

The Good Transition Plan

Climate Action Strategy Development Guidance for
Banks & Lending Institutions: COP26-version (2021)





“A goal without a
plan is just a wish.”

Antoine de Saint-Exupéry

About the Climate Safe Lending Network

The Climate Safe Lending Network (CSL) is a transatlantic multi-stakeholder collaborative of banks, NGOs, academics, investors and others aiming to accelerate the decarbonisation of the banking sector to secure a climate-safe world.

CSL is a project of Green America's **Center for Sustainability Solutions**. Green America is a not-for-profit organisation, founded in 1982, focused on economic strategies to address global climate, environmental and social justice crises.

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FOREWORD

To limit global temperature increases to 1.5°C from pre-industrial levels requires an urgent and accelerated transition of economies worldwide. There isn't a moment to lose. All strands of society must take action, including the banking community, which, through its lending and investment activities and extensive relationships with clients across all sectors is one of the driving forces of the global economy.

Systemic change on this scale relies on a deep integration of sustainable practice across banks, ensuring that environmental and socially-responsible decisions are enacted across the financial value chain, in every boardroom decision, in every financial product, in every customer relationship. Banks need to adjust their business models and strategies, set robust, ambitious and science-based climate targets, and develop and execute credible transition plans for a climate-safe future; all elements of the gold standard Net-Zero Banking, Insurance and Asset Owner Alliances convened by the United Nations. By creating a high ambition focal point, such as these Alliances, and the Principles for Responsible Banking, banks can redesign their strategies and optimise the vast opportunity of creating positive value and impact in a zero-emission, nature-positive and socially-equitable world.

These plans must be backed up by a collaborative process and the acceleration of good practice across the industry that incorporates a broad view of sustainability – factoring in social impacts, the natural environment as well as financial risks. We welcome the publication of the Good Transition Plan which draws together a breadth of engaged stakeholders from across the world and synthesises key insights and practical tools that can help shift mindsets and behaviours and make a practical difference to banks' client relationships and wider role in society. Initiatives such as The Climate Safe Lending Network can also provide important opportunities to accelerate collaboration and learning. With a range of thought leadership such as this Plan adding to the global conversation banks can be more empowered to demonstrate leadership on this critical challenge of our time.



Puleng Ndjwili-Potele,
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United Nations
Environment Program
Finance Initiative,
UNEP FI

EXECUTIVE SUMMARY

In the decisive decade ahead, banks will be judged on the ambition and execution of their climate strategies. CEOs and bank senior managers can use this document to develop the key actions their bank should take to become a climate-safe lender. The main elements of a Good Transition Plan considered here are the following:

Governance & Organisational Development

- Organisational structures that support climate plans
- Embed climate change in the culture
- Lock climate into strategy and purpose
- Create a learning and review cycle
- Support decision-making with key climate policies

Measurement, Disclosure & Reporting

- Include the full extent of the bank's business
- Measure the real economy impact or 'delta' as assets decarbonise
- Use best available data and continuously improve data quality
- Onboarding new clients – introducing "KYCO₂"
- Enhanced due diligence - measure more than climate: incorporate full-spectrum sustainability
- Use clear accounting principles if using 'negative emissions'

Net zero & Paris-aligned Targets

- Set a net zero target between 2030 and 2050 using NZBA principles
- Scenarios should be selected and updated to reflect a climate-safe world
- Set interim 2030 targets for each covered sector
- Anchor the highest-level ambitions in a strategy development process by reaching for 2030

Decarbonising Balance Sheets & Economies

- Proactive dialogue with clients on their climate strategies
- Support relationship manager training to develop transition expertise in their field
- Offer pricing structures to incentivise sustainability and climate goals
- Link the demand for green to drive the development of green assets

- Provide sectoral products and technical assistance
- Just Transition: integrate broader social & environmental factors by applying different lenses to strategy
- Consider adaptation, resilience and the needs of vulnerable communities

Stopping Flows of Finance to Fossil Fuels & Deforestation

- Implement a near-term end (2022) to all expansion and exploration of fossil fuels and deforestation, in line with leading practice
- Assess legacy fossil fuel and deforestation assets and create reduction pathways
- Develop product features to support the reductions
- Create an engagement plan for all the affected stakeholder groups
- Analyse the systemic impact of the bank's decisions on the wider market

Financing Innovation & Drawdown

- Invest directly in net zero technologies and start-ups
- Focus bank innovation labs on climate
- Review risk appetite policy to support climate innovations

Agency & Broader Influence

- Engage in peer-learning & collaboration
- Ensure consistency and reinforcement via all advocacy, lobbying and industry engagement
- Recognise the full extent of agency within a client relationship

Business process ideas for creating a transition plan

- Climate Crisis Strategy Board/Management Away-Day planning guide
- A KYCO₂ procedures manual (a blueprint for Enhanced Due Diligence)
- Climate CRM – equipping customer relationship managers with transition expertise
- Loan pricing/risk capital models that integrate sustainability in all sectors
- Sectoral lending principles, such as the Poseidon Principles on lending to decarbonise shipping
- Non-circumvention principle/a strategy design principle to prevent 'disclosure-avoidance'

INTRODUCTION: WHAT THIS DOCUMENT IS FOR

This document is intended to help banks create a good, climate-safe transition plan that serves all their stakeholders. Since the signing of the UN Principles for Responsible Banking in September 2019, more and more banks are setting climate targets. Four in five of the major European Banks now have net zero targets in place but very few have set sector specific or interim targets.¹ Many stakeholders are now calling for detailed ‘transition plans’ from companies and banks to fill these gaps. There is a fair chance that transition plans will become a regulatory requirement.

The priority for many banks in the coming 12-18 months is therefore to develop an effective transition plan based upon practical actions capable of achieving their chosen targets. With such a plan in place, banks can have more confidence to face the climate challenges of the next decade and beyond.

But this should not be seen as simply another chore or an activity for banks to add to their compliance checklists. Rather, this should be framed as a massive strategic opportunity for banks to position themselves in the context of a global, whole-of-economy transition, with emerging business models, technologies and approaches that will define future success. A transition plan will require tuning in to the needs of clients and stakeholders; it will mean applying design thinking and creativity to business propositions that can accelerate transition; and it will rely upon some tough decisions that will challenge deeply held assumptions about the bank’s purpose and modus operandi.

The Good Transition Plan offers guidance on how banks can calibrate what ‘good’ means, given current scientific understanding of climate change and local market

and policy contexts. It considers broader environmental and social impacts to help design a framework that considers all the relevant sustainability factors. It contains a roadmap for the process, together with some practical advice and checklists, including top-down and bottom-up approaches and some practical ideas for implementation presented as synthetic case studies from the fictional ‘ZeroBank’.

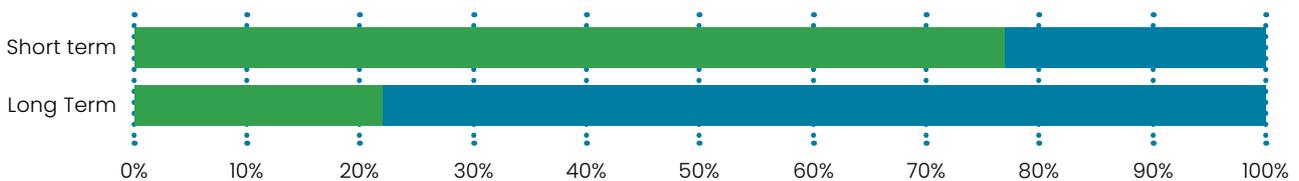
“[Financial] Firms are very confident in the resilience of their climate risk strategies in the short term, but not over the long term. 77% of firms think that their strategy is resilient over the next 1 to 5 years, but that confidence drops to 22% as we look toward 15 years and beyond”

Global Association of Risk Practitioners, 2021²

Who should read this document

The document is written for C-suite executives and management at banks, who are best placed to lead a net zero transition process. It is meant as a guide not a technical manual and reflects the insights of bankers and expert stakeholders who have already engaged with the dilemmas and tensions that transition raises. It examines some of the fundamental processes of change that would help define the future of the bank, recognising that there is significant uncertainty about the long-term success and resilience of financial institutions’ climate strategies.

Confidence in climate strategy resilience



1 <https://shareaction.org/wp-content/uploads/2021/09/Countdown-to-COP26.pdf>

2 <https://climate.garp.org/insight/2021-climate-survey/>

What is a transition plan?

A transition plan is a tool for turning long-term climate targets into practical actions. But it is more than just a bundle of targets, indicators, and policies; it is also a cultural and strategic commitment to reboot the bank’s relationship with climate change from top to bottom, from linking the bank’s high-level corporate purpose with planetary health to reforming everyday business processes. It is a new and important part of a bank’s core strategy.

A transition plan needs to set out a theory of change for a bank’s portfolio and its clients in the real economy. It should also set out a plan for its own operations to be net zero (but since the challenges of a bank in this regard are not unlike many other companies in the economy and banks’ operational emissions are a tiny fraction of its Scope 3 emissions, they are not covered in this document). It needs to set out how the bank will deliver these changes through its policies, the way it incentivises its staff, its products, services and relationships. It will recognise the critical changes required in its governance, organisational and business process, and identify the learning and development needs for the bank’s people and partners.

Double materiality

The Taskforce for Climate-related Financial Disclosures (TCFD) has issued proposed guidance on transition plans.³ However, this was framed narrowly in terms of the inward risks and opportunities, from the climate to the financial institution. While this is a critical component for banks, a truly climate-safe transition plan should also consider the outward impacts of financial institutions’

activities on the climate. This ‘double materiality’ (including the contribution to systemic climate risk or potential climate solutions) has been referred to in much of the EU’s revised strategy for sustainable finance and in the recent guidance by the Swiss government on their implementation of TCFD by the end of 2023.⁴ The outward aspect is important not just for banks to be good climate citizens (by reducing their contribution to climate risks which may be suffered by all) but also so they can understand the external impacts they can contribute through climate solutions.

	Single materiality TCFD (financial institution risks and opportunities)	Double materiality Climate Impacts (contributions to climate change)
Risks	Inward risks for Bank	Contribution to climate risks
Opportunities	Inward opportunities for Bank	Contribution to climate solutions

The case for developing a Good Transition Plan

As change brings costs as well as benefits, it can be useful to identify the benefits of net zero transition for each stakeholder group to encourage buy-in. The table on the next page summarises some of the topics that might come up in conversations with stakeholders.

³ https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf

⁴ <https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-84741.html>



Reaction	Response	Benefits
<p>"It is up to our clients to reduce their own emissions."</p>	<p>"Banks have high agency to effect change."</p> <p>"Engaging with clients on transition will make clients in the bank's portfolio more sustainable."</p> <p>"Engaging with clients will build competitive advantage."</p>	<ul style="list-style-type: none"> ■ Manage and reduce balance sheet risks ■ Engage clients more closely ■ Motivate and engage staff ■ Hire new talent ■ Strengthen the bank's expertise and culture
<p>"Climate disclosures and transition planning are a cost."</p>	<p>"Climate disclosure is already mandatory in some jurisdictions, transition planning may soon become mandatory. Like compliance for anti-money laundering processes, it is a cost of doing business".</p> <p>"Well-designed processes will make these activities efficient."</p>	<ul style="list-style-type: none"> ■ Refresh business processes ■ Strengthen regulatory engagement
<p>"It is hard to leave revenue and profit from fossil fuel lending on the table."</p>	<p>"What is your analysis of the impact on return on equity (RoE)? Growth in sustainable business could offset lost revenues if we commit sufficiently, and they are all rapidly-growing markets".</p> <p>"Short-term RoE impacts can be mitigated by redeploying capital, avoiding potentially higher capital charges on fossil fuel assets, and avoiding the risk of stranded asset losses."</p> <p>"Staff pay can be linked to transition goals as well as traditional measures."</p> <p>"Investors are increasingly asking us to decarbonise."</p>	<ul style="list-style-type: none"> ■ Contribute to climate mitigation ■ Manage and reduce balance sheet risk ■ Build the bank's reputation and social license ■ Improve investors' ESG credentials
<p>"There is insufficient market flow in growth areas to compensate for the loss of high carbon assets."</p>	<p>"Sectors are changing rapidly. We have already seen huge growth in markets such as renewable energy, others are likely to follow."</p> <p>"Pro-active bank activity can build the market in key sectors."</p>	<ul style="list-style-type: none"> ■ Incubate or attract future clients ■ Develop links with other partners (investors, public banks etc) who could be valuable sources of future growth
<p>"Too much uncertainty and risk around new technologies."</p>	<p>"Banks and other partners (government, public banks, investors) can de-risk an area and help it to flourish."</p>	<ul style="list-style-type: none"> ■ Seize opportunities in fast growing markets
<p>"We just don't have all the data available"</p>	<p>"Have you asked for the data? Clients might know more than you expect and be willing to share with you if there were a shared benefit."</p> <p>"Are there some third-party sources or proxies that could be helpful in managing interventions until data quality is improved?"</p>	<ul style="list-style-type: none"> ■ Make interventions and propositions using existing proxy data ■ Develop better data sources

Why do we need mandatory transition plans?

Transition plans are not yet mandatory for bank supervision purposes, but they might be before too long and they are necessary in the meantime. Following the publication of the Intergovernmental Panel on Climate Change's (IPCC) sixth assessment, COP26 President Alok Sharma, commented that we are on the "brink of catastrophe". Modelling what might happen in a future catastrophe situation is, to say the least, extremely difficult. However, many believe that the irreversible nature of climate change foreseen by climate scientists with self-perpetuating feedback loops create conditions that we should regard as fixed deadlines.

"Scientists and analysts consider 4°C of warming to be an existential threat, incompatible with the maintenance of human civilisation, and 3°C to be catastrophic, perhaps leading to outright chaos in the relations between nations. Applying stress tests to such circumstances is problematic. Even at 3°C, the impacts may be so great as to be potentially infinite and unquantifiable, making model-based scenario testing largely irrelevant. It is unlikely that the banking system could survive such levels of warming."

Degrees of Risk (Spratt & Dunlop, 2021)

There are two corollaries to this. Firstly, governments, regulators and financial institutions need to be applying the precautionary approach. The consequence of 'overshooting' on global temperature increases might

mean that we no longer have control of the situation. And it is impossible to tell with any certainty where that tipping point might be. Secondly, to check whether we are on track, we need to be aware of how all plans 'add up' globally, across countries and across sectors. Without good visibility on our current course, steering by governments will be much more difficult.

Given that financial institutions, especially banks, are financing long-term ventures and infrastructure in the real economy, they are a hugely important lever in helping steer the transition. If finance flows into new innovative clean technologies and climate solutions, it could drive scale and cost reductions that can accelerate our progress. Conversely, if finance flows into misaligned high-carbon assets, it will either tip us beyond a climate-safe world or risk being stranded with much of that risk blowing back to governments and ultimately to the public. And for the rest of the economy, we are relying on banks to use all of the skills, tools and competencies at their disposal to help businesses and individuals make the transition. For these reasons it is important that all banks have rigorous climate transition plans in place. Whilst for many, sustainability credentials are a competitive 'point of difference' the 'Race to Zero' can only be won collectively.

There is a growing chorus for transition plans to become mandatory. GFANZ has asked G20 leaders to set a target for financial institutions to have net zero transition plans by 2024.⁵ Prominent investors and NGOs are also calling for mandatory transition planning, arguing that voluntary action will not deliver the speed of transformation required.⁶

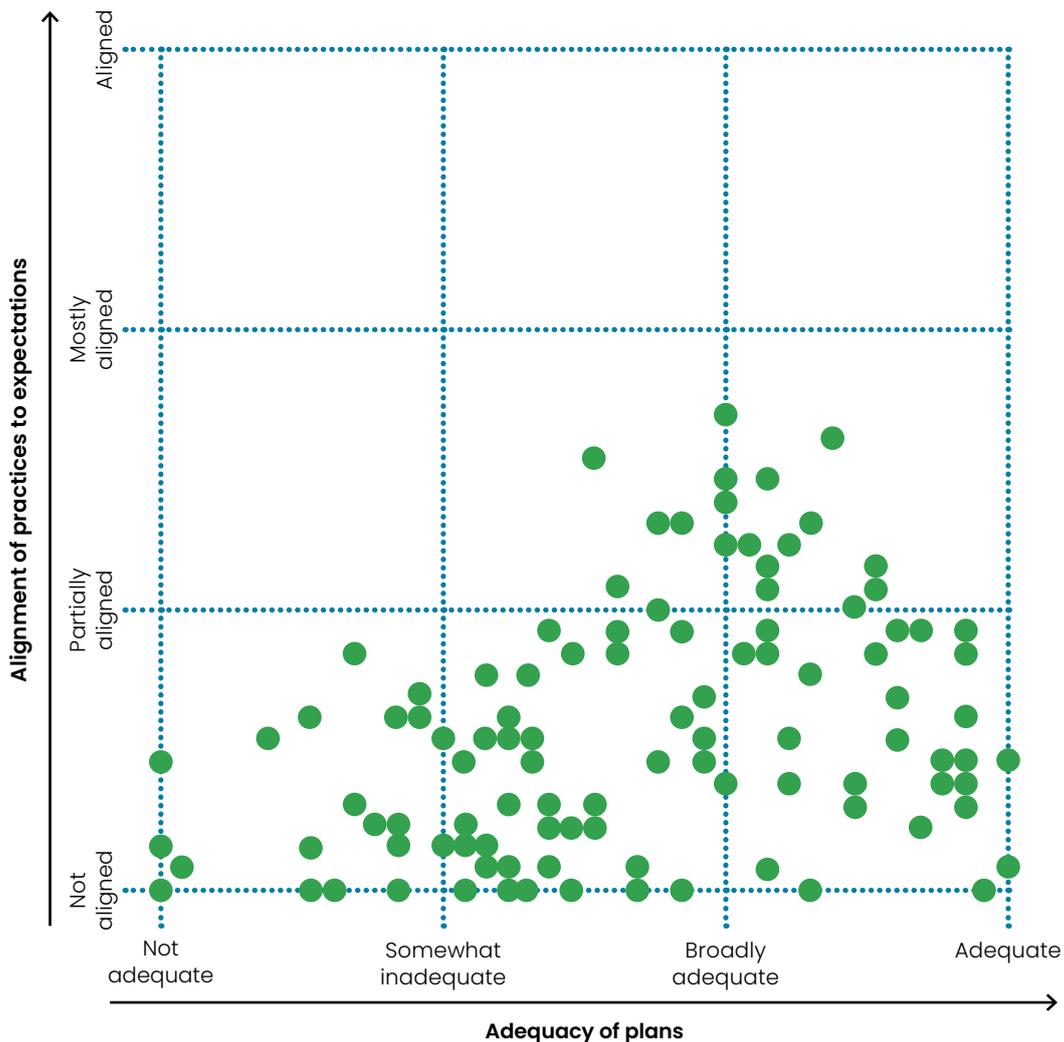
Banks are used to complying with regulations and producing reports. For transition plans, it is imperative that these are aligned to climate-safe goals (limiting global temperature increase to <1.5C degrees). As the recent European Central Bank (ECB) climate risk review of European banks discovered, there is still some way to go on ambitions that align with supervisory expectations.⁷

5 <https://assets.bbhub.io/company/sites/63/2021/10/GFANZ-call-to-action.pdf>

6 <https://ciff.org/news/ciff-calls-on-leading-central-banks-to-take-climate-action/> and https://www.wwf.org.uk/sites/default/files/2021-10/Net_zero_scorecard_report.pdf

7 https://www.bankingsupervision.europa.eu/press/publications/newsletter/2021/html/ssm.nl210818_5.en.html

How banks' practices align with the expectations mapped against the adequacy of their plans to advance those practices



Envisioning a net zero banking sector

Contributions to The Good Transition Plan shared ideas about how the industry might look if all banks had good transition plans in place. Some aspects of their vision include:

- Sustainability is embedded in all functions of the bank and its strategy; the CEO and the board are invested, involved and accountable.
- Executive and senior staff remuneration is aligned with achieving progress towards achieving net zero goals.
- Decisions are made based on an analysis of the climate impact of every loan at all levels of the bank from the loan originator to the senior management.
- Fossil business line leaders are engaged by bank leaders to shift their department to align with a new strategic direction, new products and new market development. A fear of loss is replaced by recognition of opportunity.
- Potential for 'bad banks' or other structures to emerge to facilitate the responsible retirement of carbon intensive assets that cannot transition.
- Employees from many backgrounds can influence the bank's goals. Bank structures create conditions for reaching diversity goals.
- Decarbonisation targets are adopted across the sector so that banks are not disadvantaged for being sustainable.

Methodology – how this document was created

The Good Transition Plan is the result of a multi-stakeholder process conducted between May and October 2021, starting with a synthesis of available stakeholder guidelines, expectations, and practices (and recognising that this is incomplete and evolving rapidly). The main elements were identified in the 2021 Climate Safe Lending Network (CSL) report, **Taking the Carbon Out of Credit**, with the later addition of two elements: Governance & Organisational Development, and Agency & Broader Influence.

These elements were further explored at two two-day industry convenings, each hosted by CSL in May 2021 and September 2021. The content includes inputs from a survey of banks and other stakeholders promoted by UNEP FI, as well as face-to-face interviews and written comments from representatives of banks, governments, academia, NGOs and industry experts, and an industry roundtable held in mid-October 2021. In all, more than 100 experts and practitioners from across the world have participated in the process. By involving a large number of diverse stakeholders, the

Climate Safe Lending Network hopes to provide clarity on how to calibrate the level of ambition in banks' net zero transition planning and support efforts to optimise that ambition. The Good Transition Plan is a working document designed to capture the thinking as it is now and is likely to be reviewed and updated in future.

Structure of this document

The next section of this paper looks at the strategy development process: getting started, assembling the team, setting the ambition, and then deciding what should be in the transition plan. The section ends with a table summarising useful supporting materials.

