NATIONAL ROUND TABLE ON THE ENVIRONMENT AND THE ECONOMY
TABLE RONDE NATIONALE SUR L'ENVIRONNEMENT ET L'ÉCONOMIE

Canada

CASE STUDY

THE ROYAL BANK OF CANADA

Decision-Making Processes Committee
National Round Table on the Economy and the Environment

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THE ROYAL BANK POLICY ON THE ENVIRONMENT

The Royal Bank of Canada believes that human welfare depends upon both sound economic growth and maintenance of a healthy environment, and recognizes that the two are inextricably interconnected. The Bank is therefore committed to managing its operations in such a way as to promote these twin aims. Our policies and business actions shall be so shaped as to promote environmental protection in ways which meet the needs of the present without compromising those of the future.

THE BANK'S POLICY IS TO:

- responsibly manage all aspects of its business to help ensure that recognized environmental standards and legal requirements are met;

- continue to give appropriate consideration to environment regulations and risks in its assessment of proposed loans and investments, and in management of its assets;

- so manage its internal operations as to promote environmental protection in all feasible ways, having due regard for associated benefits and costs;

- work with industry, government and public group to help determine economic and environment priorities;

- provide support, through its program of corporate philanthropy, for selected non-profit groups doing sound and effective work in conservation and/or the environment;

- communicate with relevant stakeholder groups, in timely and candid fashion, on the environmental aspects of the Bank's policies and operations;

- encourage all employees, throughout the organization, to be conscious of environmental considerations and, in a pragmatic way, be protective of the environment in their work.

SECTION I

Background:

The Royal Bank of Canada, with assets of over $123 million, is Canada's largest financial institution and the 2nd largest bank in North America. It provides banking and related financial services to close to eight million retail and business customers through its 1,600 branches, specialized business centres and 3,000 banking machines.

It has over 80,000 common shareholders and 55,000 employees.

The bank is policy-driven, and has a policy governing all areas of its activities.

Issues:

In February 1990, the Public Policy Committee of the Royal Bank's Board of Directors approved a Policy on the Environment.

The initiation of that policy began with the Royal's Chairman and Chief Executive Officer Allan Taylor who asked early in 1989 the following questions: "Do we have a policy on the environment? If we do, what is it? If we don't should we have one? If we do, what should it be?

Public opinion research had shown for a considerable period of time that the environment is a top issue on the Canadian public's list of concerns. It was quite clear that the issue is an entrenched trend, reflecting a deep shift in the public's view of the world.

That concern was shared internationally, and there was growing broad support from most sectors of society in Canada, including business people, for the fundamental proposition put forward by the Bruntland Commission - i.e. human welfare on a broad scale and a healthy natural environment.

The Royal Bank of Canada is pervasively involved in the country's economic and community life, dealing with individuals, families, agriculture, fishing, small business, large corporations and all levels of government. It is also involved in various ways with some third-world countries. Additionally, the Bank has an earned reputation for thoughtful, responsible policy and behaviour.

Tools:

It was very quickly established that any thoughtful consideration of the bank's policy on "social responsibility" would include environmental considerations. However, given the importance of the environment issue, it would be appropriate to put in place a clear and explicit statement of overall Royal Bank policy regarding environment.

Actual or potential areas of bank involvement in the issue would include: internal operations, communication with relevant stakeholder groups, participation in public policy discussion, donations, and customer service, particularly since environmental risks are playing an increasingly important part in financial credit risk.

It was decided that, as well as creating a general policy on the environment, the bank should expand and develop its credit policy with respect to the environment.

The tools available to allow both policies to be developed were:

1) A commitment or agreement from senior executive that the issue was important.

2) People who could apply concentrated brainpower to give more than a superficial analysis of the question.

3) Experienced line bankers (law department, corporate banking and commercial real estate) who could lend the benefit of their knowledge and experience.

4) General information available from outside the organization: legislative developments, the shared experience of other businesses, documents such as the Bruntland Commission report.

