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Principles for  
Responsible Banking

Guidance for banks

# Foundations of Climate Mitigation Target Setting

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Principles for Responsible Banking

# Acknowledgments

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# Introduction

Scientific findings show unequivocally that climate impacts are already threatening lives and livelihoods and will only worsen as the planet continues to warm. Certain impacts experienced beyond an average warming of 1.5°C could be irreversible. Findings warn of the loss of species and biomes, with serious consequences, not least for food security, safe shelter, economic activity and by extension for all humans. We have already experienced an average global temperature rise of 1.1°C, and even if we were able to stop further emissions of greenhouse gasses (GHGs) today, we would experience more warming. Therefore, the focus must be on reducing emissions (mitigation) as quickly as possible, but also adapting to the physical climate change that is now unavoidable. While banks have low direct emissions, their climate impact comes predominantly from what they finance or invest in, their financed emissions, and their off-balance sheet activities, their facilitated emissions. On average, banks' financed emissions are 700 times greater than their operational emissions.

Banks collectively have direct access to most companies and individuals globally and can be at the core of the systemic change needed to help transition the economy by, for example, mobilizing their clients and stakeholders, engaging with policymakers and regulators and working pre-competitively with peers. Banks can view their portfolios and holdings in a holistic manner, managing their full carbon-footprint, across sector, geographic and asset class exposures. Measuring the emissions associated with their portfolio, setting targets in line with the latest science and defining policies and strategies to align their portfolio with global climate goals are key steps in leveraging banks' unique role in the economy. It is important to point out that reducing financed emissions does not automatically reduce real economy emissions; climate strategies need to be carefully thought through to ensure real world impact.

This document introduces banks to the key stages in the climate mitigation journey and should be seen as a starting point for further research. These stages are not sequential, but often are run iteratively and in parallel.

- The **first stage** is about familiarising yourself with the concepts, frameworks, and regulations that may affect your bank's business, based on the latest climate science.
- The **second stage** outlines key considerations in the measurement and disclosure of financed emissions, which is essential to understanding your portfolio and the extent of its impacts on climate.
- The **third stage** is about setting robust, science-based targets that will give you a mid- to long-term strategic direction for financing decisions and the integration of climate impact in all aspects of your business.
- The **fourth stage** is all about meeting those targets and having a positive impact.

For more details on the target setting process, please consult the [Guidelines for Target Setting for Banks](#) and the [Foundations for Climate Target Setting](#) page.

# 1. Understand the landscape

## Developing a good understanding of the terminology used

Some terms you might see occur frequently are listed in the [Glossary](#) at the back of this document. Additional resources are linked in the [Resources](#) section.

## Knowing how to apply international and national frameworks

For climate, the key framework is the [Paris Agreement](#). Its central aim is to strengthen the global response to climate change by keeping the average global temperature rise in this century well below 2°C above pre-industrial levels and striving to limit it to 1.5°C. Countries implement the Paris Agreement through [Nationally Determined Contributions](#) (NDCs), which guide policymaking to support the necessary emissions reductions. In addition, the [Sustainable Development Goals](#) provide guidance on linkages to other impact areas.

You should seek to finance the unique mitigation and adaptation needs of the areas in which you operate, for which you will need to be familiar with how climate change affects your country and what implications it has for people and the economy. Your national context determines the minimum level of ambition and informs your choice of climate scenario. To be Paris aligned, you need to align with what the latest climate science deems necessary to meet the goals of the Paris Agreement—limiting global warming to well-below 2°C above pre-industrial levels and pursuing efforts to limit warming to 1.5°C, with no or low overshoot. This ambition should be reflected in your choice of scenario in the target setting process.

## Embedding climate mitigation in your bank's business

It is essential to involve your bank's highest governance bodies as well as colleagues across the bank throughout the process. The following steps will demand strategic and long-term decisions associated to your bank's business. The [Taskforce for Climate-Related Financial Disclosures](#) (TCFD) provides additional recommendations for involving the board and senior management in this process. Developing a full transition plan for your bank is an iterative process, taking several years to develop and will need to be refreshed periodically.