The subsequent section looks at each element of the transition plan in detail across seven chapters: governance, measurement and disclosure, target-setting, decarbonising balance sheets, stopping harmful flows of finance, financing innovation, and influence.

The concluding section looks at communication and regulatory issues around transition plans.

The appendix contains a summary of recent papers and resources in this area.

THE STRATEGY DEVELOPMENT PROCESS

1. GETTING STARTED

At the time of writing, 82 banks from 36 countries have so far joined the UN-convened Net Zero Banking Alliance (NZBA) since its launch on 21 April 2021 and the number is expected to rise. Membership of the NZBA commits banks to achieve net zero by 2050 at the latest. Many more banks are also developing net zero and/or Paris-aligned targets. NZBA banks are required to set sector-specific targets and to publish evidence on the action being taken. As this is so recent, climate strategies that could be regarded as complete transition plans have yet to be published. So the targets that exist today are likely to be placeholders. Once there has been a thorough strategy process, new insights will emerge about what might be possible. These insights could throw up further challenges, but also shed light on new opportunities and clarify the thorny decisions that need to be taken to go further and faster.

A recent report concluded that **sustainability change projects are more than twice as likely to fail as other change projects** (47% failure rate for sustainability projects compared for all change projects).⁸ With this in mind, it is crucial to start the transition planning with **senior level buy-in** and to keep the plan under continuous review through **learning and review cycles** that will allow the bank to incorporate emerging opportunities and updated scientific insights.

Who should be involved

The transition planning should be led by a senior person in a transversal, whole-of-business role, such as **corporate strategy or the C-suite**. Responsibility should not be placed with a sustainability or ESG lead in case this causes the process to develop as a “sidecar” strategy; the net zero transition plan needs to be part of the bank’s core strategy. Sustainability and ESG leads will need to support the process along with people who are skilled in change management. **Embedding the transition plan in core strategy** will mean working out how to update the regular strategy processes and

ensuring that the new climate elements in the core strategy are kept up to date.

The transition plan team should start by **identifying and consulting with the stakeholders affected** – including staff teams, clients, investors and supervisors – and making sure the process is designed to maximise **diversity of thought** and overcome groupthink. Diversity should include seniority (recent graduates will likely have a different view than more senior staff members) and geographical spread (staff from places more exposed to climate disruption will have different views from those in ‘safer’ places) as well as its other aspects. Gathering initial feedback from stakeholders will help to **identify internal tensions and trade-offs** that will need managing, for example between positive contributions toward climate action and direct commercial benefit (often in the short term).⁹

Setting the ambition

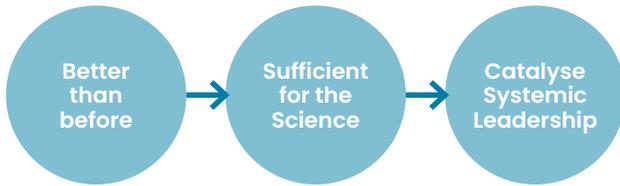
Depending on the choices made, the level of **climate ambition could be calibrated at different levels:**

- The intention to do **‘better than before’**. This points in the right direction but is incremental in its approach and may be far from commensurate with what is scientifically required.
- Starting with the end in mind, selecting actions that are **‘sufficient for the science’**. The principle behind science-based targets is to compare ambition levels to the latest scientific understanding. It is based on a redesign process using insights from published transition pathways and portfolio alignment tools.
- Attempting to **‘catalyse systemic change’** across the financial sector. This is a deliberate strategy to demonstrate leadership and drive the banking sector’s collective actions to be ‘sufficient for the science’ recognising the Race to Zero is one we can only win when ‘everyone crosses the line’. It is based

⁸ <https://www.bain.com/insights/transforming-business-for-a-sustainable-economy/>

⁹ <https://bothbrainsrequired.com/wp-content/uploads/2021/05/2021-05-17-Win-Win-in-the-Time-of-Net-zero-Final-16pp.pdf>

on a transformative strategic redesign considering the institution’s clients, peers, and stakeholders and defining its potential role as a leader.



Examples of differential levels of ambition include:

- The choice of scenario (the degree of ‘overshoot’ beyond 1.5C degrees, or the reliance on future atmospheric carbon dioxide removal).
- The degree to which near-term action is prioritised (leading to ‘concave’ rather than ‘convex’ transitions).¹⁰

It is worth noting that banks do not change their strategy in a vacuum: ambitions must be matched

with client ambitions or client exits. For transition plans that go beyond mere target setting, the bank must therefore consider its approach to **client relationships** and the degree to which it is able to find creative ways to influence and support client transitions proactively. For example, some banks have been reflecting climate performance back to clients relative to the sector that they are in, helping to catalyse action. Others have gone a step further to suggest ways in which clients could make progress and connecting them to relevant partners.

“Take ownership over the transition – [banks should] see themselves as responsible for making it happen, rather than conduits for a transformation that others are undertaking.”

Large bank

¹⁰ <https://www.climatesafelending.org/2050-no-longer-the-measure>

2. DEVELOPING THE MAIN ELEMENTS

Once a bank has identified its transition team and ambition level, it is time to consider the core elements of the plan.

The TCFD has identified several core aspects that belong in a transition plan, as summarised in the table below.¹¹

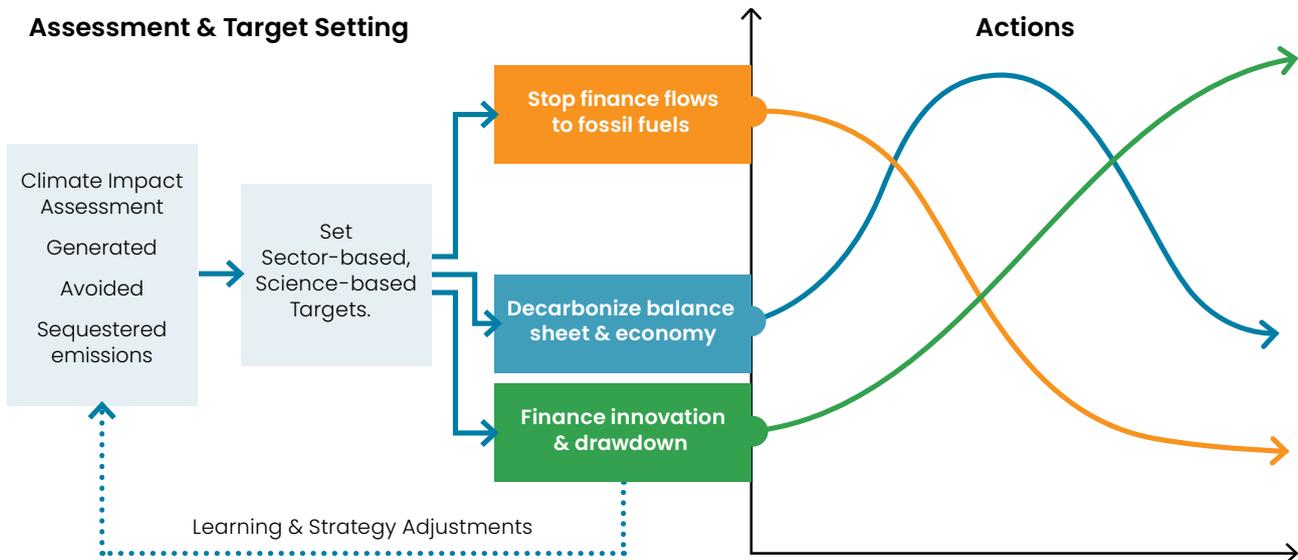
	Climate Prototype	CA100+	TPI	UN Race to Zero		IIGCC	Investor AGENDA
				SBTI	GFANZ		
Alligned to TCFD reporting	■	■	■	■	■	■	■
Disclosed as part of the broader organisation strategy	■	■	■	■	■	■	■
Anchored in quantitative elements, including climate-related metrics and targets	■	■	■	■	■	■	■
Approved and overseen by the board	■	■	■	■	■	■	■
Actionable and linked to specific initiatives	■	■	■	■	■	■	■
Detailed and verifiable	■	■	■	■	■	■	■

The elements identified by the Climate Safe Lending Network and explored in this paper are based on the Climate Safe Lending Pathway outlined in Taking the Carbon Out of Credit (see the flow chart below).

This framework has been broadened and converted into the following elements of a continuous strategic cycle:

■ Governance & Organisational Development

- Measurement, Disclosure & Reporting
- Net zero & Paris-aligned targets
- Decarbonising Balance Sheets & Economies
- Stopping flows of finance to fossil fuels & deforestation
- Financing Innovation & Drawdown
- Agency & Broader influence



¹¹ https://assets.bbhub.io/company/sites/60/2021/05/2021-TCFD-Metrics_Targets_Guidance.pdf

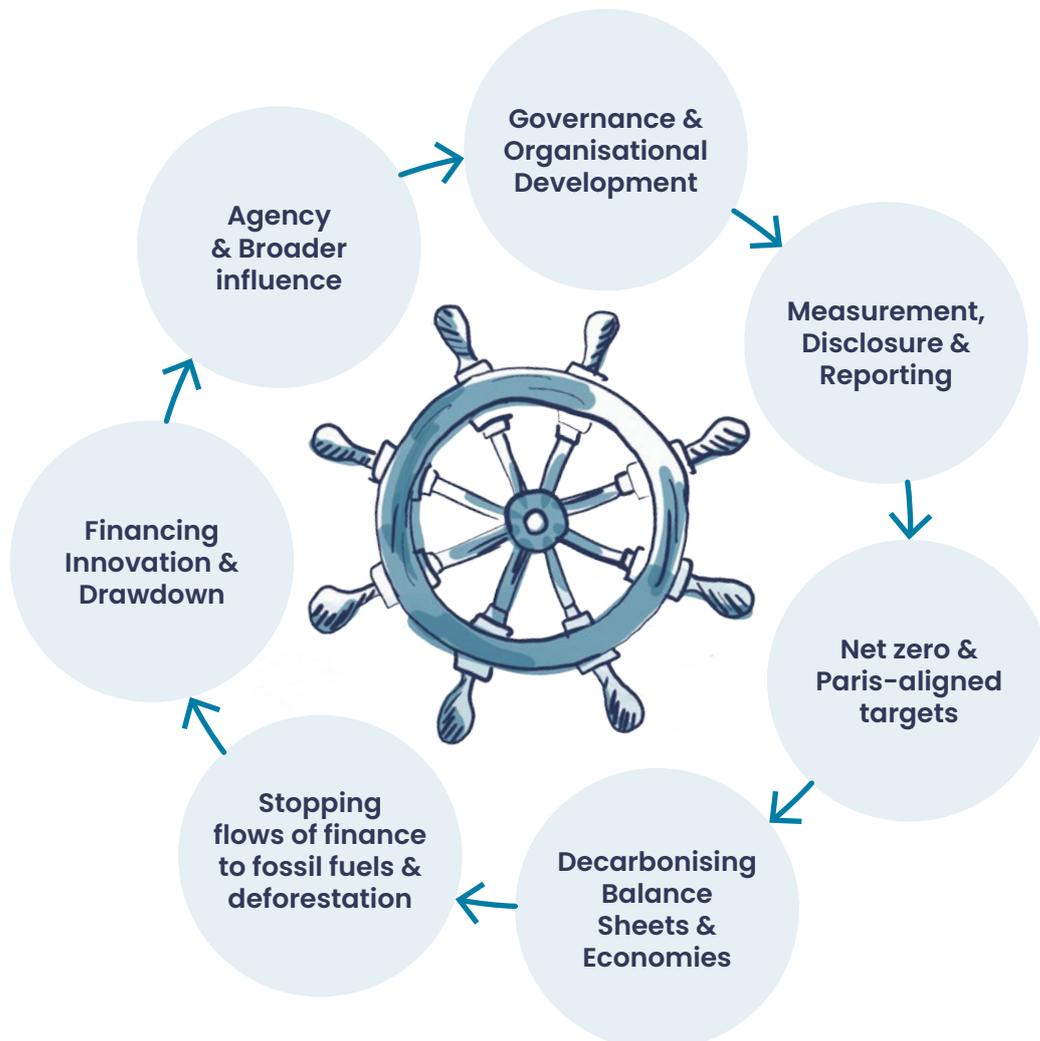
Exactly where you start in this process depends on the context of your organisation. For many banks, the entry point will be governance, in order to anchor the senior level buy-in that will drive the whole process. The next steps after that are to measure the bank’s financed emissions and to set targets. For other banks it may be possible to start with decarbonising the balance sheet, assuming that governance, measurement and target-setting are already well advanced. The measurement and target-setting stages form an iterative cycle with each other as the bank progresses against its targets.

Decarbonising the balance sheet will be the largest workstream as it covers all sectors and will involve considerable staff training and client engagement. Success here is likely to ease progress in other areas, such as reducing fossil fuel finance or stepping up innovation, because staff will be more familiar with new tools and targets and will have a greater understanding of incentive structures linked to net zero targets. Agency and influence is a continuous activity, driven by governance, strategy and the needs of frontline staff.

The job of the transition plan is to orchestrate these elements in a holistic and appropriate way for the bank given its context, so that the detailed work can take place of adapting policies, relationships, products, services, internal processes, organisational structures, resources, learning, development, culture and core beliefs.

“Make net zero part of corporate purpose, business planning and every aspect of operational activity, delivered through a Just Transition, scaling up climate positive financing and phasing out the financing to fossil fuels and other climate harmful activities on a time scale consistent with the science, with a major uplift in action in the rest of this decade.”

Nick Robins, Professor in Practice
– Sustainable Finance, LSE



3. SUMMARY OF MATERIALS

Numerous guidelines and reports are available to support transition planning. The list is constantly growing but we summarise here some of the recent ones and their relevance for each element of a transition plan. One-page overviews of these reports can be found in the appendices.

We analysed the leadership level of the content of each report/body against the seven elements of good transition plans outlined in this paper. We acknowledge that each body/organisation continues

to produce new and innovative content around the features, strategies, and tools banks need to implement good transition plans and that this table is subject to change.

We hope this table will give readers a snapshot of where the climate-finance sector stands in terms of various levels of ambition related to the features of transition plans, where there may already be high levels of ambition, and where more guidance and action may be needed from the sector.

Report/Body	Measurement	Target setting	Stop Flow to Fossil Fuels	Decarbonise Banking Activities and Economy	Financing Innovation & Drawdown	Governance & Organisational Development	Disclosure, Reporting	Broader Influence
A4S	■	■	■	■	■	■	■	■
BankTrack	■	■	■	■	■	■	■	■
Ceres	■	■	■	■	■	■	■	■
ClimateAction 100+	■	■	■	■	■	■	■	■
Carbon Disclosure Project (CDP)	■	■	■	■	■	■	■	■
ClientEarth	■	■	■	■	■	■	■	■
Climate Policy Initiative	■	■	■	■	■	■	■	■
IIGCC	■	■	■	■	■	■	■	■
Net Zero Banking Alliance (NZBA)	■	■	■	■	■	■	■	■
Rocky Mountain Institute (RMI)	■	■	■	■	■	■	■	■
Sustainable Markets Initiative - Financial Services Taskforce	■	■	■	■	■	■	■	■
World Benchmarking Alliance (WBA)	■	■	■	■	■	■	■	■
World Resources Institute (WRI)	■	■	■	■	■	■	■	■

■ This category is not discussed in depth

■ The transition plan features in this category show a moderate level of leadership or are similar to what others are discussing

■ The transition plan features in this category show sector leadership



GOOD TRANSITION PLAN ELEMENTS

1. GOVERNANCE & ORGANISATIONAL DEVELOPMENT



This chapter is about putting in place the organisational and governance structures needed to deliver a successful transition plan and ensure accountability. The actions include:

- Create formal organisational and accountability structures to support the transition plan
- Align job descriptions, incentives, performance criteria and culture with the transition plan
- Embed the transition in key documents
- Put decision-making policies in place

Organisational structures that support climate plans

To fully integrate transition plans into a bank there needs to be a **whole of organisation approach** that encompasses **strategy, structure** (governance and accountability), **people** (diversity of voice, sustainability skills), **work processes** (including tools, screens, checklists, policy guides) and **rewards**, in addition to **culture**. All of these organisational facets need to be calibrated with a climate/sustainability orientation and be aligned with each other otherwise change is difficult to sustain. Ultimately, this has to be **led from the top**,

with the CEO and board committing to decarbonisation as an organisational priority and **named individuals bearing accountability**. As one banker put it, “governance is the heart that pumps motivation and commitment to all the organisation to foster an actionable sustainability strategy”.

The CEO needs to clearly communicate this priority to all of the staff and ensure that goals and benchmarks are set, resources are available for execution, and progress is reviewed. All staff need to have a solid understanding of the overall strategy and the specific role that they play in contributing to success, with structures to ensure appropriate board oversight.¹² It requires accountability at every level to ensure that actions are carried out and that progress is reviewed to assess whether modifications to the strategy are required.

There is a **sequencing aspect** to this. Creating the organisational structures is a high priority task – 80% of respondents to the CSL survey said this should be done within 12–18 months – but it will take a few months to complete. Meanwhile, the process of setting targets and implementing the business changes outlined in other chapters cannot wait. Transition leaders will need to empower the organisation’s early movers and ensure that the benefits of early implementation, such as refreshing work processes and attracting new talents, are captured from the start, while ensuring that this work does not distract from building the governance foundations.

Embed climate change in incentives and culture

Banks have changed their cultures and conduct in the past and must update them now to reflect societal attitudes on climate change. For many banks, a step that would have a large and immediate impact on culture is to include net zero goals in the **performance appraisal, assessment and remuneration incentives** of leaders and responsible employees, from the CEO down, with climate-related key performance indicators (KPIs).

For example, incentives for customer relationship managers could be modified to reflect sectoral transition plans and targets. This could include modifying the KPIs on which managers are assessed to include transition indicators in their area.

But culture change must be relevant for the context of each bank. By allowing space for reflection, individuals within the bank and its wider group of stakeholders can be encouraged to take responsibility and ownership for how to co-create the means of executing strategy. It can be healthy to **allow space (for example in staff away-days) to discuss personal concerns** and perspectives on the transition (such as how it might affect people’s job satisfaction or prestige) and to **reflect on how accountability should be distributed** within the organisation.

Training is also an opportunity to influence culture, for example encouraging bankers who are used to operating in an ‘expert’ mental model to have more confidence to push clients about net zero transition, which may be a new area to them.

To assist bankers in applying what they learn to their day-to-day work, training should be integrated with work functions and processes instead of being treated as a one-off skills development session. For example, incorporating best practices into a standard format used for client engagement conversations.

In addition to being led from the top, a successful transition must include bottom-up elements that allow transformation to emerge from the system organically. Internal and cross-departmental **employee networks, working groups, and forums** can help employees to see climate as their responsibility. Banks might consider having a dedicated **‘Sustainability Council’** composed of leaders from across the organisation, who would monitor climate progress against the transition plan, with the group updating the board on climate progress at least twice a year.

¹² See ‘Climate Financial Risk Forum Guide 2020, Risk Management Chapter’, <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-risk-management-chapter.pdf>

Planning a climate change away-day

Away-days and off-site meetings can be useful ways to introduce change. While teams will have their own approaches, here are some questions that could be considered as part of a climate change away-day:

Before the meeting:

- What are the specific goals of the away-day?
- Who needs to be in the room?
- What is the right blend of diversity that is appropriate to represent multiple perspectives for supporting informed decision making and commitment to action?
- How can open questions be asked of clients, employees, other stakeholders in such a way that there is complete freedom to share their thoughts, concerns and ideas? How can this 'data' best be synthesised and overlaid on our climate analysis (incorporating scientific views, transition scenarios, market and policy trends, competitor analysis and portfolio impacts)?
- What 'groundwork' (e.g., expectation setting, getting input on topics to be discussed, making sure everyone is prepared to fully participate) needs to take place to ensure that the away-day makes the best use of everyone's time?

Examples: if 'data' is really a problem, ask employees and clients what has been asked for, and what is available; if transition pathways are unclear, ask clients what their transition plans would be in their ideal world (are there self-limiting beliefs that the bank could help overcome?); if RoE might be negatively affected by stopping misaligned activities (e.g., fossil fuel bond issuance/advisory) what impact would that actually have and what do investors actually think about those consequences?

Starting the meeting

What patterns, entrenched views and mindsets might distract from a design process that could harvest the highest potential from the group's creativity? How can team members prime themselves to be open and develop their listening and sensing skills (perhaps including being part of the stakeholder research leading up to the day)? How can we separate what we really know, from the shared opinions and perspectives that we think?

How can the evidence and results of the preparation be summarised to focus the group on the areas which

result in the most significant impact? Which changes could lead the bank to make the most difference in the near term?

Example: create an overview of the climate impacts of the portfolio and revenue-generating activities with a visualisation of what would happen if no action were taken, what best market practice would achieve, what is theoretically possible and what the cumulative impact would be if the whole banking sector were to do the same (compared to the remaining carbon budgets).

Organisation considerations

What are the key factors that hold us back today and what assumptions are these based upon? Are they still really true for everyone? What would be the optimal design for the journey to the end goal?

What is the vision of what we want to achieve? As individuals, how are we relating to the climate and where are the tensions between our personal hopes for the future and the bank's current trajectory? What can we harvest from our collective imagination about an optimal future state?

Example: identify tensions in path dependency such as incremental improvements in business approaches which still have considerable residual emissions compared to designing those emissions out completely. Consider technology readiness and the real preconditions for 'bankability'. If the transition plan relies upon large quantities of emissions-removal, what is the current level of investment and acceleration of these new investments within the bank's plan?

Identify the options

Given our framing of the key challenges in the areas which would make the most difference and our collective vision of the optimal future state, what are the key decisions for the bank? What options exist and what implications would this have on resources, skills, processes, products, relationships, risks and returns in the short and long term?

Making resilient commitments

Given there will always be insufficient data, incomplete views of the future and uncertainty about developing new capabilities and relationships, how can clear commitments and decisions be taken that build in learning and adaptation through a clear sense of the ultimate objectives that drive them?