SECTION II

Royal Bank Policy On the Environment

The specific area for discussion in this paper are the credit policy aspects of the Royal Bank's overall policy on the environment. These are implied in the second point of the general policy which reads:

> "continue to give appropriate consideration to environmental regulations and risks in its assessment of proposed loan and investments, and in management of its assets."

Analysis of the Issues

At the time of research, the law department and some areas of corporate banking were already aware of the fact that environmental risk was becoming an increasingly important factor in credit risk. There were a number of ways in which this was happening, some of them constituting a considerable extension of what had earlier been understood by lenders as the normal risks of lender liability.

- **Impact on borrower's cash flow**

  As government environmental standards are raised and as enforcement is made tougher, borrower companies may be forced to incur additional unanticipated costs such as fines, clean-up costs, increased waste-disposal costs, and the installation of new pollution control/abatement equipment. These could seriously affect their cash flows and consequently their ability to service bank debt. If the borrower has violated regulations or is ordered to undertake extensive cleanup, the viability of the business could even be threatened.

- **Impact of Value of Security**

  If the lender's security is dependent upon potential title to real property, the value of the security can be severely damaged or even destroyed by the presence on site of hazardous wastes or residues. Often a sale of premises may not be permitted until cleanup of the contamination, and cleanup costs may well exceed the value of the property. Liability for cleanup costs generally attaches to whoever is in "care, control of management" of the property regardless of when the contamination occurred.

- **Direct liability of lender and/or receiver**

  If the lender takes over control of the business in the course of enforcing its security interest, the lender could end up assuming liability many times greater than either the loaned amount or the original estimated value of the security. The liability could take the form of responsibility for cleanup costs in relation to pre-existing contamination (or for the consequences of any new release of contaminants), or for damages in common law civil liability suits brought by third parties. Banks are, of course, seen as the ideal "deep pocket" targets for such suits. Moreover, if the lender is in a position of "care, control and management" of a current source of contamination which is in violation of governmental regulations, officers and directors of the lender could also become subject to criminal penalties including fines and/or imprisonment.

Solutions

It was concluded that a lender can protect itself, and its shareholders, without imposing draconian restrictions on its clients. Also, in terms of sustainable development, it was realized that bankers contribute to sustainable development simply because of the way the credit system works.

An expanded credit policy on lender liability was approved in February, 1990, by a senior management committee. That policy was distributed internationally in the form of procedural guidelines for corporate account managers.

This document highlights environmental concerns, while at the same time pointing out that the bank does not intend to steer clear of lending in environmentally-sensitive industries. We continue to assess lending risks on a company-by-company basis and judge each credit application on its fundamental merits, including those related to the environment.

Our role remains that of managing and controlling risks - not avoiding them.

Before loans are committed, account managers are not routinely expected to explore with borrowers such issues as:

- environmental regulations
- the generation of hazardous wastes
- and the ability to pay for potential cleanups and third-party damages.

Account managers are not expected to be environmental experts, but are asked to request an environmental audit when an audit would appear appropriate. Special caution is taken where real estate is involved.

The policy also reinforces the bank's due diligence procedures. We've always recognized the need for clients to meet regular requirements, including environmental laws, a part of a loan application. It's also in our client's best interest to understand this need. Now, we're ensuring that these requirements are uniformly integrated into the overall lending process.

Results

Early indicators of our improved lending guidelines indicate that our clients fully appreciate the nature of our questions about the environmental factor in credit applications.

They realize, as we do, that the laws and regulations relating to the environment are undergoing substantial change.

We are continuing to communicate internally with our account managers to reinforce our policy, as well as accepting speaking engagements to business conferences.

Conclusion

Whether referring to our overall policy on the environment, or to the credit aspects of that policy, the same conclusion results. The commitment of the senior executive was important to the process. The rest was unleashing the forces for change. In many ways we found we were legitimizing disparate efforts within the organization to effect positive change.

