day board duties of a newly appointed female executive can even begin. Maybe not quite as cut-throat as the HBO series Succession, but still, complex enough to warrant a very healthy scrutiny of companies that have just added their first female executive.

And yes, these are early days. In time, we may see some differentiation with some companies faithfully meeting the mandatory minimum representation of female executives, while others might see that balance shifting over time with greater and greater proportions of women joining the management board. Germany's lawmakers have sketched out the starting line, but it's very much up to companies and their investors to take the next steps.

For Guilherme, the story of BNP being sued under France's Duty of Care Law is an interesting one. A lawsuit does certainly grab headlines. And the successful lawsuit against Shell in the Netherlands certainly ruffled some feathers. But at the same time, a lawsuit does look to force a binary outcome. And if the suit is unsuccessful, the story ends there. Lawyers are paid and company is not compelled to make any of the changes that litigants have argued for. But regardless of the outcome of the lawsuit for BNP, it has definitely raised important questions. Because knowing how much fossil fuel a bank is funding is an increasingly important question – because it both measures an externality (how that financing is exacerbating climate change), and a financial risk (in the form of stranded or depreciating assets in a transition to a low-carbon economy).

And for investors that really want to dig into those questions, there may be a need to broaden the scope. Not just knowing how much fossil fuel is being financed, but all activities that are accelerating climate change, and conversely, all activities that are mitigating climate change. And maybe unsurprisingly, investor and regulator demand for that data, is definitely on the rise. Because many of BNP's stakeholders may not want to take the bank to court, but they will want to know how prepared the bank is to manage its longer-term climate risks. Maybe not per the strict legal definition in France, but a duty of care all the same.

And that is it for the week. A massive thanks to Guilherme and Florian for their take on the news with an ESG twist. And thank you very much for tuning in, it's been a fun double header for me this week and last, but the unparalleled Mike Disabato will be back in the host's chair next week.

If you did enjoy this episode, please don't forget to give us some stars on your podcast platform of choice, and an encouraging comment goes an amazingly long way for me and Mike. It also helps our show to find future listeners, which is what this is all about. Thanks again, and until next time, please do take care of yourselves and those around you.

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