After the meeting

How will what transpired during this meeting be communicated? Who will this information be shared with? What needs to happen to ensure that the process for developing and executing a good transition plan moves forward? How will the people who are involved in this process continue to be informed and engaged?

Lock climate into strategy and purpose

An early step in the transition plan should be to **anchor climate in the bank’s high-level strategy**. There is also guidance available on how to **incorporate zero targets and goals in the bank’s constitutive documents**.¹³ Locking the transition plan into these key documents would help to ensure that responsibility lies with the board who are responsible to the shareholders; however, it is recommended that broader stakeholder processes should be encouraged as part of an inclusive strategy process. A good practice would be to review climate policies, strategies, projections and performance against targets every three years and consulting with a broad range of stakeholders (industry experts, clients, community leaders, NGOs, and other partners).

Create a learning and review cycle

Since the outlook for sectors, understanding of climate science and government policies are likely to change regularly, it is important to have a **clear review cycle** in place for transition plans. Both the Net Zero Banking Alliance and other stakeholders suggest review processes with **ultimate accountability resting with the CEO and board**.

Support decision-making with key climate policies

As developed in the subsequent chapters, banks can help frontline decision-making by putting in place clear policies:

Sector policies: definitions, exclusion policies, and conditions.

- **Sector visions and transition plans**, informed by published sector transition pathways and bank’s own judgments based upon client plans, policy & economic analysis, supply chains and technology developments.
- **Risk appetite policy for innovation**, product development, and credit risk to ensure that emerging solutions can be supported whilst maintaining prudent controls across the portfolio.

UNEP FI Guidelines for Climate Target Setting for Banks¹⁴

- Targets shall be reviewed periodically, for instance in line with business strategic planning.
- At a minimum, banks shall review their targets every five years.
- Banks should strive to align their ambition with any major changes in international agreements or national goals.
- Banks shall change or restate baseline data in line with revisions made to the targets or boundaries if required.
- As climate science evolves, banks should review their methodologies and targets at the earliest practical opportunity (e.g., following the publication of new IPCC reports).
- It is important that climate targets should be part of broader organisational strategic plans. Climate targets should be appropriately governed and approved by the CEO or executive committee. They should be reviewed by the board, or the highest-level governance body that normally oversees and approves the strategic plan.

¹³ <https://www.clientearth.org/media/40/omeroa/2020-10-16-principles-for-paris-alignment-position-paper-ce-en.pdf>

¹⁴ <https://www.unepfi.org/wordpress/wp-content/uploads/2021/04/UNEP-FI-Guidelines-for-Climate-Change-Target-Setting.pdf>



Synthetic Case Study: Recent Governance Changes at ZeroBank

"We have amended the Terms of Reference for our management and board committees to prioritise social and environmental impact, which means redesigning all of the papers that were produced for review.

"We have extended the scope of our internal audit team to check on how well suited our governance and decision-making was to our climate goals and have committed to include the findings in the strategic objectives section of our Annual Report.

"We have added metrics that incorporated climate targets including outputs and key milestones in our strategic change programme.

"Our remuneration committee has just written a proposal that links the majority of financial incentive packages for senior executive team members to our sustainability KPIs."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan.)

Governance & Organisational Development Summary

Starting points

- Organisational structure
- Job descriptions, performance criteria, incentive policies
- Strategy and constitutive documents
- Sector policies and plans

Key components for governance and organisational development:

- Organisational structures that support transition and provide accountability
- Embed climate change in the culture
- Lock climate into strategy and purpose
- Create a learning and review cycle
- Support decision-making with clear climate policies
- Cultivate expertise in climate-aligned finance
- Align rewards with climate KPIs

2. ASSESSMENT AND TARGET SETTING: MEASUREMENT, DISCLOSURE & REPORTING



This chapter looks at measuring and disclosing how much carbon your bank is financing, and then at monitoring the improvements. The main actions are:

- Measure on-balance sheet carbon, using PCAF or similar
- Measure or estimate carbon from all other activities
- Set up systems to track the decarbonisation of assets in transition
- Expand know-your-customer (KYC) processes to gather clients' sustainability data
- Use clear rules if using carbon offset accounting

Include the full extent of the bank's business

A good transition plan calls for transparent disclosure of the bank's activities. The ambition should be to include all the bank's activities, even where methodologies for doing so are not yet mature.

Different banks have different business models and the relevant elements to measure are set out in the diagram below. These include the full range of GHG impacts of the balance sheet (financed emissions) as well as off-balance sheet financing, advisory and underwriting activities.

“Just start measuring, disclose, and set targets. Many banks are holding back due to challenges related to data and methodology accuracies. The industry, however, is just not mature enough to support perfect methodologies and targets, while the topic urgency requires banks to act now. Improvements will come along the way.”

Banker, large European bank

Measurement and disclosure methods will need time to expand and evolve. Banks in some countries may need more time to develop the initial data. An end-state would ideally include mandatory carbon accounting and standardised measurements that include double materiality across all banking activities. That may take a while so to avoid ‘the perfect being the enemy of the good’, banks should get started now on measurement, understanding that in some cases **a rough estimate is better than none at all.**

The TCFD consultation (2021) includes recommendations specifically for banks to:

“... describe significant concentrations of credit, investment, and underwriting exposure to carbon-related assets. Additionally, banks should consider disclosing their climate-related risks (transition and physical) in their lending and other financial intermediary business activities.”

On-balance sheet emissions are increasingly being reported via the **Partnership for Carbon Accounting in Financials (PCAF)**¹⁵ under sector-based methodologies.

There is global momentum for accounting for financed emissions in this way with the TCFD guidelines now referencing PCAF and banking regulators looking to make this mandatory. The Paris Agreement Capital

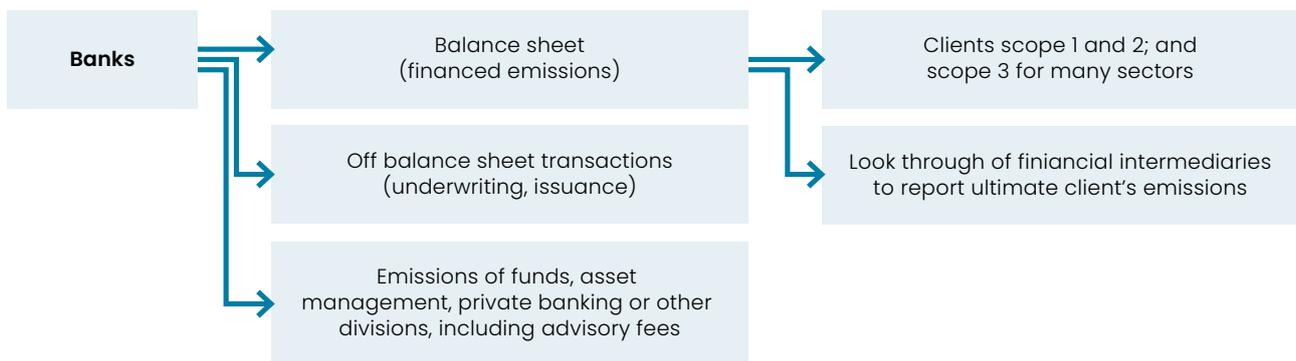
Transition Assessment (PACTA)¹⁶ is also applied by some banks to test the divergence from transition pathways for certain sectors within their portfolio with reference to a number of different scenarios. When a bank accounts for its clients, this has generally included the scope 1 & 2 (under the GHG protocol) of the client’s emissions; however, for many high impact sectors such as fossil fuels, the downstream scope 3 emissions are the most salient and, therefore, these should be included. This is referenced in the UNEP FI Guidelines for Climate Target Setting for Banks as being necessary for sectors where emissions are ‘significant and where data allow’, and applies to fossil fuel sectors under the Science Based Targets initiative (SBTi) guidance for Oil & Gas.¹⁷

“Being honest about problem areas of the balance sheet such as coal will help to build trust; we can’t make progress if we only talk about the good assets.”

Rebecca Self, Director of Sustainable Finance at South Pole and former CFO of Sustainable Finance at HSBC Holdings

This will help banks to respond when investors ask if the bank is financing fossil fuels and to what extent they are aligned with IEA’s net zero pathway; in addition, the transparency will help to build trust with all the bank’s stakeholders.

Scope of banks emissions to measure (Climate Safe Lending Network/A4S)



¹⁵ <https://carbonaccountingfinancials.com/>
¹⁶ <https://2degrees-investing.org/resource/pacta/>
¹⁷ <https://sciencebasedtargets.org/sectors/oil-and-gas>

Some balance sheet exposures may be structured as facilities which are directed via (financial) intermediaries. To prevent concealment of carbon, there should be a **full 'look through'** of any intermediary company or financial institution, applying the principle of 'following the money' to prevent disclosure avoidance. (This is likely to entail similar principles and methods to put fraud prevention in place throughout the banking sector; although this may require additional systems and management processes than exist today.)

Off-balance sheet transactions whereby a bank underwrites, advises or plays a commercial role in facilitating transactions should be included, albeit not necessarily aggregated with on-balance sheet emissions. Methodologies for doing this are under development. Emissions relating to investment businesses of banks (fund management, private banking, etc.) should be reported, but again, not necessarily aggregated with on-balance sheet emissions.

Measure the real economy impact or 'delta' as assets decarbonise

Real economy 'delta' here refers to a change in the carbon emissions of a financed asset, for example as it decarbonises over time. If a bank's engagement with clients reduces those emissions, it is increasing the 'delta' – e.g., the difference made to the real economy.

Banks can easily reduce their portfolio carbon by avoiding or exiting high carbon assets. While this is the quickest route to a Paris-aligned portfolio it has some drawbacks: it can mean giving up profitable business, it has only a limited impact on reducing real world carbon emissions, and it could perversely make higher carbon assets more profitable for banks that are still willing to take them on.

The harder but more climate-friendly path is to **work with clients to reduce the emissions from their assets**. Seen from a bank's perspective, a portfolio of assets in transition will emit more carbon but would provide a bigger real economy delta as the bank's engagement helps the clients to decarbonise the assets.

Examples of high-ambition 'delta' would be the conversion of housing to zero/near-zero emissions via deep retrofit (high quality insulation, integrated renewable energy and replacement of fossil-fuel based heating systems) or the transformation of manufacturing

processes such as using green hydrogen (produced via renewable energy electrolysis) in steelmaking.

In practice, it is up to each bank to pick the right balance between portfolio alignment via asset selection and the harder route of client engagement and asset decarbonisation. Some may choose to disclose the carbon emissions for each of these routes separately to gain a sense of control over whether their efforts are making a difference and to show how their transition strategy is working.

The UNEP FI Guidelines for Climate Target Setting for Banks offer two approaches to help **measure changes in the real economy**: measuring financed emissions and measuring emissions intensities. These enable the management of a wider view of climate impacts, in addition to the inward risks and opportunities covered by TCFD reporting. The role of understanding climate impacts (double materiality) is essential to understanding the systemic feedback loops these have in terms of inward risks and opportunities ('dynamic' materiality).¹⁸

Banks should be measuring both the movements in their own footprints (balance sheet financed emissions, off-balance sheet facilitated emissions and funds/asset management) and the change in the real economy. **Banks need to plan how to optimise the 'delta'** (the positive change in emissions reduction) for clients in the real economy whilst managing their own portfolio transitions. This will involve asking clients for data about changes in asset emissions but banks are in a strong position to make such requests. For those seeking tools to optimise real economy delta, the technical guidance due to be published by the Portfolio Alignment Team describes a selection of methods for banks to measure the alignment of their portfolios with Paris goals and to highlight shortfalls.¹⁹

Beyond the components of a bank's activities that directly contribute to its net zero calculation, it is important to **measure the degree to which enabling technologies are being financed** (such as renewable energy, green hydrogen production, etc.). These facilitate and accelerate the real economy transition and are important. Likewise, banks also have to consider the risks of path-dependency. This is where incremental improvements lead to more difficult conditions to continue the transition, for example power-sector strategies switching from coal to gas may lead to dependency on gas, delaying the transition to renewable energy.

¹⁸ <https://assets.worldbenchmarkingalliance.org/app/uploads/2021/06/WBA-Financial-System-Benchmark-Draft-Methodology.pdf>

¹⁹ COP26 Private Finance Hub, Portfolio Alignment Team (PAT), Measuring Portfolio Alignment: Technical Considerations, publication expected October 2021

Use best available data and continuously improve data quality

Banks should **use the best-available methods** to date to measure climate emissions, **recognising that data quality might be imperfect**. Lack of access to data is widely cited as a barrier to action but there are still useful insights from rudimentary data based upon sector-average emissions factors. In addition, banks generate data from their own analysis and regularly collect all kinds of data from clients directly – climate emissions data from supply chains must now be on that list. Using best-available data in this way will advance market-wide standardisation of client disclosures, helping data quality and reporting to improve over time, with a possible end goal being to normalise the idea that bank clients would have a standardised pack of climate data that they can hand over to each bank as needed.

Onboarding new clients – introducing “KYCO₂”

Identifying clear sector-based metrics (leveraging existing practices, especially Sustainability Accounting Standards Board (SASB) and similar metrics) and requiring clients to disclose their material metrics will drive the better data everyone wants.

Banks can adapt their “know-your-customer” (KYC) processes, originally developed to prevent financial crime, to capture data about a clients’ emissions and their transition plans as part of an **enhanced client due diligence process**. This could involve using sector-based metrics practices, for example SASB metrics. When onboarding involves asking clients for their own transition plan, banks should choose criteria to assess the plans, from whether the targets are Paris-aligned and the scenarios credible to whether the client has a responsible approach to using carbon offsets, for example. This process of becoming intimate with every client’s climate emissions and vulnerabilities should become an integral part of a bank’s diligence process

when onboarding clients and at regular ongoing intervals – **going from “KYC” to “KYCO₂”**, so to speak.

Enhanced due diligence – measure more than climate: incorporate full-spectrum sustainability

Alongside climate change, it is also important to **measure portfolio impact on nature and biodiversity, water scarcity, human rights, vulnerable communities, and all of the Sustainable Development Goals**. A wide range of tools and methodologies to measure these impacts are now available and being continuously developed.²⁰

If the purpose of enhanced due diligence is ‘to look harder’, it is important to ask about the full value supply chain of clients’ businesses in order to flush out downstream or upstream sustainability issues that may not be immediately obvious. This also applies to ‘green technologies’, for example, where there are initiatives to provide supply chain traceability in the solar power sector.²¹

The huge forecast growth in Electric Vehicles (EV) is likely to put pressure on the mining industry for materials such as lithium and cobalt with supply chain climate and sustainability risks in processes such as deep-sea mining.

Enhanced due diligence requires a will to uncover the truth about sustainability issues in and beyond climate.

It can prevent unintended consequences arising which may knock climate transition plans off course if not anticipated and managed.

“It is NOT enough to do just carbon/ fossil fuel cuts, there must be a more holistic equitable resilience and sustainability framing that is being measured by banks and reported on.”

Stewart Sarkozy-Banoczy, Precovery Labs Founder & Resilient Cities Network Sr Advisor North America and Director Global Strategic Partnerships and Development

²⁰ <https://www.unepfi.org/positive-impact/unep-fi-impact-analysis-tools/portfolio-impact-tool/andhttps://www.gabv.org/the-impact/the-scorecard>
²¹ <https://www.seia.org/sites/default/files/2021-04/SEIA-Supply-Chain-Traceability-Protocol-v1.0-April2021.pdf>

Use clear accounting principles if using ‘negative emissions’

There have been vigorous discussions about the ‘net’ in ‘net zero’. Carbon offsets are conceived as a way to deal with residual emissions and to help channel funds to emerging markets, provided they are reported separately from primary decarbonisation.

To be credible, concepts such as **carbon market offsets** or **‘avoided emissions’ cannot be used to offset generated emissions**. However, in the event that there are methods or technologies that do safely and securely sequester climate emissions, then these need to be accounted for as negative emissions. If used, they will be less vulnerable to criticism if the accounting methods and assumptions are transparently disclosed.

As well as the need to **set clear rules about when to use negative emissions**,²² there are other key considerations to embed in accounting principles:

- **How long will carbon be sequestered for?** In the case of forestry, the rate of sequestration is minimal in early years of new plantations. What happens in the event of a forest fire and the resulting release of emissions? And how can integrity be maintained to ensure that ‘afforestation’ is not a byproduct of unwarranted deforestation in recent history?
- For carbon capture, (usage) and storage (CCUS), **how can all net emissions be accounted for?** Methane release, for example, is highly significant due to its relevant warming potential compared to CO₂ (more than 80 times more in the first 20 years) and, therefore, methane leakage should never be ignored in any carbon capture system.

Synthetic Case Study: New Process for Onboarding Clients at ZeroBank

“We are upgrading our client onboarding process so we can really get to know a new client’s GHG emissions – a process known internally as ‘KYCO₂’.

“We started by pulling together sector lending teams to see what additional questions would help us to understand the GHG emissions in a client’s supply chain (the lending teams have recently taken a customised course on sustainability provided by a university).

“We’re now comparing their insights against guidance provided by the Sustainability Accounting Standards Board and our own assessment of ‘double materiality’ and impact. There are still some areas, like the embedded energy in building materials and what might happen to them at the end of life, which we haven’t decided how to treat right now but it helps to build the overall picture.

“For our SME clients and property-based lending we are asking the client for details of their primary energy use, plus transport emissions and anything else the relationship manager flags.

“For utilities and power companies we are looking at upstream and downstream emissions – those with SBTi are much easier to look at since they already have the data. “We’re working together with a few other national banks to collaborate with public utilities on an open-data project: getting hold of client data on an automated basis subject to the client’s permission.

“All of this data is being compiled into a database which helps us to benchmark clients across a sector and geography. And there is a new section in our Credit Assessment template that requires a commentary on the data for a client and how it compares with benchmarks (for example looking at the climate emissions per square metre for commercial property).

“We are developing a ‘risk-based approach’ for the highest potential climate impact sectors. This means we will check with independent data providers for the most sensitive sectors.”

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

²² <https://www.smithschool.ox.ac.uk/publications/reports/Oxford-Offsetting-Principles-2020.pdf>



Assessment and target setting: Measurement, Disclosure & Reporting Summary

Starting points

- UNEP FI Guidelines for Climate Target Setting for Banks
- TCFD guidelines (updated)
- PCAF (absolute financed emissions)
- Bank's KYC procedures
- Bank's data sources to supplement client disclosures
- UNEP FI Portfolio Impact Analysis Tool for Banks (version 2) [a standard for negative accounting emissions]

Key components for measurement and disclosure:

- Include the full extent of the bank's business
- Measure the real economy impact or 'delta' as assets decarbonise
- Use best available data and continuously improve data quality
- Onboarding new clients – introducing "KYCO₂"
- Enhanced due diligence - measure more than climate: incorporate full-spectrum sustainability
- Use clear accounting principles if using 'negative emissions'

3. ASSESSMENT AND TARGET SETTING: NET ZERO & PARIS-ALIGNED TARGETS



This chapter is about setting targets for reducing your bank’s financed carbon emissions, using science-based targets and credible climate change scenarios. The actions include:

- Set an overall target between 2030 and 2050 to be net zero, using the NZBA benchmark
- Select credible scenarios in line with UNEP FI Guidelines for Climate Target Setting for Banks
- Set early interim and sector-based targets
- Apply the Precautionary Principle by acting as soon as possible

“Measurement does not automatically translate to actions. You need to stress the targets and action part.”

**Dimitrios Dimopoulos, Head of ESG,
Piraeus Financial Holdings**

Target setting principles

The **NZBA benchmark for target setting**, below, requires banks to use widely accepted science-based decarbonisation scenarios. The Science Based Targets initiative (SBTi) currently has a rigorous framework for financial institutions to set science-based targets; however, some elements are not yet covered by the validation process (e.g., providing full alignment with 1.5 degree Celsius/net zero scenarios). The NZBA target setting process builds upon the UN Principles for Responsible Banking (PRB) which commits banks to align their strategies to the Paris Climate Agreement by being more specific about how to set targets and monitor progress.

The first step is to choose a target preferably between 2030 and 2050 for the bank’s financed emissions (in absolute terms or as an intensity measure covering all three scopes) and make it public. While the NZBA benchmark is already robust, the network plans to revise it at least every three years and banks may choose to implement above this level already.

Suggestions to **tighten the mechanism** in future revisions include:

- Setting **intermediate targets for 2025** to promote rapid action and **make full use of the early years** in a transition period (bring into line with the Net Zero Asset Owners Alliance).
- Off-balance sheet activities, including facilitated capital markets activities, will be brought into scope of 2030 targets in the next revision of the Guidelines, which will be before April 2024, once

the required third-party methodologies have been finalised and adopted.

- Being clear about **exit time horizons on the most misaligned activities** (e.g., legacy fossil fuel assets) with immediate cessation of finance to support expansion or exploration of new fossil fuels or deforestation.
- **Full look-through of intermediaries** to ensure the prevention of disclosure-avoidance.

UNEP FI Guidelines for Climate Target Setting for Banks as applicable to NZBA members²³

- Banks shall set a 2050 target to support meeting the temperature goals of the Paris Agreement
- Banks shall set an interim target for 2030 or sooner and may set further interim targets prior to that date.
- Targets shall be set based on:
 - Absolute emissions; and/or
 - Sector-specific emissions intensity (e.g., CO₂e/ metric).
- While a bank's targets may be supported by other approaches (e.g., production volume trajectories, technology mix) or measurements (e.g., financing

targets), the targets shall nonetheless be set in absolute and/or intensity terms.

- As an interim target year is approached, the next interim five-year target shall be set. Banks' targets shall include their clients' Scope 1, Scope 2 and Scope 3 emissions, where significant and where data allow. Scope coverage is expected to increase between each review period.
- Targets shall cover lending activities and should cover investment activities as explained below. Banks should be clear about which parts of the balance sheet the targets encompass.