OUR ENVIRONMENT - Notes for an address by DAVID L. ROBERTSON, Senior Vice-President, Corporate Banking, The Royal Bank of Canada to THE FINANCIAL POST CONFERENCE, Ottawa, Ontario, June 8, 1990

As a corporate citizen and lender, we've spent considerable time developing policy statements that address environmental concerns. It's been a challenging, but stimulating task, and this conference gives us an opportunity to talk about the approaches we've taken to date.

Clearly, there are many sides to the issues of safeguarding the place in which we live and work. A bank might seem to have the lowest quotient of involvement or worries in this regard. But nothing could be farther from the truth.

Unlike many of you, bankers are not experts on environmental matters. But our instincts are pretty good.

We know that environmental considerations can affect us in a number of ways. Environmental problems, for example, represent risk. And evaluating risk is our stock in trade when it comes to lending decisions.

As you might expect, we become even more attentive when risk is associated with potentially complex problems of liability that could involve ourselves and our customers.

However, contrary to popular belief and media opinion, bankers are also optimists. In every cloud of risk, there's a silver lining. In our business there are no such things as problems. Problems, as any self-respecting lender will tell you, are really opportunities.

Our clients have been quick to remind us of this. In effect, protection of the environment represents a growth industry. It's a sure winner -- and one which we're more than willing to support in our investment activities and in our lending considerations, provided that companies meet the usual criteria of good credit risk.

Obviously, a company needs more than just good environmental intentions in qualifying for credit. So we've looked very closely at how we can genuinely reconcile the best interests of our shareholders and our clients with the realities of safeguarding the environment.

In the next few minutes, I'd like to talk about how the Royal Bank is factoring the "environmental component" into credit and investment decisions and how that in turn affects our clients.

I'll touch on what we're doing to make our own contribution to conservation by improving the Royal's paper and plastic recycling and other internal activities. And finally I'll deal with how we're contributing to improved public awareness of environmental protection.

Environmental considerations are not new to us at the Royal. We've always expected that corporate clients adhere to all laws, including environmental regulations, in qualifying for credit.

But today, both risks and opportunities in this regard have considerable magnitude. The environment is, quite rightfully, at the top of the public agenda. Decisions made in the courts and among governments are increasingly in the spotlight of public scrutiny.

Bankers, like other people, share the public's growing concern for environmental protection. Not only are we worried about risk and liability, we have to consider the ethical obligations that must be met.

Over the past year, we've worked to translate that ethical concern into a set of practical principles--designed to guide us in making environment-related decisions. The next step was to establish a policy that allows us to work in harmony with our clients.

In essence, this policy stresses the interconnection between a healthy environment and sound economic growth. It commits the Royal Bank to managing its operations and shaping its activities to promote that ideal. And it encourages our staff to seek ways of helping clients meet the needs of the present without compromising those of the future.

We believe it fits well with the principles of the U.N.'s Bruntland Commission Report. There can be no argument with the key statement in that report: that a healthy environment is essential to human welfare. And that this will only be achieved through a strong economy with the resources to tackle and resolve environmental problems.

In other words, when we talk about "sustainable development", it means sustaining both a healthy ecology <u>and</u> a healthy economy.

In developing our environmental policy at the Royal, we took pains to ensure that it wasn't something simply to be hung on a wall just for show. We wanted it to be a practical extension of the way we normally conduct our activities and our relationships with clients.

We've tried to show that our commitment to the economic success of our clients is as strong as ever. At the same time we're encouraging environmental responsibility.

It doesn't mean we're steering clear of lending activities in environmentally-sensitive industries. Definitely not. We continue to assess lending risks on a company-by-company basis and judge each credit application on its fundamental merits, including those related to the environment.

Our role remains that of managing and controlling risks -- <u>not</u> avoiding them.

We do recognize that environmental considerations must be a major factor in assessing overall lending risk. And our policy is intended to highlight that fact.