## Gaining a good understanding of the regulatory and policy environment of a bank's activities

Public policies influence the pace at which the transition will take place in the real economy and thus how easy or challenging it will be for you to achieve ambitious climate targets. Many countries and regions are also developing regulatory frameworks for sustainable finance, such as for example the [EU's sustainable finance strategy](#). You can find a full list of taxonomies in operation or development [here](#).

## Having a sufficiently good overview of the range of tools and methodologies in the market

Knowing the emissions financed by your loans and investments, as well as the emissions associated with your off-balance sheet activities, is key to define goals to reduce your portfolio climate impact, identify and manage risks, and disclose progress. There are several methodology providers or approaches that you can choose from throughout your journey. The [Climate AIR toolbox](#) lists many of them with details on what they may be used for.

Of those most used, [Partnership for Carbon Accounting Financials](#) (PCAF) provides guidance on attributing the direct and indirect emissions of your clients to a financial institution ('**carbon accounting**') and [Paris Agreement Capital Transition Assessment](#) (PACTA) looks at the technology mix of assets that produce or use energy, comparing the bank's exposure to global pathways (climate scenarios). The [Science Based Targets Initiative](#) (SBTi) or PACTA can help you set targets. In addition to these, there are sector-specific methodologies such as the [Poseidon Principles](#) for shipping.

## Assessing the applicability of tools and methodologies for your bank's balance sheet

The above-mentioned methodologies differ in terms of sector and/or asset class coverage, so often banks opt to mix and match depending on their portfolio composition, data availability and regional specificities. Many banks report on their climate action and strategies, so other banks' annual reports can be a good source of guidance on which tools or methodologies may be most appropriate for your bank.

# 2. Measure and disclose financed emissions

## Measuring financed and facilitated emissions by applying chosen tools and methodologies

PCAF provides [financial institution-specific guidance](#) on how to measure your emissions. For banks, most attributable GHG emissions come from the sum of your clients' [Scope 1, 2 and, if possible, Scope 3 emissions](#), rather than your bank's own operations. This is (mostly) your [Scope 3 Category 15 emissions, or what this document refers to as financed emissions](#). Your financed emissions calculations will help you to establish your baseline, prioritise sectors and track progress over time. Guidance on measuring facilitated emissions is in development.

## Identifying data sources for GHG-emissions and continuing to improve collection of relevant climate data

To measure your financed emissions, you will need to collect client data such as emissions or production data which is, ideally, no older than two years relative to the year the data are used for. The [Carbon Disclosure Project](#) (CDP) is a commonly used source of self-reported data for large clients. Where there are data gaps, you can begin with estimated or proxy data to help you prioritise the sectors you will address first.

For example, you can use regional or national sector averages to estimate the emissions profile of a given client and/or your portfolio associated to this sector.

While the use of proxies is common, you should aim to use client-specific estimates or data where possible to improve your ability to track your clients' progress. You should recognise data limitations and plan measures to improve data quality over time to better reflect the impact of your financing and engagement decisions, for example by including GHG-specific data in the financing and investment process.

## Annually disclosing financed emissions

Disclosure of your emissions profile in your annual reporting is essential for transparency and accountability. You may not yet be able to disclose your full portfolio due to data and methodology limitations; any omissions should be explained.

# 3. Set robust, science-based targets

## Identifying material sectors

In your target setting, you should prioritise the sectors which are the most carbon-intensive (either in absolute or in intensity terms). The guidelines identify agriculture, aluminium, cement, coal, commercial and residential real estate, iron and steel, oil and gas, power generation, and transport as the most carbon intensive sectors, though bank-specific considerations (geography, sectors, policy landscape, local economies, etc.) will affect the selection process. Targets should cover a significant majority of your total financed and facilitated emissions, where data and methodologies allow.