Scenarios should be selected and updated to reflect a climate-safe world

Choosing an overly optimistic climate change scenario can render a target meaningless. For example, choosing a scenario that allows banks to finance the development of new fossil fuel resources would be less convincing than choosing a scenario in which new fossil fuels play a smaller role or none at all.²⁴ But what makes a climate change scenario credible? The following is covered in the UNEP FI Guidelines for Climate Target Setting for Banks on scenario selection:

The scenarios used by banks shall come from credible and well-recognised sources and banks should provide the rationale for the scenario(s) chosen.

- IPCC scenarios and scenarios derived from IPCC-qualifying models that meet the criteria outlined below are strongly recommended.
- Scenarios such as the IEA scenarios (e.g. SDS or NZE2050 scenarios) or sector-specific scenarios (such as the shipping decarbonisation trajectories developed under the Poseidon Principles) may be used if the individual scenarios are expected to be aligned with the temperature goals of the Paris Agreement.

²³ <https://www.unepfi.org/wordpress/wp-content/uploads/2021/04/UNEP-FI-Guidelines-for-Climate-Change-Target-Setting.pdf>

²⁴ Financial Times, "Big banks resist most direct road map to net zero emissions", 11 October 2021 <https://www.ft.com/content/9105cc47-58fb-47dc-8233-6b622fb56ae2>

- The scenarios selected shall be “no-overshoot” or “low-overshoot” scenarios (e.g., scenarios P1 and P2 of the IPCC).
- The scenarios selected shall rely conservatively on negative emissions technologies.
- The scenarios selected shall have reasonable assumptions on carbon sequestration achieved through nature-based solutions and land use change.
- Banks shall disclose which scenario their climate targets are based upon (scenario name, date and provider). Banks should disclose key assumptions used in these scenarios.
- The scenarios selected shall, where possible, minimise misalignment with other Sustainable Development Goals (SDGs).

We use the term Climate-Safe because the world is not static and neither is our understanding of climate science, as the change in focus from 2C alignment to 1.5C alignment already demonstrates. As circumstances and the science evolve, financial institutions will need to update their views about how precisely decarbonisation will be achieved.

UNEP’s 2021 Production Gap Report concludes that the world is on course to produce around 110% more fossil fuels than what is compatible with a 1.5C future.²⁵ It is based on projections by governments who collectively plan to double fossil fuel production by 2030 despite setting net-zero targets. That means we are currently financing more than double the amount of fossil fuels compatible for a 1.5-degree world. This either results in massive financial write-offs or exposes future generations to catastrophic consequences.

The wording of many stakeholders at the moment is for net zero before 2050, using a scenario that is aligned with 1.5-degrees Celsius with low- or no-overshoot and **limited reliance on carbon dioxide removal**, reflecting that carbon removal technologies are not yet commercially proven.

Despite the uncertainties, we do know that the later action takes place (or the greater the emissions in the near term) the more difficult it will become to achieve climate safe goals. This could lead to more severe social and economic consequences, perhaps via political intervention through an ‘inevitable policy response’, which would make progress on transition harder (more disorderly).

The precautionary approach implies acting as soon as possible, aiming for optimising near term action to deliver ‘concave’ transition plans, meaning steeper gradients of climate emissions reductions in earlier years.

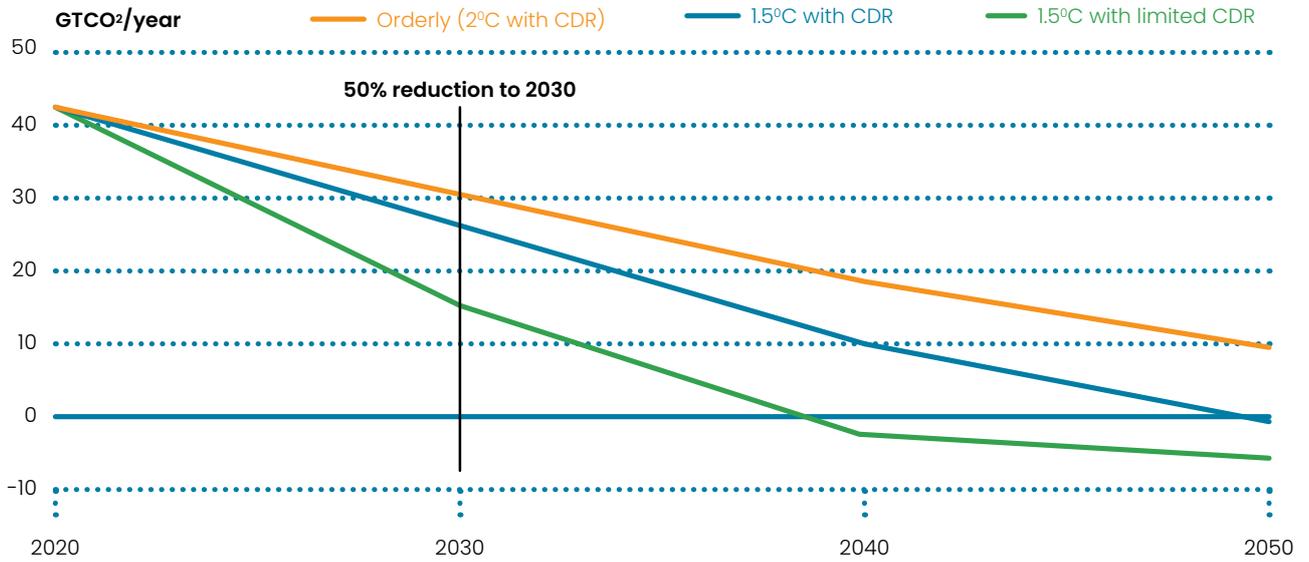
“Short-term goals to 2025 are essential; even with a 2030 target it is still possible to delay action for two or three years, time that we simply don’t have this decade.”

Jon Dennis, Sustainable Finance Manager, WWF

A commonly recommended benchmark for achieving climate-safe scenarios is a 50% reduction in GHG emissions from now until 2030 (shown below – from NGFS alternative reference scenarios); however, this may need to be larger for banks with more carbon intensity (CO₂e/\$bn) in their portfolio to start with.

²⁵ <https://productiongap.org/2021report/>

Carbon dioxide emissions: alternate 1.5°C scenarios



Source: IIASA NGFS Climate Scenarios Database, REMIND model

Meeting the IPCC’s no- or limited-overshoot scenarios without carbon capture would mean a 58% reduction in emissions by 2030 relative to 2010. Even **this may understate the task**: if 58% is the global mean for this scenario then what would the distribution look like

across different banks? The 2030 headline target among leading banks **may need to be nearer 80% reduction** since passive decarbonisation means the laggards will only do around 20%.²⁶

Emissions Pathways limiting global warming to 1.5°C

	No or limited overshoot			Higher overshoot
	P1	P2	P3	P4
CO ₂ emission change by 2030 (% change relative to 2010)	-58	-47	-41	4
CO ₂ emission change by 2050 (% change relative to 2010)	-93	-95	-91	-97
Cumulative CO ₂ Capture and Storage (CCS) until 2100 (GtCO ₂)	0	348	687	1218

Source: IPCC

²⁶ <https://www.climatepolicyinitiative.org/wp-content/uploads/2021/05/Framework-for-Sustainable-Finance-Integrity.pdf>

Synthetic Case Study: How ZeroBank's New Climate Targets are Impacting Return on Equity

"In our original assessment a couple of years ago, we found our business-as-usual trajectory for our portfolio was aligned with >3C. We held workshops in teams to understand what this meant for us as bank and as individuals. We started some deep analysis to look at what the real RoE impact would be of decisions that we had been nervous to consider fully in the past.

"We were concerned about how our investors would react and after a difficult 2020 resulting from Covid-19 we were nervous about making approaches. But when we discussed with our major institutional investors that we would perhaps see a dip in RoE for three-four years, but over the course of the (ten-year) plan we would do better, they welcomed it. In fact, they seemed really impressed with our analysis and the amount of engagement we had gone through with

high-emitting client sectors, saying it can help with their own ESG reporting.

"The bank set a very stretching target for 75% decarbonisation by 2030, getting us to 1.5 degrees –with a little bit of carbon budget to spare. Some commercial departments were able to be more ambitious than others. Some people internally say it is too high and that it doesn't need to be so aggressive. If it turns out to be, then we can still be on course for 1.5 degrees whilst relaxing the target a little (like releasing a provision). But we might find that there are more commercial opportunities in climate solutions on our new trajectory that we can keep to the target we've set out."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

In practice, banks may find it practical to use scenarios developed by the central bankers' and supervisors' network, Network for Greening the Financial System (NGFS), because these are likely to be favoured by regulators for stress testing and other purposes.

Transition plans based on sectoral pathways need to be revised even more frequently to incorporate new insights and disruptive innovations.²⁷ What counts as the 'best' solution today is very unlikely to be the optimal solution in 10 or 20 years. So, for realistic plans, banks may need to **plan for flexibility and adaptation** rather than expecting a fixed transition pathway.

Anchor the highest-level ambitions in a strategy development process by reaching for 2030

If a bank, or any business, has a strategy development process where the goals are set 30 years in the future, there is a high chance of slow-moving incremental changes. Likewise, thinking about what near-term interim targets might be without anchoring the level of ambition that needs to be reached might produce

similarly incremental results. To trigger more creative thinking that leads to more transformational changes, banks could anchor their ambition by asking the question: **what would it take to achieve net zero by, say, 2030 and optimise the degree of change in the real economy within the next 5–7 years?** The ideas that can be developed might appear radical, but by collectively focusing the expertise of teams across the bank they could be made more feasible and open up more pathways to accelerate change. The resultant effect may be that more ambitious targets are set with greater clarity and confidence about how to achieve them. **If banks were to undertake these processes in the next 12-18 months and share their insights it might stimulate a significant shift in collective ambitions.**

"A credible net zero and Paris-aligned target must have interim 2030 targets with specific reduction goals in line with net zero trajectories for each covered sector."

Senior Director, NGO

27 Transformations Required for 1.5°C Alignment and Global Sustainability and Innovation and Transformation: What it will take to finance net zero



Assessment and target setting: Net zero & Paris-aligned targets Summary

Starting points

- NZBA benchmark for setting targets
- UNEP FI Guidelines for Climate Target Setting for Banks

Key components for target-setting:

- Publicly announced target date between 2030 and 2050 by when all the bank's activities will be net zero
- Select individual targets to reduce emissions in each lending portfolio or off-balance sheet activity
- Select credible scenarios based on low- or no-overshoot, with limited use of CCS and negative emissions
- Set ambitious interim targets to drive early action, such as 2025

4. DECARBONISING BALANCE SHEETS & ECONOMIES



This chapter looks at the main task of how banks can decarbonise their financing activities across all industry sectors and speed the transition of the wider economy. The actions in this chapter include:

- Engage clients with specially trained customer relationship management (CRM)
- Develop sustainability-linked pricing and other product features
- Develop green assets
- Provide sectoral products and technical assistance
- Just Transition: integrate broader social and environmental elements
- Consider adaptation, resilience and the needs of vulnerable communities

Understanding the challenge of a multi-sector transition

To transition a bank’s core business and client base will require a wide range of strategies and approaches that can support and encourage clients to make the right changes quickly and efficiently. The NZBA encourages banks to review a **full range of levers** to decarbonise client portfolios and the economy:

- client engagement
- capacity building
- development of new tools and products
- assessment of portfolio alignment/exposure/risks
- development of policies; public policy positions and advocacy for government/regulatory action
- strategy to grow customer base

“Banks need to understand how this plays out across the whole economy, not just fossil fuels and deforestation”

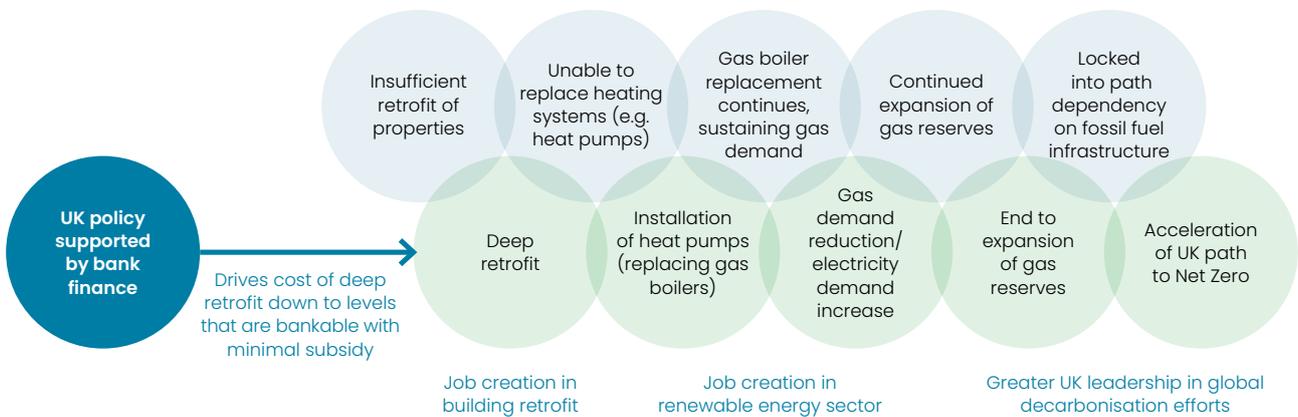
Kate Levick, Associate Director E3G

Having an awareness of how long it will take for flows of new lending in emerging sectors to replace stocks of legacy assets will help bank leaders to reconcile different interests within the bank, such as risk and business, and to convince shareholders that the process will bring long-term value.

Although **sectoral decarbonisation pathways** are emerging, it will take considerable work to apply them to individual bank portfolios. The IEA provides reliable scenarios for most relevant sectors, although data is sometimes not granular enough. Where gaps are identified, institutions such as the Rocky Mountain Institute and Mission Possible Partnership are developing further net zero scenarios. Banks need to understand the potential for transformative innovations and price developments, and how **sectors affect each other as they decarbonise**, for example when reductions in wind and solar prices open pathways to decarbonise steel through green hydrogen. It means managing uncertainty, as well as opportunity. Creating

sectoral transition plans and visions will help to build this understanding.

Another example is the link between deep retrofit of buildings and the need for new natural gas fields. The group Bankers for Net Zero is examining this in the UK, where high prices and fragmented subsidies are slowing the demand for retrofitting, which in turn is slowing the move away from gas central heating (because low carbon heating systems such as Air Source Heat Pumps work best in well insulated properties). If gas boilers continue to be installed after 2025, the point at which the IEA recommends they should be switched for alternatives, then the demand for gas will be locked in for another twenty years, which is the reference life for a typical gas boiler. At the time of writing, this is being used to justify the development of new oil & gas fields in the North Sea, despite the UK’s government’s presidency of COP26 trying to persuade other countries to stop expanding their fossil fuel reserves. If banks can intervene in this loop, for example by offering retrofit finance at scale, they would contribute both to decarbonising the domestic housing sector and the gas sector. From a commercial perspective, more lending in the retrofit finance sector should help to offset reduced lending in the gas sector.



Proactive dialogue with clients on their climate strategies

Banks' **customer relationship managers are well placed to discuss climate strategies with clients**. There is space for a dialogue about how clients intend to meet their climate objectives, what the financial outcomes are and the risks involved. There are both carrot and stick elements to this.

On the carrot side, with sufficient knowledge, **banks can inform clients** about trends and developments and **bring data insights** to reflect where a client may have deficiencies compared to its peers. And by mobilising banks' networks there is potential to introduce clients to partners who can help them make progress.

Banks cannot 'lead' their clients' strategies but if banks develop sufficient skills and competences, they can be a trusted source of feedback and be influential in shaping a client's decisions. And where a bank is unable to finance a specific type of investment in climate solutions, it could support the (potential) client by connecting them with alternative finance providers.

On the stick side, with sufficient backing from bank CEOs, customer relationship managers can **engage clients in difficult conversations** about climate change. For this to work, there must be full alignment with top management, rating models, regulatory duties, risk appetite support, and full empowerment of frontline staff (education, tools, sector insights) to help them properly engage in a scientifically-based way with clients.

Banks client engagement

Business as usual	Elements	Paris aligned
<p>Efforts to design systems to account for clients' GHG emissions</p> <p>Efforts to set client-specific GHG emissions reduction targets</p>	GHG Assessment	<p>Set Paris-aligned emissions reduction targets</p> <p>Account for all GHG emissions of all clients</p> <p>Incorporate tools to strengthen data framework</p>
Limited benchmarking efforts	Benchmarking	Benchmark all clients from the same sector on their Paris alignment performance
No clear Paris-aligned policies place	Policies	<p>Transition targets</p> <p>Ambitious time frames</p> <p>Consequences in case of noncompliance</p>
<p>Minimal climate training of relationship managers</p> <p>Responsibility for ESG/sustainability team</p>	Human Resources	<p>Relationship managers trained on Paris alignment</p> <p>Sustainability/ESG team as coordinators and innovators</p> <p>Performance incentives based on Paris alignment indicators</p>

Source: https://files.wri.org/d8/s3fs-public/2021-08/banking-beyond-climate-commitments.pdf?VersionId=w5tCECT74FHnX_XvraEmYj6jqMpBFkli

“Banks don’t like to be the policeman and are reluctant to engage with their clients about lowering their GHG-emissions towards net zero. That’s entirely understandable but the logic is that they should do it. If you are serious about this, you cannot stay silent, you cannot hide, you must speak out.”

Jacob Waslander, Dutch Ministry of Foreign Affairs

Since banks ask clients a lot of questions, from the first time clients apply for banking services through to client reviews, there are many opportunities to explore a client’s awareness of climate risks, opportunities and impacts. Banks can continuously learn and adapt their standard processes (including due diligence and review cycles) to optimise how they can assess, monitor and support clients.

WRI’s Banking Beyond Targets²⁸ provides similar guidance around moving from ‘business as usual’ to Paris-aligned products (see above).

Support relationship manager training to develop transition expertise in their field

As frontline staff, relationship managers (supported by risk and product specialists) will need training to take on a role as a client’s climate champion. To prepare for tough conversations on climate change they need to be equipped with the right knowledge, tools, and resources to effectively help clients transition. Banks should plan how they will ensure **training and competence** for relationship managers on sustainability issues with access to effective knowledge management resources. This is likely to provide banks with a competitive advantage and could even be linked to remuneration, for example by incentivising customer relationship managers to introduce transition-related covenants into the loan book.

Offer pricing structures to incentivise sustainability and climate goals

Banks are increasingly using differentiated pricing mechanisms to incentivise sustainability progress from clients. This might be based upon compliance with a specific benchmark (e.g., the Sustainable Finance Taxonomy introduced in the EU). Or it might be the attainment of an improvement in sustainability performance (for example reaching a specified level of GHG reductions in a prescribed timeframe).

For these mechanisms to be effective, there are two factors for banks to consider:

- Is the **price differential** sufficient to drive the behaviours required? There is a natural human tendency to avoid negative consequences rather than to seek gains – how can this be harnessed to ensure compliance with plans?
- Is the **level of sustainability** being incentivised at an appropriate stretching level compared to peers, sector pathways and the likely end-state for full decarbonisation?

Rather than sustainability-linked and/or green pricing being a niche product, banks should consider overhauling their pricing models to reflect climate and sustainability performance, perhaps by integrating these into risk or liquidity frameworks. While overhauling the risk model would take time, it might be possible to add supporting factors and penalty factors for internal purposes only (i.e. not towards regulators). In addition, if funding for sustainable assets becomes cheaper over time than funding for fossil fuel assets, that could justify a different liquidity add-on to the funding cost. Internal steps of this sort would help to normalise the integration of transition goals into bank lending, with a consequent knock-on effect for clients who would factor the pricing differentials into their own transition planning.

“Applying a negative risk premium to fossil fuel exposures would allow banks to build up capital to be able to absorb the upcoming losses on these exposures.”

Benoit Lallemand, Secretary General, Finance Watch

28 Banking Beyond Climate Commitments: Transforming Client Engagement and Products & Services for a Net-Zero Emissions Future

Beyond pricing, banks may be able to consider other incentives to stimulate climate action. For example, being able to **lend more** or stretching lending over a **longer period** to support investment to accelerate transition.

Link the demand for green to drive the development of green assets

There is a growing demand from individuals, businesses and the capital markets for green investments, bonds and savings. Banks are already issuing green bonds, transition-bonds, and green corporate deposits. Future iterations could include **mortgage portfolio standards**²⁹ that reward energy efficiency improvements in buildings and channel funds to retrofitting of buildings, and green bonds with pricing linked to whether the issuer achieves a certain decarbonisation goal, which could help to align investors and banks. Bank product teams should be on the look-out for evidence to support net zero product features, such as data linking property values to energy efficiency standards or similar.³⁰

It is possible that there is a green premium based upon the demand for green products enabling funding to be raised less expensively in support of a shift towards green business. But **additionality is key**: matching existing assets on the balance sheet or hypothecating the use of proceeds towards business that would have been financed in any case might not drive the bank towards increased business development, innovation or green asset growth.

Develop sectoral products and technical assistance

By focusing on particular industry sectors, either alone or working together through networks and trade associations, banks can concentrate their influence.

Banks can implement sector strategies that **identify carbon-intensive hotspots** in their lending and investment portfolios and provide incentives for their clients to decarbonise, or disincentives if clients do not meet agreed transition targets. For engagement across an entire sector, it can be additionally effective to participate in collective initiatives that support sectoral transition (for example, the Poseidon Principles for reducing emissions in shipping).

There may be some scalable technologies and approaches in achieving a net zero transition which could be accelerated by **standardising finance packages for replicable interventions**. When clients know that there are unlikely to be difficulties in obtaining finance to purchase a piece of equipment (say a green heating or cooling system) then it removes potential friction from a transaction and supports growth in demand.