What we're saying -- from a practical banking perspective -- is that sizable environmental risk may translate into high costs for the borrower, and consequently impair that borrower's credit-worthiness. So, in situations where the level of environmental risk is unacceptable, credit would not be extended.

Let me go into this a little further.

Commercial lenders are affected in several ways by the environmental problems of their clients.

- A borrowing company, forced to incur added costs for fines, clean-ups, or increased waste disposal, may encounter cash-flow difficulties, and be unable to service bank debt.

- In some cases, the survival of the business may even be threatened.

- If the loan is secured by property affected by pollution, the value of that security may be severely damaged.

- In addition, lenders face the risk of direct liability for environmental clean-ups and damage to third parties. There are also civil and criminal liabilities.

Such liabilities generally attach to the "owner" or the party in "control" of the property. And it scares me to think that this could be a lender who had to take over the management of a client's business....or who is an appointed receiver.

This is a very disturbing reality for a bank, especially as the associated costs of a clean-up could well exceed the value of the property.

Such a situation hasn't yet occurred in Canada, but there have been a few highly publicized cases in the United States.

One that comes to mind involved the Maryland Bank and Trust Company. That bank made a loan of $335,000 to a company on which it eventually had to foreclose. The bank took over the company -- only to find that its property was contaminated. It cost the bank $500,000 -- considerably more than the original loan -- in subsequent clean-up costs.

Given this kind of example -- and the perception that banks have deep pockets -- the concern among bankers is that our industry may find itself footing a large share of the bill for correcting other people's problems.

All this leads to a couple of important questions.

First, what is the Royal Bank doing to reduce the risk of liability and protect itself from other problem's arising from environmental damage?

Second what does this mean for corporate borrowers?

The answers are that we believe the Royal can protect itself, and its shareholders, without imposing draconian restrictions on its clients. The key is in both sides acting responsibly.

We've begun by building awareness of these issues among our corporate account managers, the front-line people who deal with companies on a day-to-day basis. They now have a set of general guidelines which they can apply to environmental concerns.

Our account managers are not environmental auditors. But they are equipped to ask the right questions or identify situations where it's appropriate to bring in an environmental expert. They're being given information to discuss environmental issues and to promote wider understanding among business clients.

Along with these steps, we're incorporating environmental concerns into our due diligence procedures. We've always recognized the need for clients to meet regulatory requirements, including environmental laws, as part of a loan application.

It's also in our client's best interest to understand this need. Now we're ensuring that these requirements are uniformly integrated into the overall lending process.

Before loans are committed, account managers are now routinely expected to explore with borrowers such issues as:

- environmental regulations,

- the generation of hazardous wastes,

- and the ability to pay for potential clean-ups and third-party damages.

Special caution is taken where real-estate is involved. Account managers may request a site-use history and visit a site to see if there are obvious signs of environmental damage.

If there is evidence, or suspicion of, such damage, we'll ask that an environmental audit be performed. This is paid for by the client. Where the environmental risk appears excessive, the loan will be denied.

If all is above board and the loan is advanced, the account manager will continue to ensure that environmental performance is monitored. Should environmental problems ensue, we recognize that it frequently requires time and resources to solve these problems.

Clients generally have been understanding and supportive of our approach to environmental risk. As evidenced by speeches made at this conference, many corporations are examining the environmental component as it affects their businesses and are implementing positive change.

I think clients appreciate that it's in their best interests, as well as a bank's, to know about hazards before buying property, or to resolve problems at existing operations.

In practice, our approach doesn't involve great change.

We're in the business of lending and business development. That's always meant factoring-in risk and regulations to determine credit-worthiness. We feel that by acting prudently to protect our shareholders and our clients, we're providing added encouragement to industrial borrowers to share a responsibility. In essence, we're contributing to sustainable development simply because of the way the credit system works.

It's just a matter of common sense.

I've talked a lot about protecting our mutual interests in environmentally-sensitive situations. Let me also mention something about financing eco-smart companies.