## Determining the baseline

Once you have measured your financed emissions (detailed in Stage 2) you have your baseline. Your baseline is the starting point for your targets. It should be no more than two years before the year in which you are setting the targets, though exceptions can be made for anomalous years.

## Approaches to target setting

There are a few primary approaches to setting targets ([SBTi](#) provides further examples of these, though they are not exhaustive): the first—and most used—general approach is to set targets at a sector level, based on open-source decarbonisation scenarios which outline a trajectory which must be followed over a certain period (typically until 2050). The scenarios are often based on carbon intensities (for instance, tCO<sub>2</sub>e/MWh) or on technological productions (for instance, barrels of oil). One can also calculate an “implied temperature rise” for your portfolio or portfolio coverage (i.e., what percentage of my portfolio clients have climate targets). At present, setting emissions-based targets (either absolute or intensity) is preferred.

## Identifying appropriate climate scenario(s) to use

Climate scenarios are developed by integrating economic models and models of the earth’s physical climate system; normative scenarios provide projections of potential future GHG emissions depending on estimates of factors such as, e.g., future policies, population levels, economic activities, social values, and technological change. They

can illustrate the emissions pathways required over time to constrain global heating to a particular level. When setting targets to align with a particular temperature outcome, you are aiming for the sum of your financed emissions to align with a scenario consistent with your target temperature outcome. The most commonly aligned with scenarios are from the [International Energy Agency \(IEA\)](#), the [International Panel on Climate Change \(IPCC\) scenario community](#) and the [Network for Greening the Financial System \(NGFS\)](#), though other scenarios may be better suited for different regions. Scenarios should be low- to no-overshoot, meaning the target temperature should not be exceeded for extended periods of time, and they should not rely excessively on negative emissions technologies, carbon credits or carbon capture and storage which is as yet unproven at large scale.

## Calculating the degree of alignment

Once you have calculated your baseline data, you are able to project the difference between how your portfolio will evolve and how it is “meant” to evolve if it were aligned with a certain climate scenario. The larger the gap (the “delta”), the more “misaligned” the portfolio. The delta provides you with a relative indication of the amount of effort needed to align your portfolio with the chosen climate scenario.

## Formulating intermediate sector targets

Your intermediate sector targets should be based on your analysis of where you will need to steer your portfolio in the shorter term (by 2030 or sooner) to be in line with your target temperature outcome in the longer term. It is essential to engage business areas and to align with your leadership in that process. You can set two types of targets:

1. An **absolute target** refers to a target that aims to reduce absolute GHG emissions by a set amount. Common metrics are MtCO<sub>2</sub> or MtCO<sub>2</sub>e. This ensures that your financed emissions cannot rise.
2. An **intensity target** is a normalised metric that sets a company’s emissions targets relative to an output.

You could for example use tCO<sub>2</sub>e/MWh for power generation, kgCO<sub>2</sub>e/m<sup>2</sup> for real estate or, less preferably, an economic intensity metric such as kgCO<sub>2</sub>e/dollar client revenue.

An intensity target allows a business to set emissions reduction targets while accounting for economic growth or increased market share, however this approach could hide a rise in your absolute financed emissions and is often subject to more scrutiny. Therefore, while an intermediate sector target may be set on an absolute or intensity basis, it is important to disclose *both* to provide the complete picture.

There are two ways in which the targets can be formulated: a convergence approach, where the speed of change is affected by the starting point (i.e. less carbon intensive clients have a lower rate of decrease to achieve because their starting point is 'better'), and a contraction approach, where every actor/portfolio in the market is assumed to decrease their emissions at the same rate (e.g. 2%/year).

## **Focusing on achieving a real-world impact and not causing harm**

When setting targets, it is important to bear in mind the role that banks play in the real economy and the real-world effectiveness of strategies designed to help meet the targets. It is also important to consider other environmental and social factors.

For example, extensive investments in mining of rare earth minerals for battery production could lead to environmental damage, dangerous working conditions or infringements of indigenous peoples' rights.