In market segments where the bank identifies the need for clients to have more knowledge or support, the bank may be able to organise **technical assistance**, perhaps in collaboration with other financial institutions. Whilst ensuring that conflicts of interests are carefully considered to treat customers fairly, technical assistance and advice may be delivered directly by the bank or via independent third parties. Banks can request and monitor client decarbonisation plans over the course of a loan, help the client set climate-aligned milestones, goals, and timelines, provide debt to customers with conditions, and create borrower covenants that link to loan defaults to steer behaviour and encourage acceleration towards optimum climate goals related to the client's activity.

Just Transition: integrate broader social & environmental factors by applying different lenses to strategy

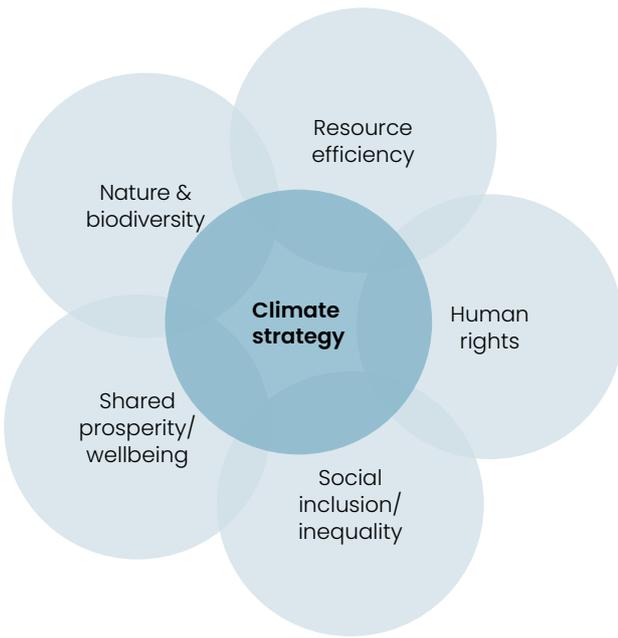
Rather than thinking of a bank having a strategy with a separate climate strategy (and perhaps further separate strategies on nature, social impact, etc.) it may be more helpful **to visualise one single bank strategy being viewed through a range of different lenses**. In implementing changes to the bank strategy with respect to climate, it is possible that there may be some unintended negative consequences when viewed through the lenses of nature & biodiversity, human rights and a Just Transition.³¹ The SDGs provide a framework with a comprehensive set of 'lenses' from which to view strategy, supplemented by a growing body of research and policy initiatives, such as the Taskforce on Nature-related Financial Disclosures, initial research on the linkages between biodiversity loss and financial instability, and proposals for an EU Social Taxonomy, among others.³²

²⁹ Climate Strategy Partners, (October 2021). *Underwriting the Renovation Wave with Mortgage Portfolio Standards for Energy Efficiency*. <https://www.climatestrategy.es/press/MortgagePortfolioStandardsREPORT2021.pdf>

³⁰ For example, see <https://solarenergyuk.org/resource/the-value-of-solar-property-report/>

³¹ <https://www.lse.ac.uk/granthaminstitute/wp-content/uploads/2019/10/Banking-the-just-transition-in-the-UK-2.pdf>

³² https://publications.banque-france.fr/sites/default/files/medias/documents/wp826_0.pdf; https://ec.europa.eu/info/publications/210712-sustainable-finance-platform-draft-reports_en



When looking at the elements of the Climate Strategy (which are just the collection of most significant decisions reflected in the corporate strategy which impact climate) through another lens, it is possible to see where there are tensions or alignment. Many nature-based solutions can have multiple positive impacts, such as climate mitigation, adaptation and resilience, health and wellbeing, prevention of flood risks and biodiversity. However, there can be negative sustainability impacts associated with some climate strategies that would need to be considered, mitigated or avoided (for more details, see the UNEP FI Positive Impact Finance Initiative tools).³³

The Climate Action 100+ initiative is developing ‘Just Transition’ indicators for investors and companies,

which banks could use in their planning to connect the environmental and human dimensions of the transition.

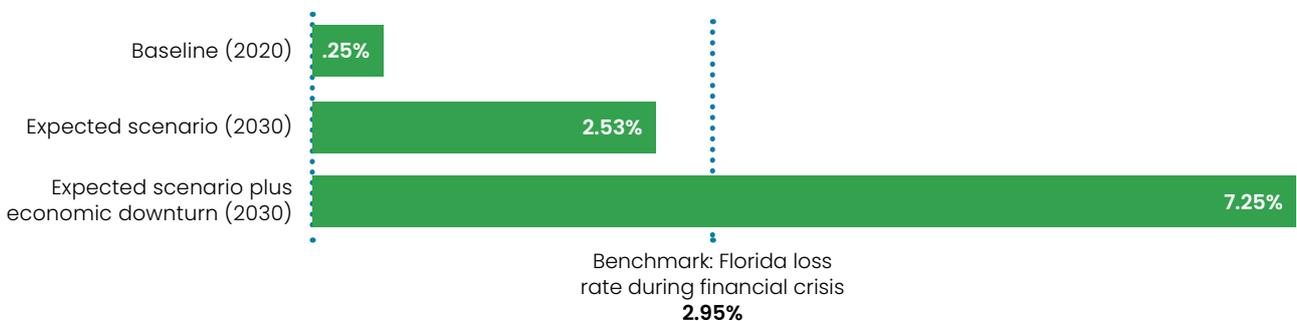
Consider adaptation, resilience and meeting the needs of vulnerable communities

Financing for adaptation and the protection of vulnerable communities is a broad and increasingly urgent topic that requires a paper of its own, however some elements are worth mentioning here.

It is not clear to what extent banks see the provision of finance for climate adaptation as part of their responsibility under a Just Transition: while around half the respondents to the CSL survey considered adaptation a priority topic, about a third said it was not important and hardly any said it featured in current practice.

In a broader consideration of a Just Transition, banks should consider the consequences of **the unequal impacts of climate on different communities and the needs to invest in adaptation and resilience**. Some Just Transition narratives have been used to frame a compromise on the speed of transition – generally used to perpetuate the status quo rather than to protect communities’ longer term needs within a transition. Work is being carried out by some lenders including CDFIs to specifically adapt their core banking processes to assess resilience. However, the major risk for society is that banks may manage transition risk by no longer providing finance to those most vulnerable; therefore, leaving them stranded.. Many householders in high flood-risk areas may struggle to receive insurance and mortgages as climate risks increase (see below).

Projected loss rates for Miami, Florida mortgage portfolio



33 <https://www.unepfi.org/positive-impact/impact-radar-mappings/>

Banks need to **develop specific place-based plans** that map out the risks and opportunities for communities within their climate-safe pathways. To consider the needs of vulnerable and underserved communities, banks should **review how they are**

currently reaching these groups and how this is reflected in the diversity within the bank, and consider how the above can be disclosed as Just Transition indicators when a suitable framework is available.

Synthetic Case Study: Relationship Managers are Leading ZeroBank's Portfolio Decarbonisation

"The transition team consulted for a long time with frontline staff over transition. Our first insight was that we needed to empower staff more at a regional level rather than from head office, so we gave our regional management the parameters to flex targets and even to adjust pricing, where it supports transition goals.

"We then added transition goals to the incentive frameworks of our relationship and business development managers, using goals agreed with each team. The new transition KPIs apply as 'gatekeepers', so that bonuses on any other metrics will only be paid if these are met as a minimum.

"The new KPIs relate mostly to customers' use of transition plans and science-based targets. We have supported this with a bespoke training course for relationship managers, covering science-based targets, why they matter and how to implement them.

"We also recognised we had been going through some real challenges on our own Scope 1 & 2 reductions - mostly on our heating and cooling system and how we could keep our transport emissions to levels they were at during Covid or better.

"We thought that would be the easy bit. When we brought together a group of experts and partners to help us out on that challenge, we suddenly realised that this was precisely the difficulty our clients must be going through right. So we published an article that described how we had been finding it really difficult but were now making progress. As a result, we are receiving more lending enquiries from people saying they want to do something similar."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

Decarbonise Balance Sheets & Economies Summary

Starting points

- Mapping of the bank's key industry sectors and the impacts, risks and opportunities in each sector
- Bank's current sector-based policies
- Client transition plans and trajectories
- Mapping of CRM skills, including transition and sector expertise

Key components for decarbonising balance sheets and economies:

- Engaging clients with specially trained CRM
- Developing sustainability-linked pricing and other product features
- Developing green assets
- Developing sectoral products and technical assistance
- Integrating Just Transition and broader social and environmental elements
- Considering adaptation, resilience and the needs of vulnerable communities

5. STOPPING FLOWS OF FINANCE TO FOSSIL FUELS & DEFORESTATION



This chapter is about ending the flow of credit to fossil fuels and deforestation and managing the consequences of that for bank stakeholders. The actions include:

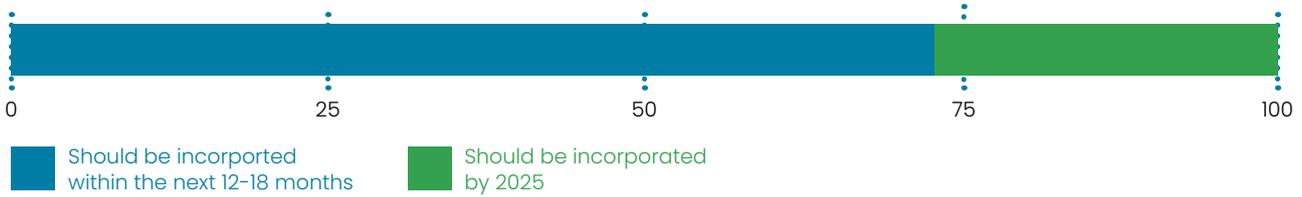
- Set a near term date to end the bank's financing of new fossil fuel resources and deforestation, in line with leading practice
- Assess legacy fossil fuel and deforestation assets and create reduction pathways
- Develop product features to support the reductions
- Create an engagement plan for all the affected stakeholder groups
- Analyse the systemic impact of the bank's decisions on the wider market

Implement a near-term end (2022) to all expansion and exploration of fossil fuels and deforestation.

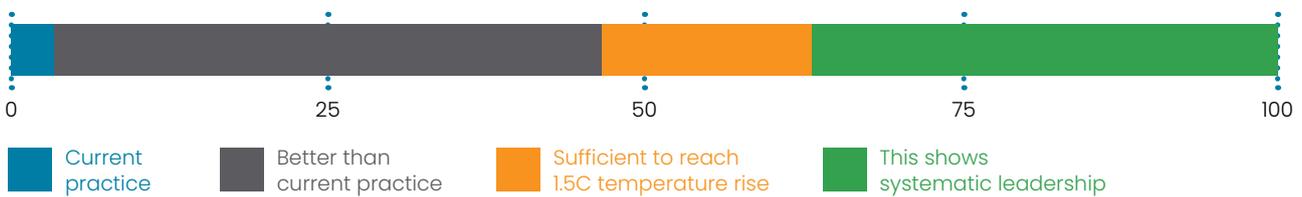
In line with the IEA net zero NZE2050 scenario implication that the expansion of fossil fuel assets or exploration for further reserves is not aligned with a 1.5-degree Celsius world, leading practice is for banks to implement policies to **end all such facilities**. This includes **direct lending with a specific corporate purpose, or general corporate lending** to companies who are continuing those activities. This should be implemented for all new facilities from now onwards and should be feasible to implement for all drawdowns of loans (including those where contractual commitments exists) **by the end of 2022**.

There is a substantial gap between what stakeholders think should be done and current practice.

Respondents timeframe for implementing a near-term end (2022) to all expansion of fossil fuels and products that cause deforestation



Bank practices and their ability to implement a near-term end (2022) to all expansion of fossil fuels and products that cause deforestation



Source: CSLN survey

A specific clarification here relates to the need to look-through financial structures. Banks are free to choose how to structure their loans. It is possible to ringfence finance for specific corporate purposes to ensure that only aligned activity is supported. What is less clear is whether this practice of ‘Green-lining’ is effective in preventing flows to unaligned activities. Therefore, the more robust version of a policy would **be ruling out “any type of financial service to any new fossil fuel projects”** (from World Benchmarking Alliance and several NGO expectations).

In the CSL survey, more than 70% of respondents favoured ending lending for new fossil fuels and deforestation activities in the next 12-18 months, although hardly any reported that this was current practice.

Assess legacy fossil fuel and deforestation assets and create reduction pathways

Alongside the immediate steps of ending flows of finance to expanding or exploration of new fossil fuels, banks should look at how best to **phase out finance to existing fossil fuel and environmentally damaging activities**. Setting targets in this area is more complex and needs to take account of industrial transition

pathways, macro-economic effects and regulatory limitations, for example where a utility client is obliged by the government to maintain a certain level of coal power. However, there is a consensus forming on the latest end date for coal finance phase out being 2030 in OECD countries and 2040 globally. For companies that still have fossil fuel activities there should be near term implementation of policies that:

- ‘phase[s] out the provision of any type of financial service to existing projects and companies across the fossil fuel value chain, unless they have a clear corporate strategy aligned with 1.5°C pathways’
- [excludes] any type of financial service to companies across the fossil fuel value chain that do not have a corporate strategy aligned with 1.5°C pathways.

(World Benchmarking Alliance)³⁴

While client engagement is part of this, banks may need to apply **conditions within facility agreements**:

- **Pricing** could be linked to sustainability goals with discounted margins based upon outperformance (sustainability-linked loans).
- **The amount of borrowing** could be increased in the event that investment was made to accelerate decarbonisation.

34 <https://assets.worldbenchmarkingalliance.org/app/uploads/2021/06/WBA-Financial-System-Benchmark-Draft-Methodology.pdf>

- **Covenants and conditions** within facility agreements could be added to specifically require compliance with transition plans and climate targets, requiring progress reports from the borrower. The bank could link non-compliance (which is not remediated) to an event of default, thereby giving grounds to terminate the relationship.

Create an engagement plan for affected stakeholder groups

When this leads to banks losing business and clients, there will be a real **need for bank leaders to engage with stakeholders and manage the fear of transition**. For internal stakeholders, linking the process to sectoral targets and incentives linked to those targets may help, especially when other banks are moving in the same direction (see box below). Practical aspects to consider include communicating the financial impact to shareholders who may resist temporary negative impacts on return on equity, redeploying and re-incentivising staff, and finding replacement business

without lowering standards, especially if other banks are chasing business in the same growth areas.

“I think it’s the business ambition that is lacking – i.e., that banks should lead the transition and be willing to lose revenue to get there. That’s not realistic, but it’s probably required without regulation”

Banker

In off-balance sheet activities, including **advisory services**, there are also opportunities to align with broader decarbonisation outcomes. For example, if a bank is assisting with the sale of a client’s carbon intensive asset, the bank could help to ensure that the sale is done in a responsible manner with a phase-out plan developed by the buyer. This would add to the bank’s ‘real economy delta’ (see page 23) and, for clients with their own net zero plans, is likely to be seen as a value-added activity.

Banking alliances and fossil fuel phase out policies

Commercial banks’ ambitious action consists of setting targets aligned with 1.5°C warming, including near-term targets for 2025 and 2030, the adoption of sectoral transition plans, full phase out for coal by 2030 or sooner, phase out plans for other fossil fuel clients without credible transition plans in place, and increasing finance for sustainable activities.

The **Collective Commitment to Climate Action (CCCA)** supports ambitious action in the banking sector by requiring banks to set and publish sector-specific targets that strive for a Paris-aligned trajectory within three years of joining, as outlined in the Guidelines for Climate Change Target Setting.

Signatories to the **Net Zero Banking Alliance** are expected to set concrete near-term (2030 or sooner) targets within 18 months of joining, as outlined in the Guidelines for Climate Change Target Setting.

CPI adds that, with regards to coal, banks should commit to prohibit financing for new and existing coal-related projects, commit to full phase-out of coal

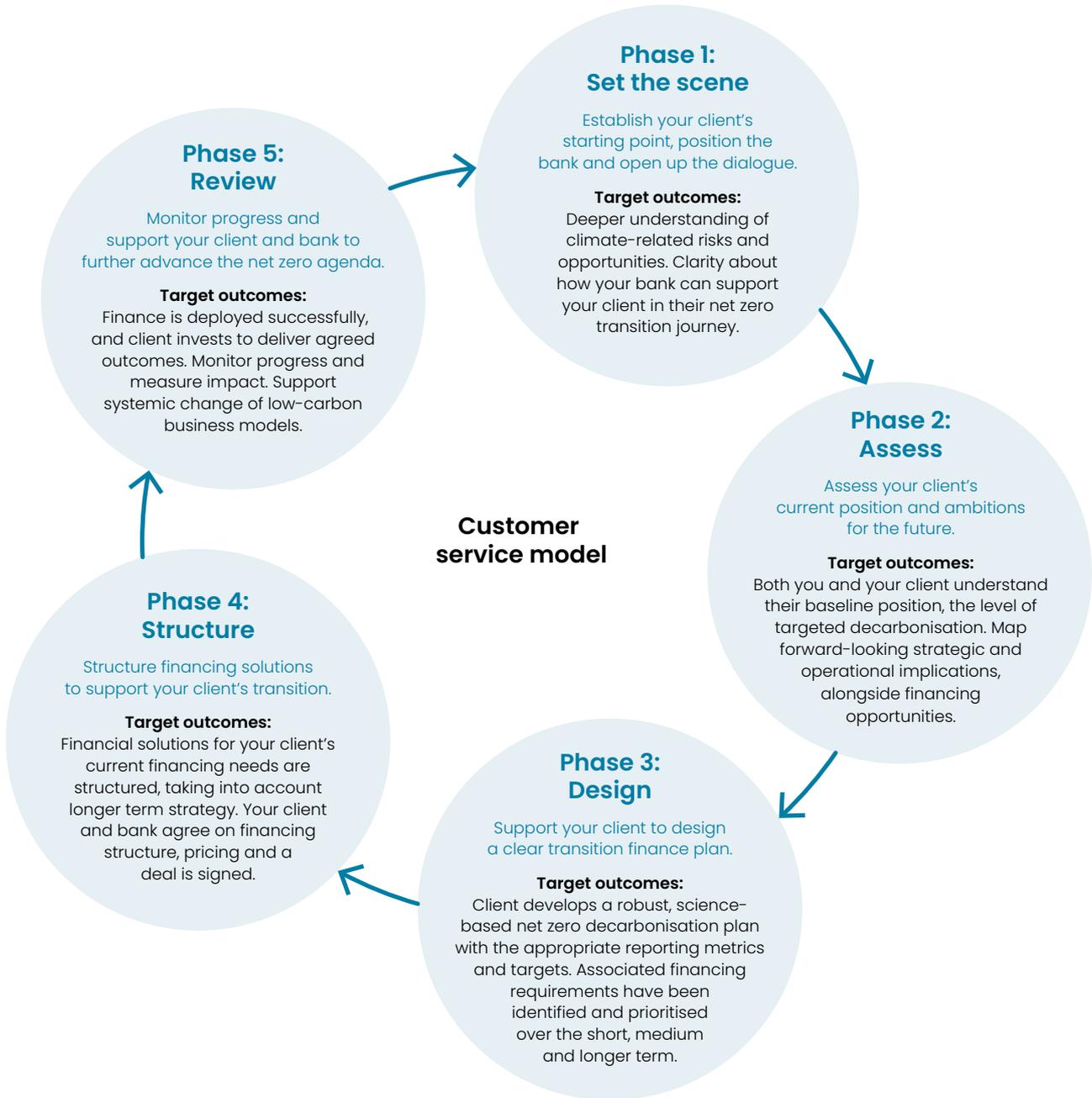
clients by 2030 for OECD countries at minimum and globally at least by 2040, as well as prohibit financing for other customers with material exposure to coal (e.g. 15-25% of revenues or power generation derived from coal).

As examples, **NatWest** became one of the first major banks to announce its commitment to become Paris-aligned in 2020, including halving emissions by 2030, fully phasing out finance to coal by 2030, stopping lending and underwriting to oil and gas companies without credible transition plans by the end of 2021, and providing GBP 20 billion in funding and financing for sustainable and climate finance by 2021. **Unicredit’s** coal policy is a total phase-out of coal sector financing by 2028. **ING** had already reduced direct exposure to coal-fired power plants by 43% in 2019 and aims for total coal phase out by 2025. And **La Banque Postale** has committed to full phase out of fossil fuels from 2030 including no finance for new fossil fuels as of 2021 and achieving net zero by 2040.

Sources: CPI, CSLN

An equally big challenge is managing possibly long-held relationships with fossil fuel clients. The Cambridge Institute for Sustainable Leadership has produced

a useful guide, with a host of ways that banks could specifically engage with clients through the various dimensions of their relationship.³⁵



Source: Adapted from client engagement phasing in *Let's Discuss Climate: The essential guide to bank climate engagement* published by the University of Cambridge Institute for Sustainability Leadership, May 2021 (page 12).

35 <https://www.cisl.cam.ac.uk/resources/sustainable-finance-publications/lets-discuss-climate-the-essential-guide-to-bank-client-engagement>

Two contrasting paradigms



Phase out other harmful lending including deforestation and harm to natural ecosystems

The same logic applied to fossil fuels also applies to other areas of environmentally harmful activity. From a climate perspective, rainforest deforestation and destruction of ocean ecosystems is highly significant, with broader risks of biodiversity loss, water scarcity, removal of peatlands and other factors also relevant to consider. Rainforest Action Network's "Keep Forests Standing Policy Scorecard"³⁶ has evaluated leading companies and banks on their impacts to deforestation and other harm to people and nature, and offers strategies to mitigate harm to people and planet. It shows there is still considerably more progress required on this topic. Whilst some banks have implemented No Deforestation, Peat or Exploitation (NDPE) policies which is a positive development that should be adopted by all, this is not regulated and there has been scarce independent monitoring to ensure compliance. From a timing perspective, banks should plan how they ensure enhanced due diligence with safeguards to ensure the implementation of NDPE policies.