There's a variety of them. They may specialize in environmental consulting, engineering, waste management, and pollution control or they may manufacture and market "green" products.

This sector already consists of more than 3,300 firms employing almost 150,000 Canadians. It's healthy industry, with annual estimated growth of eight percent a year to 1993 -- almost four times the projected national growth rate.

This is also one of the sectors that has been targeted by our venture capital unit, the Royal Bank Capital Corporation. This subsidiary participates as an equity investor in growth companies that have above-average profit potential and proven management teams.

I'll give you just a couple of examples of companies in the environmental arena that are in the Royal Bank Capital Corporation's investment portfolio. One is a firm that's developing environmentally-safe herbicides and pesticides, as well as an alternative to chemical fertilizers.

Another is a company that provides the petroleum industry with systems for containing hazardous liquids. Demand is so great for their product that they can't keep up with production.

Royal Bank Capital Corporation continues to be interested in these kinds of investments. A viable approach from companies that can take advantage of the accelerating demand for environmentally safe products and services will be listened to seriously.

Before closing, I do want to emphasize that, in addition to promoting environmental protection as a lender, and green products as an investor, the Royal is also striving to meet good conservation standards.

For example, we're one of the largest consumers of paper in the country, and we're very conscious of paper recycling. Operations in some of our larger centres have been recycling paper for over 15 years, and we're working to expand those activities.

In terms of progress to date, we send about 100 tons of paper a month to recycling centres across the country. To put it in perspective, that represents about 1,900 trees per month or over 22,000 trees per year.

And we're taking this used paper back into our system and finding a growing number of applications for it.

For example, circular letters, which go out every day to all units across our domestic and international system, are not printed on recycled paper. Annually they represent 3.1 million pieces of paper -- all of which cross my desk.

There's also an envelope which was developed in conjunction with Canada Post to ensure that an address printed on the recycled paper could be read by their electronic sorters.

We've also arranged to recycle plastic-based materials, including the six million night deposit bags that our customers use every year.

In addition, we're contributing to environmental protection by building awareness and fostering dialogue. We recently sponsored the printing of the book called "Home and Family Guide: Practical Action for the Environment". You have a copy in your registration kit.

This book is a handy, little masterpiece prepared by the Harmony Foundation headed up by Michael Bloomfield. It provides Canadians with practical ideas for contributing to a better environment. More than 20,000 copies have been sold so far. That makes it an official Canadian best-seller!

It costs $7.50 per copy, including mailing and can be order directly from Harmony Foundation based here in Ottawa.

<u>Conclusion</u>

They say a journey of 1,000 miles begins with the first step. I'm please to say that, at the Royal, we've taken our first step -- and a few more.

The progress we're making is being achieved with the co-operation of various other parties. We strongly believe that co-operation is the way to go in developing better environmental management.

As part of our policy, we're dedicated to working with all parties to help make Canada a solid example of co-operative effort in protecting both the environment and the economy.

Much remains to be done.

We all must help our policy-makers to resolve disparities in standards and regulations. At present, even the definition of what constitutes "hazardous waste" varies from province to province.

We all must begin -- <u>urgently</u> -- to analyze the benefits and costs of environmental action. The slow pace in tackling pollution problems in industrialized countries is partly due to the problem of assigning costs and assessing trade-offs.

Nationally, we're dealing with broad and complex problems that affect each of us in different ways. The solutions must be sought jointly; not on an adversarial basis. We have a common purpose, and a common future. We need a common spirit to reach our shared objectives.

That entails, first of all, improved dialogue and a consistent and cohesive approach on the part of governments, corporations, labour and environmental groups.

Sustainable development will <u>not</u> be achieved, and economic and environmental problems will <u>not</u> be solved, through rhetoric or endless confrontation. Our best weapons are co-operation, hard work and common sense.

If we can cement the theme of co-operation, dedication, and practical solutions at this conference, we'll be able to say we've achieved the objectives that we came here to discuss.

And that will be a major step indeed.