Analyse the systemic impact of the bank's decisions on the wider market

There is a complex relationship between banks' roles in providing finance and companies pursuing misaligned activities. Some banks have recounted the feeling of being trapped within a competitive system whereby to turn down business would just send their client to a competitor. This is the legacy paradigm based on low transparency and societal awareness that has led to the narrative that 'if we don't do it then someone else will' – hence there is no reason not to continue. For as long as everyone does continue then it locks everyone into the pattern.

In countries where some banks started turning down finance to coal-fired power plants, others followed. With 62 per cent of total renewable power generation added in 2020 having lower costs than the cheapest new fossil fuel option³⁷, it is unlikely that those banks will ever return to coal. And when excluding misaligned activity becomes the norm, there is a greater reputational pressure to fall in line and also apply those exclusions. The systemic analysis of a single bank decision is difficult to determine, which is why transition plans could include a role for pre-competitive collaboration in networks, which are seeking to coordinate alignment on climate alignment and broader sustainability standards. As explored further in chapter 7, similar dynamics can apply to banks' lobbying activities, where it can take only a few voices to change an industry view, for example on regulatory proposals to manage the risks of financing fossil fuels.

³⁶ https://www.ran.org/wp-content/uploads/2021/04/RAN_KFS_Scorecard_VENG.pdf

³⁷ <https://www.irena.org/newsroom/pressreleases/2021/Jun/Majority-of-New-Renewables-Undercut-Cheapest-Fossil-Fuel-on-Cost>

Synthetic Case Study: Closing the Door on New Fossil Fuels, Opening New Doors at ZeroBank

"We presented plans for ending financing for new fossil fuels and deforestation to our institutional investors. The conversations were more positive than we expected, given how profitable some of our off-balance sheet business lines were. That allowed the real 'change work' to begin.

"At the start of the process, we were involved in far more bond issues for fossil fuel companies than we were issuing green bonds. So we brought our investment banking teams together (mostly just within one country) and discussed our new direction.

"There was huge push back at first and many of the teams argued that it was a pointless exercise as the business would simply go elsewhere. But after the second session, things started to shift: many in the team felt that there probably were under-explored opportunities in green bonds; that they had recently had very interesting conversations with their clients

who were looking to transition rapidly; that our current reputation was perhaps holding us back and that we weren't seen as being future-oriented.

"Some staff did leave the team and under our new policy, which prevents us from supporting the expansion or exploration of new fossil fuels or any business linked to new deforestation, we weren't able to do business with some previous clients.

"But some clients surprised us and the team members who stayed were quick to reorient their energies into developing new relationships and markets.

"We're about to be involved in a huge green hydrogen deal that even some in our team admitted they never thought would be possible a couple of years ago."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

Stopping the flow of finance to fossil fuel and deforestation Summary

Starting points

- Bank membership of alliances with phase-out goals (NZBA, CCCA)
- Inventory of fossil fuel and deforestation activities being financed
- Map of affected stakeholders
- Analysis of barriers to switching flows of finance away from fossil fuels and deforestation.
- Analysis of regulatory interventions that the bank is advocating for and how this could help or hinder progress.

Key components for reducing fossil fuel and deforestation finance

- Implement a near-term end (2022) to all expansion and exploration of fossil fuels and deforestation
- Phase out finance to existing fossil fuel activities
- Phase out other harmful lending including deforestation and harm to natural ecosystems
- Engage with shareholders, clients and staff
- Analyse the systemic impact of the bank's decisions on the wider market

6. FINANCING INNOVATION & DRAWDOWN



This chapter looks at what banks can do to promote the new technologies and industries that will help us reduce greenhouse gas levels. The actions include:

- Financing GHG emissions removal technologies or approaches (such as nature-based solutions)
- Finance or invest in climate start-ups and VCs
- Give bank innovation hubs a climate focus
- Adopt a higher risk appetite for climate innovation

By recognising that the most pressing need is to eliminate emissions from all activities, the primary focus for innovation should be focused on decarbonisation within existing portfolios – looking at alternative approaches and technologies that perform the necessary ‘functions’ for the economy (e.g. ‘mobility’ rather than ‘transport’).

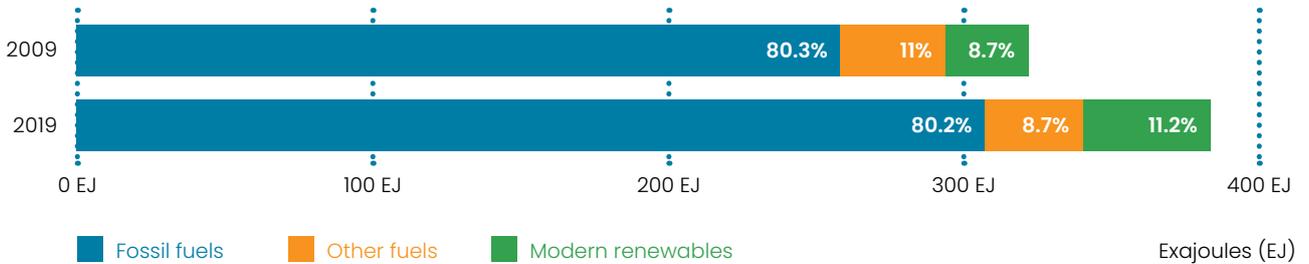
Investing in renewable energy and technologies that replace their GHG-emitting counterparts are essential but they don’t remove carbon from the atmosphere, so they don’t “offset” emissions. Only removal of CO₂ via carbon capture and storage (CCS) or nature-based

solutions (trapping carbon in soils, algae or forests etc.) has the potential to sequester carbon and be part of a net zero calculation. For all of these new approaches, a full social and environmental consideration is essential – how can the nature-based solutions be optimised for biodiversity; what is the full supply-chain GHG-impact of CCS; what is the level of resilience for these schemes in the long term (e.g. the risk of CCS leakage or forest fires). There are complicated and interlinked factors that need to be considered carefully. New business models are required to stimulate investment into solutions that have multiple positive impacts – for example a nature-positive restoration project that results in cleaner water, flood defence, greater levels of community health and wellbeing, carbon sequestration and increase in local biodiversity. These multiple-impact (and multiple-revenue source) business models may be more complicated than a business whose ‘product’ is sold to one ‘customer’ at a time. But structuring these new business models so that they can receive investment and banking support could play a critical role in helping reach net zero globally and in being able to reduce some of the damage of climate change thereafter.

The size of the task, or the size of the opportunity depending on your point of view, is enormous: renewable sources still supply barely more than tenth of the world's energy, investments in renewable energy are only around one-sixth of fossil fuel investments, and

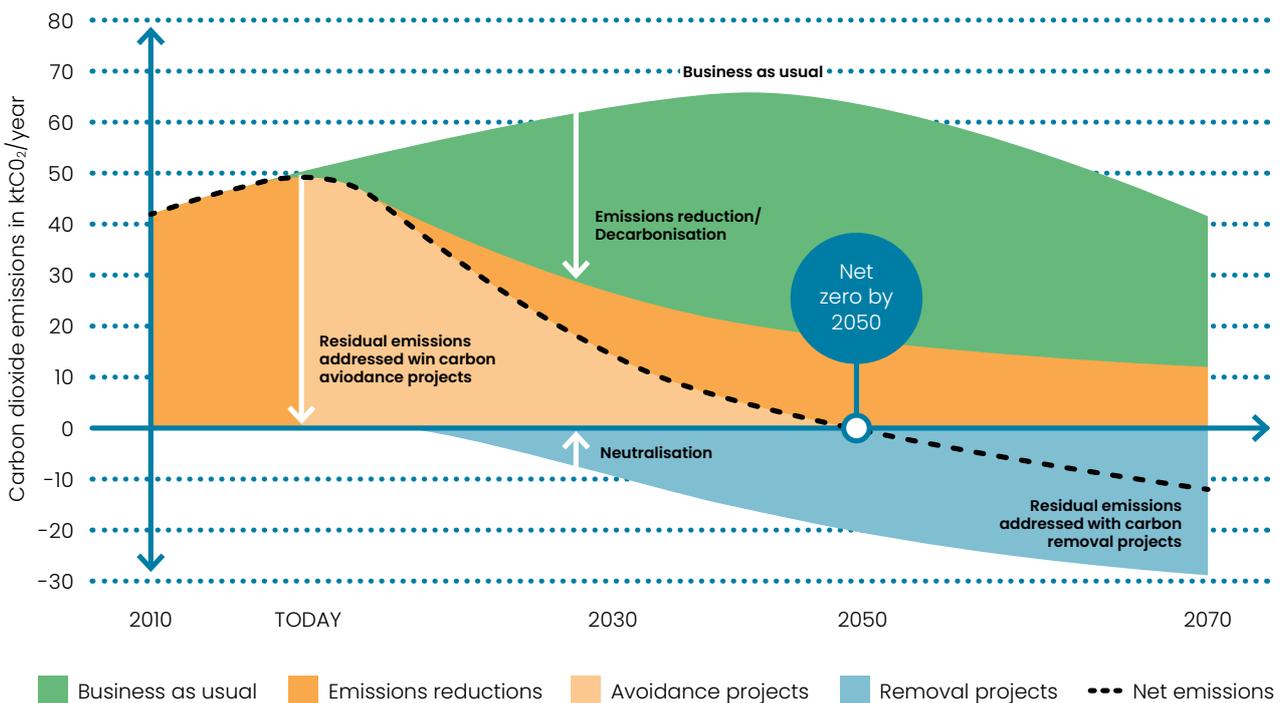
the potential need for carbon capture and storage – a commercially unproven technology – is equivalent to many years of current total global GHG emissions.³⁸ Banks can contribute to solving these daunting challenges in several ways.

Carbon mitigation and removal both needed at a massive scale



Source: REN21

The net zero pathway



Source: Circular Carbon Network

38 <https://www.reuters.com/business/environment/global-fossil-fuel-use-similar-decade-ago-energy-mix-report-says-2021-06-14/>; <https://www.ren21.net/five-takeaways-from-ren21s-renewables-2021-global-status-report/>; <https://circularcarbon.org/market-report/>

Synthetic Case Study: Supporting Innovation among ZeroBank's Clients and Staff

"We are aiming for a culture that supports new approaches. There was some scepticism at first, but our new strategy is to encourage much more entrepreneurship within our relationship teams.

"We're piloting open-innovation sessions where we invite an 'innovation catalyst' to meet clients, local partners and our relationship teams.

"It's the clients and partners who really help us understand what is needed and where commercial opportunities are getting held up. We're seeing a lot of enthusiasm and energy from these processes and can see a real uplift in staff engagement, motivation and productivity. And our clients are coming to us

with far more ideas as a consequence, helping us to move faster in the direction we want.

"For example, the lending and investment teams have been working on a finance package for a city-based shared Electric Vehicle and energy storage concept. All the ideas really came from a couple of clients and partners, but we have gained knowledge and connections as a result leading to business from this venture and much more besides."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

Invest directly in net zero technologies and start-ups

To help break out of legacy mindsets, banks may need to go 'upstream' to collaborate with start-ups, innovators, and venture funders to help innovate new solutions. There are **opportunities for banks to finance or invest directly in the net zero transition**. For example, technologies such as green hydrogen – produced via electrolysis from renewable energy – were uncompetitive with other fuel sources some years ago but economies of scale and endogenous market growth are quickly changing the economics. Banks acting as early investors can speed the technology and position themselves to profit from any growth and long-term financing relationships that emerge. Where banks have set net zero targets based on climate scenarios that rely on new technologies such as direct air carbon capture and storage, making a direct investment in those technologies would show coherence. However, such 'third horizon' investments are highly speculative and need careful risk oversight.

Focus bank innovation labs on climate

Many banks have in-house innovation labs that focus on creating digital solutions and improvements to the customer experience and features that help them

compete or integrate with fintech companies. There are some examples of bank innovation labs and accelerators helping historically-excluded communities start businesses, or addressing food waste, and increasingly in searching for climate solutions. Labs create differentiated spaces that draw upon the bank's core expertise and offer the flexibility and freedom to explore, so **banks can leverage their internal innovation efforts**, resources, and teams to create and scale climate solutions, while partnering with experts, investors, and entrepreneurs. Engagement with banks at an early stage can help less mature climate solutions achieve feasibility and scale, which could accelerate the pace of climate safe transitions and develop a pipeline of commercially feasible lending opportunities for banks.

Review risk appetite policy to support climate innovations

To facilitate the measures above, banks might consider how they can **increase their risk appetites within a portion of the business footprint**, whilst maintaining a prudent approach overall, including other adjustments to the risk policy designed to manage climate risk³⁹. The transition will require all businesses to make changes to their operating practices, technologies and business models. Therefore, banks will need to find ways to lean into uncertainty and stray from their proven business-as-usual approaches. This has major implications for

39 See 'Climate Financial Risk Forum Guide 2020, Risk Management Chapter', <https://www.fca.org.uk/publication/corporate/climate-financial-risk-forum-guide-2020-risk-management-chapter.pdf>



risk appetite policies which govern the extent and terms of engagement with new sectors and approaches. Accepting higher risks in a narrow envelope of activity, perhaps in partnership with venture capitalists or other banks, could drive market development, as long as banks maintain overall stability. Banks could also explore using different types of blended finance or emerging government guarantee vehicles, which could allow them to increase exposure in key growth areas without running into prudential constraints. In the EU, both member states and the EIB are developing such guarantee vehicles.

Financing Innovation & Drawdown Summary

Starting points

- Bank's investment strategy
- Details of in-house innovation hubs
- Bank's risk policies

Key components for financing innovation and drawdown:

- Invest directly in net zero technologies and start-ups
- Focus bank innovation hubs on climate
- Review risk appetite policy to support climate innovations

7. AGENCY & BROADER INFLUENCE



This chapter is about harnessing banks' considerable influence to drive the net zero transition through their lobbying efforts and the effects that banks have on each other, their clients and the world around them.

The actions include:

- Join relevant bank networks and external initiatives
- Review lobbying operations to ensure consistency with net zero transition goals

Engage in peer-learning & collaboration

By **joining peer learning networks** (e.g., NZBA, GABV, UN Principles for Responsible Banking, Climate Safe Lending Network, CISL Banking Environmental Initiative – or one of the many organisations working together with banks – RMI, Ceres, Green Finance Institute) banks can share learning and best practices around net zero transition plans, and work out how to apply transition-related credit terms and conditions consistently across a sector, rather than institution by institution.

Banks can **engage in initiatives to standardise and close gaps in methodologies** – including the use of transition plans – by working in partnership with international standard setters, government officials, NGO partners, and experts. Banks in developed countries could show solidarity by **partnering with individual banks in the global south** to support them in transition planning. Banks seeking more collaboration with their communities could provide **mentoring and scholarships** to young people as future change-makers.

There is a role for **trade associations to help banks share best practice** and hash out common approaches to emerging problems such as when a green technology causes environmental damage (e.g. green hydrogen production and water stress, or EV batteries and deep sea mining).

“Banks should actively support climate related policies that impact sectors in which their clients are active.”

François Meloche, Director of shareholder engagement, Bâtirente

Ensure consistency and reinforcement via all advocacy, lobbying and industry engagement

Banks can **influence policy makers and regulators** to create a policy environment that is conducive to moving the whole economy towards net zero. Climate-aligned policy within **financial regulation** (such as disclosure frameworks and capital rules – a banker located in Asia said integrating climate into the Basel rules would have the most effect locally) can lead to regulatory stability and enable climate risks to be fully integrated into supervisory policy. Likewise, **regulation in primary sectors** – for example applying to building codes, energy markets, carbon pricing and agricultural subsidies – play an enormous role in the effectiveness of national government policies. In all of these deliberations, financial institutions have a hugely influential voice and role to play. A good principle here is for banks to do as much as they can until they come up against a policy constraint and then be very clear to policymakers what changes they need to go further, rather than waiting for governments to act first.

The urgency with which decarbonisation needs to take place implies that banks ought to be willing to take actions that penalise clients or result in credit downgrades. For this to be possible, the finance sector or its trade associations will likely have to develop industry standards to avoid first mover disadvantage.

Equally important is the need to **end lobby practices that undermine the net zero transition**. Historically, banks' in-house public affairs teams and trade associations lobby with the aim of maximising profitability. But banks should not support lobby positions that undermine or delay their own net zero transition plans, especially in cases where regulation to create a level playing field is the best way for progress to occur. To avoid undermining the transition, as well as accusations of greenwashing or 'timewashing', transition leaders should ensure that they have powers of sign-off over their bank's public affairs positions and that they are kept informed of trade association positions so that they can take corrective action where necessary. This could include producing **board reports on lobby consistency**. Having a climate-consistent policy on lobbying would also strengthen the hand of banks' customer relationship managers to raise concerns about unhelpful lobbying by clients, should the need arise.

“No one who has a net zero ambition should be supporting industry groups that lobby against necessary measures, which is something we're seeing play out in real time.”

Large European bank

Recognise the full extent of agency within a client relationship

As primary allocators of capital in the real economy, banks are highly influential. At a time when the global economy is recovering from Covid-19 and faces many risks and uncertainties, businesses will be highly sensitised to the signals they pick up from interactions with a bank.

This carries additional responsibility for banks' relationship managers and communications teams, because **messages about which projects banks deem 'bankable' may travel far and wide** among businesses and policymakers.

“The reality is that banks in many instances are still limiting their agency to avoid conflict with clients in the high emitting sectors. This is materially setting us back and making it harder for us to have the kind of public sector supports and policies we will need to meet our targets.”

Banker, USA

As banks influence the views of other professional advisors and market participants, they can even alter demand for services. There is an apparent paradox in green finance of there being simultaneously 'not enough money' (a funding gap) and 'not enough projects' (a demand gap). Yet demand and funding are connected in a cycle. The more that a bank indicates its willingness to work through the technical difficulties in helping to transform the operations or business model for a client, the more that others in the market will believe this is possible and demand similar services.

Synthetic Case Study: A New Approach to Advocacy at ZeroBank

"We reviewed all of our direct advocacy positions and the positions taken by the associations which we belong to so that we can identify any contradictions to our climate strategy. It was an illuminating process to say the least.

"We'd started measuring our portfolio carbon and supported international efforts publicly, but we saw that one of the banking federations that was meant to be representing our voice was advocating for the opposite. We are taking steps to stop that from happening.

"We have joined collaborative processes with banks and other partners to organise how climate and environmental data can be collected and shared more efficiently.

"But it is our work on public policy that has been overhauled the most. When we looked at our decarbonisation targets, we realised we needed policy intervention in some countries to have any hope

of meeting our goals. Rather than just 'signing-on' to generic calls for governments to take action, we worked with clients, experts, policy makers and other banks (including our local competitors) to develop proposals for how we could get these markets started.

"We knew that if we could shift the policy in small but meaningful ways we could kick-start the market in priority areas, like the deep-retrofit of properties.

"We also started to do some modelling on the carbon price given the vast range of values being placed on what it should be. Given our new strategy we concluded it should probably be around \$120 per tonne of CO2 equivalent in today's money. We can give examples of what this means for the ability for us to finance certain types of businesses which is far more convincing than just saying we need a price on carbon."

(ZeroBank is a fictional bank used here to illustrate the actions that banks can take to implement a good transition plan)

Agency & Broader influence Summary

Starting points

- List of memberships of external alliances and networks
- Review of bank and trade association lobby positions on regulatory and market policy in relation to climate

Key components for using the bank's agency and broader influence

- Engage in peer-learning & collaboration
- Ensure consistency and reinforcement via all advocacy, lobbying and industry engagement
- Recognise the full extent of agency within a client relationship

COMMUNICATING AND REGULATING A TRANSITION PLAN

This chapter looks at how bank leaders might communicate about transition plan with key stakeholders. The actions include:

- Communicating with stakeholders
- Using transition plans in regulatory dialogues

Like any corporate strategy, a climate transition plan is needed by different stakeholders. Each has their own specific needs which may require tailored communication.

- Management & Employees
- Clients
- Investors
- Regulators
- Partners
- General Public

Communications should be designed to help these stakeholders hold bank leaders to account for meeting transition targets, for example through regular progress updates, inviting competent stakeholders to provide feedback, holding staff forums and so on. These communications need to be understandable and jargon-free, especially when targeted at depositors, retail investors and the public. At the same time, communications should not shy away from communicating the double-materiality aspect of their transition: how banks are impacting the climate, not just how climate change is affecting the bank. Above all, communications should avoid platitudes and demonstrate the substance of what the bank is doing.

“Everyone says ‘We’re embedding sustainability in everything we do’ but it’s what comes underneath that is important. How do you communicate that?”

Kate Levick, Associate Director E3G

Transition Plans and regulation

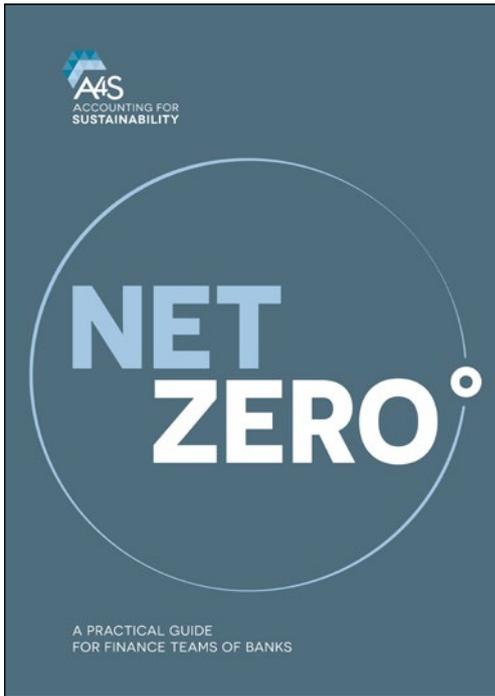
Transition planning is increasingly a topic for bank supervisors and regulators. A core mandate of a regulator is to ensure that banks have the correct systems and controls to manage future risks – both for banks and the financial system. Since climate change poses an existential threat to the financial system, the regulation of climate transition plans will increasingly be integrated into formal regulatory mandates. Regulators and central banks are rapidly educating themselves about climate change risks (the ECB is recruiting a Climate Scientist to advise senior management of the central bank directly) and can draw on transition plans when assessing banks’ climate-related micro and macro-prudential risks and applying stress tests. They can shed useful light on new concentrations of risk that emerge during a bank’s net zero transition, including growth areas and assets at risk of becoming stranded. If transition plans become mandatory, as seems likely, banks with plans based on credible scenarios and science-based targets will be starting from a stronger position.

APPENDIX

SUMMARY OF KEY REPORTS AND REFERENCES

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Accounting for Sustainability (A4s): A Practical Guide for Finance Teams of Banks

About this guide:

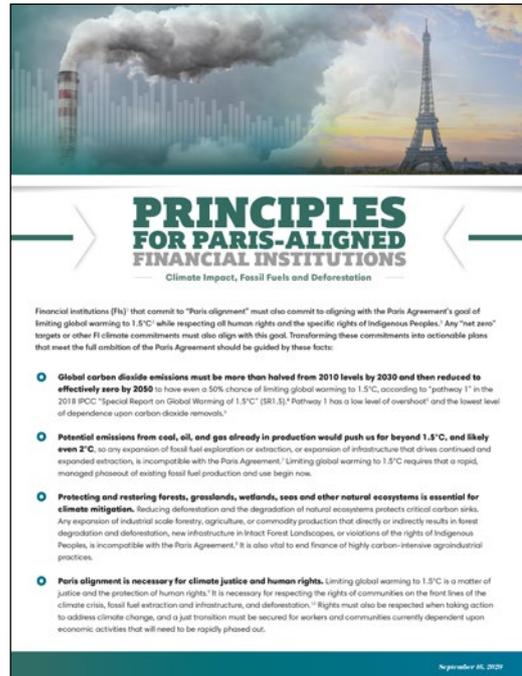
This guide is written for finance teams within banks to understand better the pivotal role they can play in helping their bank to achieve a net zero ambition. It outlines the net zero landscape, the business case for action and the practical steps that finance teams can take, along with links to further resources. While this guide focuses on the banking sector, much of the content is applicable to other financial institutions. A separate A4S guide is available for those finance teams in other sectors.

From the guide:

“The whole financial system, including the banking sector, has a crucial role to play in reaching global net zero emissions. Banks represent a large proportion of the world’s available capital and are in an influential position, through their lending and financing activities, to support the transition to a net zero economy.⁵ By supporting their clients’ transition activities and by directing capital away from carbon intensive activities and towards technologies, companies and projects that are aligned with a net zero emissions economy, banks can have a real impact on a global trajectory to limit global warming to no more than 1.5°C.

Chief Financial Officers (CFOs) and finance teams within banks can support the efforts and plans of their

organisations to progress towards net zero emissions by: sourcing, analysing and providing the information needed to drive decisions, developing and setting interim targets, measuring, monitoring and reporting progress over time and incentivising action within the bank. A4S published Net Zero Top Tips for CFOs in April 2021, based on insights from our global CFO Leadership Network. Building on these top tips and the A4S CFO Net Zero Statement of Support, this guide explores the steps that finance teams of banks can take to help their organisations progress towards net zero emissions. It draws on practical guidance, knowledge and case studies from the A4S Essential Guide series to help finance teams address the practical issues of setting credible net zero targets and embedding them into finance processes and decisions.”



BankTrack: Principles for Paris-Aligned Financial Institutions: Climate Impact, Fossil Fuels, and Deforestation

From the report:

“Financial institutions (FIs) that commit to “Paris alignment” must also commit to aligning with the Paris Agreement’s goal of limiting global warming to 1.5°C² while respecting all human rights and the specific rights of Indigenous Peoples.³ Any “net zero” targets or other FI climate commitments must also align with this goal. Transforming these commitments into actionable plans

that meet the full ambition of the Paris Agreement should be guided by these facts:

Global carbon dioxide emissions must be more than halved from 2010 levels by 2030 and then reduced to effectively zero by 2050 to have even a 50% chance of limiting global warming to 1.5°C, according to “pathway 1” in the 2018 IPCC “Special Report on Global Warming of 1.5°C” (SR1.5). Pathway 1 has a low level of overshoot⁵ and the lowest level of dependence upon carbon dioxide removals.

Potential emissions from coal, oil, and gas already in production would push us far beyond 1.5°C, and likely even 2°C, so any expansion of fossil fuel exploration or extraction, or expansion of infrastructure that drives continued and expanded extraction, is incompatible with the Paris Agreement. Limiting global warming to 1.5°C requires that a rapid, managed phaseout of existing fossil fuel production and use begin now.

Protecting and restoring forests, grasslands, wetlands, seas and other natural ecosystems is essential for climate mitigation. Reducing deforestation and the degradation of natural ecosystems protects critical carbon sinks. Any expansion of industrial scale forestry, agriculture, or commodity production that directly or indirectly results in forest degradation and deforestation, new infrastructure in Intact Forest Landscapes, or violations of the rights of Indigenous Peoples, is incompatible with the Paris Agreement. It is also vital to end finance of highly carbon-intensive agro-industrial practices.

Paris alignment is necessary for climate justice and human rights. Limiting global warming to 1.5°C is a matter of justice and the protection of human rights. It is necessary for respecting the rights of communities on the front lines of the climate crisis, fossil fuel extraction and infrastructure, and deforestation.¹⁰ Rights must also be respected when taking action to address climate change, and a Just Transition must be secured for workers and communities currently dependent upon economic activities that will need to be rapidly phased out.”

Carbon Disclosure Project (CDP): Financial Services Disclosure Report (2000)

From the report:

- “The transition to a net zero economy – critical in avoiding the most catastrophic effects of climate change, is dominating discussions in the world’s most influential boardrooms and governments.

This is evident from Blackrock Chairman Larry Fink’s recent letter to CEOs, and from preparation for the UK’s upcoming presidency of COP26. Rather than diverting attention, the ongoing COVID-19 pandemic is focusing minds in business and government on the need to meet global systemic threats such as climate change.

- Every company, in every sector, has a part to play – such is the scale of change needed. However, the finance sector is especially critical. The transition to net zero will require huge amounts of capital directed at decarbonising the economy and enhancing resilience to changes already in the system. It is clear the finance sector needs to play a major role in this.



- The time is now for the sector to step up. What is required is, yes, green finance; but also, for finance to become green. Financial institutions’ largest climate impact stems from the activities they enable through their loans, investments and insurance underwriting. It is these financing portfolios that must be aligned with 1.5 degrees Celsius world, for financial institutions to continue to thrive. With so much long-term capital still being directed at fossil fuels², and our time and carbon budget running out, the sector must act now. Financial institutions that do not align their portfolios face enormous risks, including from stranded assets.
- The importance of the finance sector’s role in achieving the low carbon transition is recognised

directly in the Paris Agreement. Its aims include “making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.”

- The Taskforce for Climate-related Financial Disclosures (TCFD) also directly recognised how critical the sector is. It released guidance for banks, asset owners, asset managers and insurance companies, along with its recommendations.
- As regulators move towards mandatory climate disclosures in line with the TCFD framework, it is likely that financial institutions will be among some of the first market participants required to comply. In the UK’s “Roadmap towards mandatory climate-related disclosures”, banks, insurance companies and the biggest pension schemes will be required to align their disclosures with the TCFD recommendations in 2021, ahead of most listed companies. The EU Sustainable Finance Disclosure Regulation, set to roll out in several stages over the next two years, contains reporting obligations at both the company and product level, and entails a comply-or-explain assessment of the main negative impacts their investments will have on the environment and society.
- Regulation on mandatory climate disclosures for financial institutions will only be accelerated by the Network for Greening the Financial System (NGFS) – a group of Central Banks and Supervisors willing to share best practice in incorporating climate considerations into financial regulation. An assessment is needed of how ready the global finance sector is to play the role required of it; whether it has the tools to manage climate related financial risks, whether it is positioned to provide the capital flows needed for low carbon technologies and enhanced resilience.
- An assessment is also urgently needed of how ready the global finance sector is for reporting in line with the TCFD recommendations.

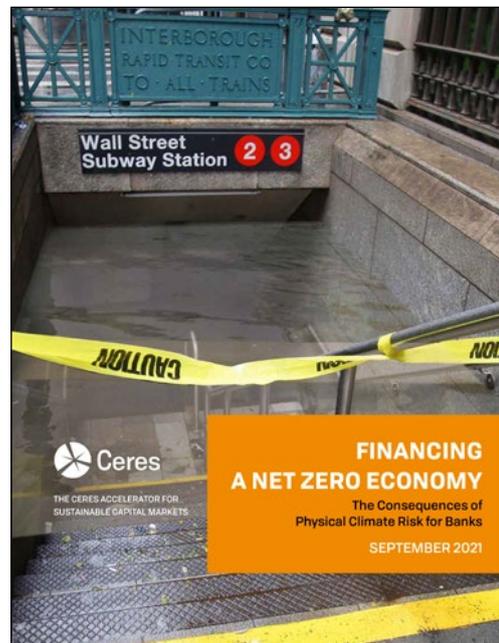
Ceres: Financing a Net Zero Economy: The Consequences of Physical Climate Risks for Banks

From the report:

“As the lynchpin of the global economy, financial institutions have an essential role to play in minimising the worst impacts of climate change. How banks respond to the climate risk that they individually and collectively face is critical. Whether banks act proactively

and ambitiously or reactively and modestly is reflective of how they measure and analyse their exposure to climate risk.

In the fall of 2020, Ceres analysed the risks banks face from climate transition risk. Those findings indicated that banks that fail to prepare for the energy transition face far higher risks than what has been disclosed. The cumulative exposure could be over \$500 billion from just the syndicated loan portfolios of the nation’s largest banks. The total balance sheet exposure is much larger, meaning that without a deliberate carbon transition, a future where well-prepared banks can thrive along with the rest of society will not be possible. Transition risk, though, is only one part of the climate risk equation. The world is increasingly experiencing all-year forest fire seasons, catastrophic flooding, years-long droughts, and deadly heat waves. In fact, as this report was being finalised the National Oceanic and Atmospheric Administration reported that July 2021 was the Earth’s hottest month on record. The physical impacts of climate change are already here and they are growing. Failing to take a proactive approach to the clean energy transition will turbocharge these physical risks that banks—and broader society—face.



In addition to the human toll, these impacts have the potential to grind down our economy, challenge the stability of some bank portfolios, and punish us year after year, decade after decade, for our failure to take action. And, perhaps unsurprisingly, the burden of that failure will fall disproportionately on developing countries and historically marginalised communities in all

countries, including the United States.¹ In addition to their societal toll, these physical risks present major threats to banks' portfolios, some of which are already playing out through changes in asset prices and insurance premiums. Ultimately, these physical risks, combined with the potential transition risks, could impact the safety and soundness of certain financial institutions. Beyond the incentives banks have to support the transition and capture its enormous opportunity, the reality is they—and the sectors they finance—need to be prepared for an increase in physical climate risk that is already baked into our collective future.

So far, analyses of physical risk disclosed by banks have been piecemeal, covering only a few elements of the problem. This is in part due to model uncertainty, data limitations, and the long timescales involved. While these challenges are real, they don't change the fact that comprehensive analysis of physical risk is needed across sectors and asset classes. Banks must better understand how these risks fit together and—critically—how they can generate indirect, systemic effects across the economy, disrupting supply chains, national economies, and the lives and livelihoods of individuals.

This report presents a framework for this kind of comprehensive analysis of the physical risks being unleashed by climate change, as shown in Figure 1. Banks should prioritise the most important climate hazards, understand how climate change will affect them going forward, and convert economic impacts on physical assets, labour productivity, and agricultural yields into financial risk metrics. Additionally, the indirect economic impacts on supply chains and national economies must be accounted for—a difficult challenge that no U.S. bank has yet overcome.”

Client Earth: Principles for Paris-Alignment Position Paper (2020)

From the paper:

“We are already feeling the impacts. Increasingly severe extreme weather, droughts, floods and fires are now part of our daily reality. At the same time, rapid technology advances, strengthening policy responses, and shifting consumer preferences are reshaping our economies and our lives. Unless we rapidly reduce global GHG emissions through a just and orderly transition, mounting climate hazards will have disastrous and irreversible socio-economic impacts – affecting all of us.

- Business and investors are now waking up to the critical role they will need to play in this transition. Spurred on by industry led initiatives, like the Taskforce on

Climate-related Financial Disclosures (TCFD), it is now standard practice for firms to consider, manage and disclose commercial and financial risks associated with climate change. Increasingly, it is an explicit legal requirement. This mainstreaming of 'climate risk' has been an important step in catalysing private sector action. However, as analysis of the macroeconomic implications of climate change become more sophisticated, expectations on companies and financial institutions are also rapidly evolving.

- In recent years, studies by central banks and others have become increasingly clear that, over the medium term, the biggest financial threats from climate change are not from short-term shocks or stranded assets, but from broader systemic macroeconomic impacts. Because such systemic threats are largely unhedgeable through a narrow risk management paradigm, leading firms have realised that the only way to meaningfully protect the interests of shareholders, beneficiaries and stakeholders is to contribute to rapid reductions in global GHG emissions, in line with the goals of the Paris Agreement.



- The UN has also recently launched a major new 'Race to Zero' umbrella campaign that aggregates net zero commitments from other initiatives across the private and public sectors, including from cities, universities and sub-national regions.
- We believe that this transition from a paradigm of narrow and reactive 'climate risk' management to

one of strategic alignment with the Paris Agreement is a significant step forward. Because of the strong potential to influence company capital expenditure and operations, widespread uptake of ‘Paris-alignment’ or ‘net zero’ objectives by investors and business could rapidly accelerate reductions of GHG emissions in the real economy. This in turn will help minimise risks of capital misallocation and stranded assets as governments scale-up their policy response and technology and consumer trends further develop. Mitigating these systemic climate-related risks is in all of our best interests.

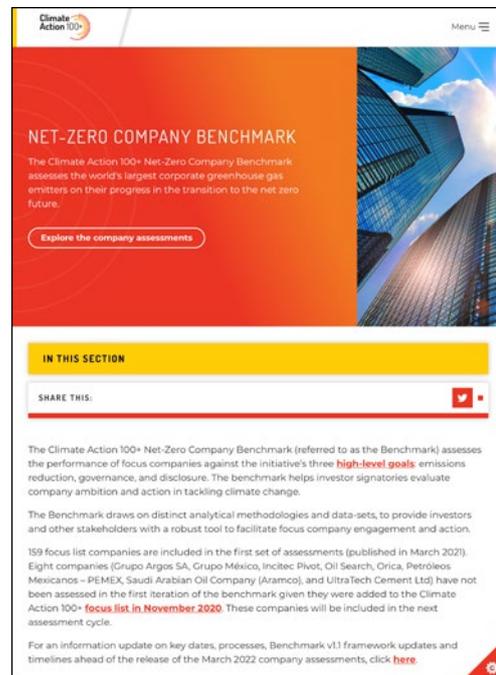
- Currently, a wide variety of methodologies and frameworks for assessing ‘Paris-alignment’ or ‘net zero’ objectives are being used and developed. These differ significantly based on approach, scope, and assumptions used. Various attempts are now underway to achieve consensus methodologies. However, because of the ‘constructive ambiguity’ inherent in the Paris Agreement itself, and the lack of current consensus on emission reduction trajectories and alignment methodologies, there is a significant risk that Paris alignment and ‘net zero’ commitments will act as greenwash (or ‘greenwash’) for inadequate and incremental change.
- Over time, improvements and standardisation of methodologies will help to address this problem. In the interim, some level of flexibility may also be helpful in driving uptake and ambition and prevent the lack of a perfect approach becoming an excuse for delay. To ensure that bold ambition is translated into real action, we believe that initially a principles-based approach, supported by clear, non-negotiable ‘Red lines’ can help strike the required balance between flexibility and credibility. Based on a review of existing methodologies, we propose three overarching ‘Paris alignment principles’ and 10(+1) corresponding ‘Red lines’, that we believe should underpin all ‘Paris-alignment’ or ‘net zero’ claims and initiatives made by businesses and investors, as well as legislative and regulatory interventions intended to support them.

Climate Action 100+ Net zero Benchmark

About the Benchmark:

The Climate Action 100+ Net zero Company Benchmark (referred to as the Benchmark) assesses the performance of focus companies against the initiative’s three **high-level goals**: emissions reduction, governance, and disclosure. The benchmark helps investor signatories

evaluate company ambition and action in tackling climate change.



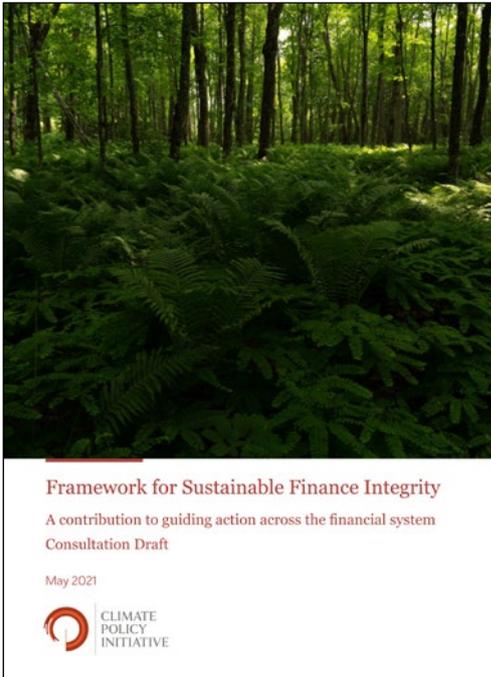
The Benchmark draws on distinct analytical methodologies and data-sets, to provide investors and other stakeholders with a robust tool to facilitate focus company engagement and action.

Climate Policy Initiative: Framework for Sustainable Finance Integrity

About the consultation draft: The Framework for Sustainable Finance Integrity (“Framework”) is a draft document, intended as a contribution to a clear pathway to financial system integrity and materiality that will help smooth the financial sector’s move to sustainability and net zero and reinforce the multiplier effect these actions will have on achievements in the real economy. The document outlines a set of guardrails to deliver results and foster integrity. The document has been developed based on a rigorous, technical evaluation of existing initiatives and critical actions identified by civil society

From the paper: “This draft Framework for Sustainable Finance Integrity (“Framework”) is intended as a contribution to a clear pathway to financial system integrity and materiality that will help smooth the financial sector’s move to sustainability and net zero and reinforce the multiplier effect these actions will have on achievements in the real economy. The document

outlines a set of guardrails to deliver results and foster integrity. The document has been developed based on a rigorous, technical evaluation of existing initiatives and critical actions identified by civil society.



The draft framework suggests minimum benchmarks for meaningful sustainable finance commitments and identifies leadership benchmarks to highlight best practices in sustainable finance across the major sectors of the global financial system. These benchmarks recognise that there is value in having as many financial actors as possible move towards sustainable, net zero operations, but at the same time, that continual strengthening and improvement is imperative to reach critical global goals this decade. The Framework also suggests a credible approach that academia, think tanks, and civil society can use to analyse and monitor progress on sustainability, and hold providers of finance to account.

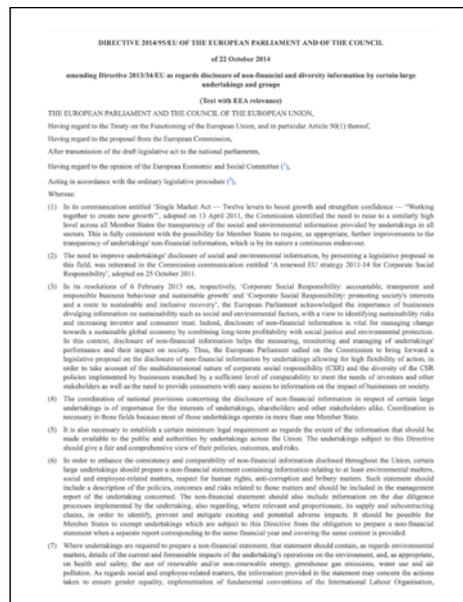
Benchmarks are defined in three categories that were developed based on a bottom-up analysis of commitments:

- Targets and objectives:** This category includes targets that financial sector actors have set at the strategic level of institutions, encompassing long-term targets that focus on Paris Agreement and Sustainable Development Goal alignment and/or reaching net zero emissions for both new investments and overall portfolios, as well as more specific targets that would illustrate interim progress and help drive action in the

near-term: for example, climate finance and near-term emissions reduction targets, as well as targets to phase out fossil fuel financing and investment. While most financial sector targets to date have focused on climate mitigation, targets for pollution (e.g., “zero pollution”), adaptation and resilience finance, biodiversity conservation, and Just Transition are also considered in this category and highlighted where information is available.

- Implementation:** This category covers the measures that an institution would take to achieve its targets and to improve its ability to do so. It includes approaches to mainstream sustainability in its governance and operations, for example via mandates and strategies, decision-making processes and tools, investment products, performance management, and risk management. It includes actions taken on shareholder, client, and policy engagement. It also includes commitments made to cooperate with others in the sector, for example through sharing of best practices.
- Metrics and transparency:** This category covers the development and adoption of metrics to track and report on performance both internally within the organisation as well as externally, for example via climate- and nature-related disclosures, and to use that data to improve performance over time. This document lays out a set of “minimum” and “leadership” benchmarks in these categories.”

The Corporate Sustainability Reporting Directive (from the European Union)



About the Directive: “EU law requires certain large companies to disclose information on the way they operate and manage social and environmental challenges.

This helps investors, civil society organisations, consumers, policy makers and other stakeholders to evaluate the non-financial performance of large companies and encourages these companies to develop a responsible approach to business.

[Directive 2014/95/EU](#) Directive 2014/95/EU – also called the Non-Financial Reporting Directive (NFRD) – lays down the rules on disclosure of non-financial and diversity information by certain large companies. This directive amends the [Accounting Directive 2013/34/EU](#).”

The Institutional Investors Group on Climate Change (IIGCC): Investor Position Statement: A call for Corporate Net Zero Transition Plans

From the position statement: The next decade is crucial to meeting the net zero goal of the Paris Agreement. According to The Intergovernmental Panel on Climate Change (IPCC), global GHG emissions must fall by 45% from 2010 levels by 2030 to limit warming to 1.5°C.¹ Encouragingly companies are increasingly moving to align with and provide disclosures on how they will meet net zero emissions objectives. For example, 52% of Climate Action 100+ focus companies are now targeting net zero at some level. Details on how such commitments will be delivered are however often limited. At the same time investors are increasingly looking to align portfolios overall with net zero objectives. Detailed disclosures from companies showing how they will achieve net zero objectives as well as demonstrated progress is essential for investors to deliver net zero alignment of portfolios. Therefore, investors require a wide group of companies to rapidly scale up the provision of detailed transition planning and implementation progress disclosures. Accordingly, investors supporting this statement call on listed companies which they deem to be material to their portfolios to:

- **Disclose a Net Zero Transition Plan:** Investors require clear planning regarding how companies plan to transition to net zero emissions. A plan should be provided within overarching Taskforce on Climate Related Financial Disclosures (TCFD) climate reporting and use the recent Climate Action 100+ Net zero Company Benchmark as core indicators. Comprehensive net zero planning disclosures should at the least include the elements laid out in Annex A - ‘Table 1’ below.

- **Provide a routine vote on the implementation of the Net Zero Transition Plan:** Where net zero transition planning has been provided, there is a need to ensure that progress is made on implementation given the scale of the climate challenge. In jurisdictions with strong governance conventions and where permissible in local law a routine advisory vote on implementation provides one effective mechanism to do this. Alternatively, where advisory votes are not permissible, investors might consider reflecting their opinion on the implementation of the transition plan in their voting behaviour on other agenda items, such as the election of board members or discharging of the board. Where there is low voter support for either the plan, or the implementation of the plan, companies should explain publicly investors’ rationale for withholding support and any remedial action undertaken ahead of the next Annual General Meeting (AGM). If mitigating actions are deemed to be insufficient investors may wish to escalate concerns on other voting items.

Investor Position Statement: A call for Corporate Net Zero Transition Plans
An investor call for corporate net zero transition plans with routine votes and director oversight

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3. **Identify the directors responsible for Net Zero Transition Planning:** To ensure adequate oversight of implementation it is critical to ensure director accountability for the plan. Ultimately, whilst responsibility for planning resides with the whole Board, and in particular the Chair of the Board, it is important that companies clearly identify any principal directors, that have been assigned responsibility for the development and implementation of the Company’s Net Zero Transition Plan and corresponding disclosures. This enables investors to determine which directors of the Board, in addition to the Chair, should be engaged with and potentially (as a last resort) voted against when a plan hasn’t been provided or implementation is insufficient.

The effectiveness of voting is dependent on the build out of high-quality assessments of corporate net zero transition planning to support investors taking decisions. The supporters of this statement acknowledge the critical role that proxy advisors and data providers will play in assessing the quality

¹ IPCC Special Report on Global Warming of 1.5 °C, <https://www.ipcc.ch/sr15/>

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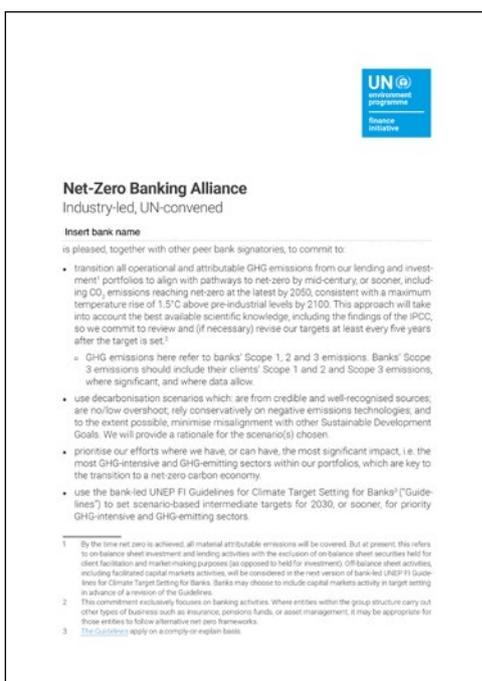
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Net zero Banking Alliance (NZBA): Commitment Statement

The Commitment Statement is a pre-requisite for joining the Net zero Banking Alliance, and is signed by a banks CEO. All banks that have signed the commitment will:

Transition the operational and attributable GHG emissions from their lending and investment portfolios to align with pathways to net zero by 2050 or sooner.



Within 18 months of joining, set 2030 targets (or sooner) and a 2050 target, with intermediary targets to be set every 5 years from 2030 onwards.

Banks' first 2030 targets will focus on priority sectors where the bank can have the most significant impact, ie. the most GHG-intensive sectors within their portfolios, with further sector targets to be set within 36 months.

Annually publish absolute emissions and emissions intensity in line with best practice and within a year of setting targets, disclose progress against a board-level reviewed transition strategy setting out proposed actions and climate-related sectoral policies.

Take a robust approach to the role of offsets in transition plans.

McKinsey & Company: Banking Imperatives for Managing Climate Risk

From the article:

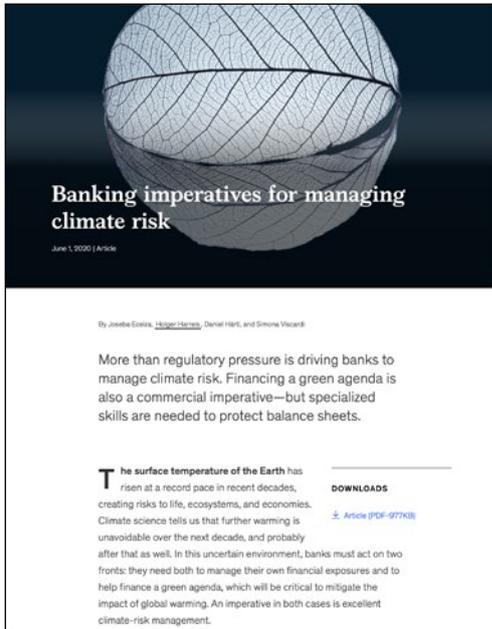
"More than regulatory pressure is driving banks to manage climate risk. Financing a green agenda is also a commercial imperative—but specialised skills are needed to protect balance sheets.

The surface temperature of the Earth has risen at a record pace in recent decades, creating risks to life, ecosystems, and economies. Climate science tells us that further warming is unavoidable over the next decade, and probably after that as well. In this uncertain environment, banks must act on two fronts: they need both to manage their own financial exposures and to help finance a green agenda, which will be critical to mitigate the impact of global warming. An imperative in both cases is excellent climate-risk management.

The physical risks of climate change are powerful and pervasive. Warming caused by greenhouse gases could damage livability and workability—for example, through a higher probability of lethal heat waves. Global warming will undermine food systems, physical assets, infrastructure, and natural habitats. The risk of a significant drop in grain yields—of 15 percent or more—and damage to capital stock from flooding will double by 2030. In aggregate, we expect that around a third of the planet's land area will be affected in some way.

Disruptive physical impacts will give rise to transition risks and opportunities in the economy, including shifts in demand, the development of new energy resources, and innovations arising from the need to tackle emissions and manage carbon, as well as necessary reforms in

food systems. Sectors that will bear the brunt include oil and gas, real estate, automotive and transport, power generation, and agriculture. In oil and gas, for example, demand could fall by 35 percent over the next decade. The good news is that these changes should also precipitate a sharp decline in emissions.



January 2020 was the warmest January on record. As temperatures rise in this way, it is incumbent on banks to manage the relevant risks and opportunities effectively.

Furthermore, regulation increasingly requires banks to manage climate risk. Some have made a start, but many must still formulate strategies, build their capabilities, and create risk-management frameworks. The imperative now is to act decisively and with conviction, so effective climate-risk management will be an essential skill set in the years ahead.”

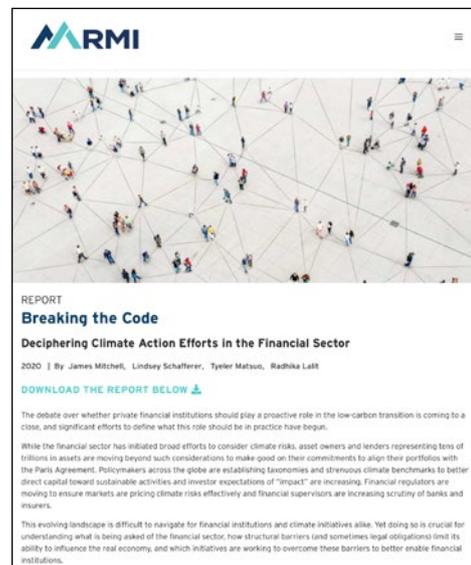
Rocky Mountain Institute (RMI): Breaking the Code: Deciphering Climate Action Efforts in the Financial Sector

From the report:

“The role of the financial sector in supporting the low-carbon transition is rapidly being defined by two significant trends. This shift poses challenges to financial institutions—particularly those with an international footprint—that must navigate a flurry of new regulatory requirements, shifting customer

expectations, and highly ambitious voluntary initiatives. It also holds tremendous opportunity for those who navigate new challenges adeptly.

The first of these trends is the global acceptance that climate risks are a threat to financial stability. A mere three years after the publication of the recommendations of the Task Force on Climate Related Financial Disclosure (TCFD), regulators in most of the world’s major financial markets are increasing or mandating climate-related disclosures from corporates, the largest asset managers are pushing for reporting standardisation and threatening to use voting power against corporates who fail to comply, and financial supervisors are increasing scrutiny of banks and insurers.



The second is the cementing expectation that the financial sector should be a driving force for decarbonising the real economy and the proliferation of efforts to define what that means in practice. Asset owners and lenders representing tens of trillions in assets have begun to move beyond such considerations to make good on their commitments to align their portfolios with the Paris Agreement. Policymakers across the globe are establishing taxonomies and strenuous climate benchmarks to better direct capital toward sustainable activities and investor expectations of “impact” are increasing.

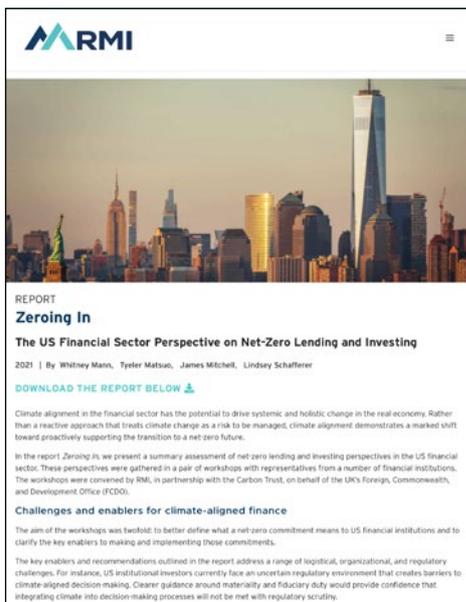
The intent of this report is to take stock of the regulatory and policy efforts, market trends, and voluntary initiatives actively shaping the role of private financial institutions in supporting decarbonisation of the real economy; to clarify what these efforts are trying to achieve; and to identify key questions that will need to be addressed to move forward effectively.

Charting the Course to Climate-Aligned Finance, published by the Center for Climate-Aligned Finance at Rocky Mountain Institute, identified the five major barriers that any financial institution must overcome when seeking to align their portfolios with the temperature goals of the Paris Agreement: working around the structural challenges to influence the real economy, overcoming competitive disadvantage, selecting methodologies to assess alignment, understanding decarbonisation pathways, and sourcing adequate data. This report takes stock of major trends and initiatives by identifying the efforts being made to overcome these barriers. See Exhibit 1 for a picture of the current landscape of efforts.

Rocky Mountain Institute (RMI): Zeroing In: The US Financial Sector Perspective on Net zero Lending and Investment

From the report:

“The US Perspective in Net zero Lending and Investing Debates Private finance is rapidly climbing the global climate agenda, and increasingly private financial institutions are expected to play an active role in the transition to a net zero future.



A growing number of financial institutions are responding to these changing expectations by making holistic commitments to align their lending or investing portfolios with net zero or climate-aligned targets. As these climate-alignment commitments have gained momentum, so too have efforts to support their

achievement through the development of frameworks, data solutions, tools, and other products.

Notable among these efforts is the agenda set forth by the Private Finance Hub, established by the UK’s presidency for the 2021 UN Climate Change Conference of the Parties (COP26), which aims to “ensure every financial decision takes climate into account.” This agenda—addressing topics such as climate-related reporting, financial regulation, and metrics for assessing climate alignment—has the potential to bring the clarity and consistency needed to advance the implementation of climate-alignment commitments. However, any framework or work stream focused on climate-alignment implementation must be informed by the experiences and needs of financial institutions.

The views and perspectives of the US financial sector are critical to ensure developments around climate alignment are informed in a US context. To ensure that these perspectives are understood, the UK’s Foreign, Commonwealth, and Development Office (FCDO) commissioned RMI, in partnership with the Carbon Trust, to hold a series of workshops to elicit the views of US financial institutions on the topic of net zero or climate-aligned investing and lending. This report summarises key findings from those workshops and puts forward recommendations to help enable US financial institutions to make and implement net zero commitments.”

Sustainable Markets Initiative – Financial Services Taskforce: A practitioner’s guide for banks – Considerations for banks in setting a net zero strategy

From the press release:

The FSTF Practitioner’s Guide combines the knowledge and collective experience of 11 banks. The first part of the guide provides recommendations on key choices banks will face as they develop robust strategies, alongside an overview of the potential trade-offs involved and insight into the decision-making processes, highlighting areas for potential common ground across the industry. The second section explores how banks can engage with clients and policymakers to deliver financing to help accelerate the transition to a low carbon economy, and disclose progress transparently for stakeholders.

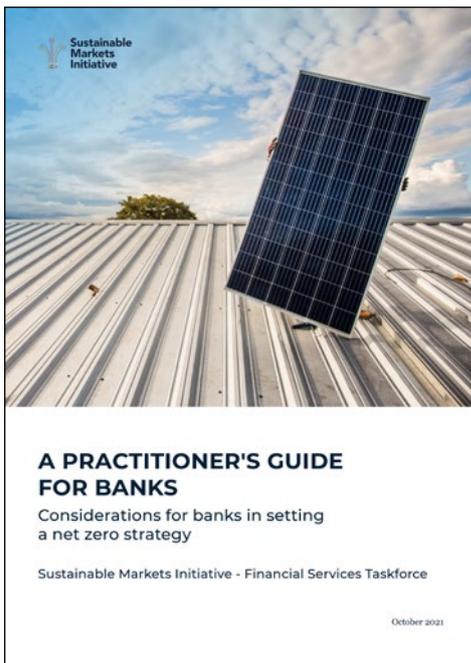
1. Defining the Scope of Emissions.

Banks disclose emissions metrics related to capital markets financing, where material, noting that they may develop their own methodologies or wait for industry

methodology to emerge Banks shape the development of industry standards to enable consistent reporting of financed (on-balance sheet) and facilitated (off-balance sheet) emissions.

2. Measuring the Baseline.

Banks either follow PCAF or a comparable methodology. If a comparable methodology is used, banks publicly disclose the methodology and assumptions employed. Banks collaborate across a range of stakeholders to champion emissions data disclosures across the economy.



3. Selecting Future Emissions Scenarios

Banks choose science-aligned net zero scenarios that limit warming to 1.5°C with no- or low-overshoot and are appropriate for their sector and geography mix. If a 1.5°C scenario is not selected, banks should disclose the rationale. Banks support the further development of publicly available, credible 1.5°C scenarios with no- or low-overshoot that contain required sector and geography disaggregation. They should review their targets as these become available.

4. Measuring Portfolio Alignment

Banks use or develop methods and tools that are suitable to their specific circumstances in order to deliver meaningful outcomes. Banks provide rationales for their chosen methods and tools, and transparent information about the metrics, methodologies, assumptions and data sources used in them.

5. Setting Targets to Reduce Financed Emissions

Banks closely evaluate the use of both absolute emissions and emissions intensity targets for the fossil fuels sector as data, methodology, science and client business model transitions evolve. Whether setting absolute emissions or emissions intensity targets, banks should set targets that are consistent with the absolute emissions reductions implied by science-based pathways.

6. How and Where to Use Carbon Offsets

Banks help to catalyse and accelerate carbon markets, such that finance flows to valid emissions reduction and removals opportunities. Supporting efforts of bodies such as the SBTi, Voluntary Carbon Markets Integrity Initiative (VCMI), and the Taskforce on Scaling Voluntary Carbon Markets (TSVCM) to assess potential roles for offsets or develop principles for their use and recognition. Separate accounting of offsets from financed emissions to provide transparency. When measuring financed emissions, banks should not account for credits they have bought. They may choose to buy credits to accelerate the global net zero transition, but these should be disclosed separately.

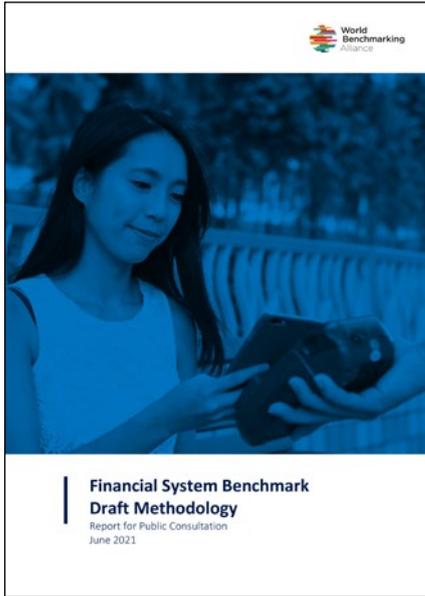
7. Disclosing Progress

Banks follow Taskforce on Climate-Related Financial Disclosures (TCFD) recommendations as they increasingly include net zero reporting in annual reports. Banks work with standard setting bodies to determine which disclosures will go in the annual report versus supplementary documents or websites.

World Benchmarking Alliance (WBA): Financial System Benchmark Draft Methodology

From the draft methodology:

Economic activity has placed the world on an unsustainable path, environmentally and socially. Financial institutions, as a key enabler of the economy, have contributed to this path and have a central role to play in helping reverse this trend. This unsustainable trajectory is not only concerning for people and the planet, but it represents a risk for financial institutions themselves. And as the 2008 financial crisis and the COVID-19 pandemic have demonstrated, issues that may seem contained to products or regions, like sub-prime mortgages in the United States or a new virus outbreak in Wuhan, can quickly ripple through a globalised real economy and the entire financial system.



What is required is a transformation of the financial system so that financial institutions enable a sustainable allocation of resources, and a more accurate representation of risks and opportunities, in line with planetary boundaries and societal conventions (as these are globally defined, e.g. by the Paris Agreement, the UN Guiding Principles on Business and Human Rights). The Financial System Benchmark aims to assist that transformation by publicly evaluating and assessing the world’s most influential financial institutions on their readiness to revert this unsustainable trajectory, and their actions in influencing economic activity towards an urgent alignment with planetary boundaries and societal conventions.

Following a year-long consultation, including the publication of the scoping report in January 2021 and the review and incorporation of existing sustainability standards and frameworks (see Appendix 1 for full list, and Sources section per indicator proposed), this draft methodology brings together the key topics and issues on which society expects financial institutions to take action. It describes the necessity for a financial system benchmark, presents the draft indicators along with the rationale for each issue, outlines proposed approaches to scoring and weighting of the measurement areas and sets out provisional timelines for data collection and publication. WBA methodologies and benchmarks serve as both roadmaps and accountability mechanisms for the private sector, highlighting where practice is lagging and, where possible, setting out the steps they can take to meet the needs and expectations of stakeholders.

The Financial System Benchmark will assess 400 financial institutions, focusing on asset owners, asset managers, banks and insurance companies. These 400 institutions

are part of the 2,000 most influential companies globally (the SDG2000) that WBA will assess by 2023, across different sectors and industries. All 400 institutions will also be assessed on WBA’s core social indicators. These baseline expectations – applied to all 2,000 keystone companies that WBA assesses – have been subjected to extensive consultation and feedback during 2020 and, as such, are not part of this consultation.

Once we have received and incorporated feedback, WBA will publish a finalised methodology for the Financial System Benchmark in December 2021. This will be used to assess the 400 financial institutions. The process, and how institutions in scope can be involved (beyond providing feedback on this draft methodology) is covered in ‘The Benchmark development process’. The first benchmark results, including institutional scores, ranking and scoring guidelines, are expected to be published in late 2022.

World Resources Institute (WRI): Banking Beyond Climate Commitments: Transforming Client Engagement and Products & Services for a Net zero Emissions Future



From the working paper:

- Increasingly, private sector banks are committing to shift their portfolios to net zero emissions by 2050 to align with the objectives of the Paris Agreement—a welcome trend given their important role in shaping and advancing inclusive, sustainable economic growth.



- This paper explores the changes and innovations banks need to make in their client engagement as well as their products and services; these two business model elements will be central to achieving alignment with the Paris goals.
- Banks face important challenges, which represent opportunities for change, including collecting emissions-related data, strengthening the climate-related knowledge of relationship managers and key back office functions (credit analysis, credit risk, and product managers), and rewarding staff for climate relevant transactions through performance incentives. These challenges are shared by banks operating in developed, emerging, and new frontier markets.
- Banks should design a Paris-aligned client engagement strategy that clarifies to clients and other stakeholders how, and over what time frame, their relationships and offerings will change.
- This strategy should include five steps: data collection and management, setting emissions reduction targets, benchmarking clients' emissions reduction performance, drafting clear client engagement policies, and equipping relationship managers with knowledge and tools about climate change and Paris alignment.

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