# 4. Implement the targets

## Engaging the whole bank and setting up appropriate governance structures

Buy-in from the board, senior executives and employees across the bank is a key enabler of strategic integration of climate considerations in your bank. While leadership's role is to set the strategy, empowered and knowledgeable employees will actively seek opportunities to support the low-carbon transition. Over time, sustainability considerations should be integrated across the product offering and customer service model. This [report](#) from Cambridge Institute for Sustainability Leadership (CISL) emphasises the opportunities of coherently addressing climate change in the business.

## Making financing decisions in all relevant areas of the business to meet the targets

There are a few direct ways to steer your portfolio, which is likely to begin with portfolio-wide and sector analysis. You may wish to include climate risks and how each sector will behave in the following years in your assessment. This may subsequently inform your decisions around risk appetite and commercial strategy, which guide the development of phase out policies, decisions about sectoral exposure limits and client engagement strategies.

For example, you could choose to phase out coal financing by 2030 or decide to reduce your exposure to high-emitting sectors. A review of climate criteria before issuing a loan can help you decide whether to finance a client or not. The maturation of loans is another key point at which carbon reductions in the portfolio can be achieved through transition to the financing of less carbon-intensive clients, technologies or activities. However, it is important to distinguish between financed emissions and 'real economy emissions' and dissociate the two when developing financing decisions to meet targets (an impact in the 'real economy' is the most important outcome).

## Engaging with clients to support their transition

You should also work with your clients to ensure they are working towards the same goal by making them aware of the implications of scientific developments, explaining emerging policies and establishing deadlines. Their degree of engagement with the transition to a net-zero economy can be a good indicator of their quality of management and their own risk management capabilities.

For example, you could [link the interest rate of a product to carbon performance](#), ask for transition strategies, request specific GHG-related data, or determine a point in time by when data should be made available from the company or a robust transition strategy needs to be in place.

## Engaging with policymakers to support regulatory development

Public policy is an essential driver of change in the real economy. The context in which you operate can either hinder or facilitate your progress towards your target temperature outcome. Policy engagement can help you anticipate and mitigate transition risks. Hence, it is in your best interest to engage with policymakers to advocate for policies that will support real economy change that enables a faster zero carbon transition.

For example, you could work with sectoral associations to set new standards (e.g., in mining or deforestation), agree on data collection and reporting from a specific sector and engage policy-makers/regulators on these.

## Developing clear positions on areas such as carbon intensive sectors, offsets and facilitated emissions

While these areas are still nascent, there is significant scrutiny on these topics and clear explanations for the approach taken can be helpful for stakeholders. According to the Guidelines for Climate Target Setting, offsets should only be used when there are limited technologically or financially viable alternatives at the point of declaring 'net zero'. The Net Zero Banking Alliance (NZBA) is developing a position paper in 2022 on "offsets". Facilitated emissions should be included in targets over time as methodologies emerge.

## **Establishing measures to track and report on progress against targets**

You should develop and disclose Key Performance Indicators (KPIs) to track progress against your targets. To reach the set targets there is a suite of options available, which can be combined and together lead to the desired results. These options may include credit policies, limits, client engagement, divestment, and sector policies such as fossil fuel reduction plans, though this list is not exhaustive. You should develop a transition plan and make this public to build confidence in your approach to align your portfolio.

KPIs could for example include % emissions reduction, % carbon intensity reduction, % of clients engaged, % of clients with public transition plans or tracking of finance directed to green projects or climate solutions.

## **Revise targets as needed, but at least every five years, to adjust to an evolving scientific understanding and a changing policy environment**

The revision of targets is an iterative process that involves some or all steps outlined above, as needed.

# Sample intermediate target

As a first step, your bank should commit to a high-level target, **e.g., reaching net zero by 2050, in line with a 1.5°C temperature goal**. This high-level target should then be complemented by intermediate portfolio-wide and sectoral targets for 2030 or sooner, with subsequent intermediary targets set no more than five years apart to ensure continued near-term progress.

A good intermediate sector target would fulfil the following criteria and disclose accordingly:

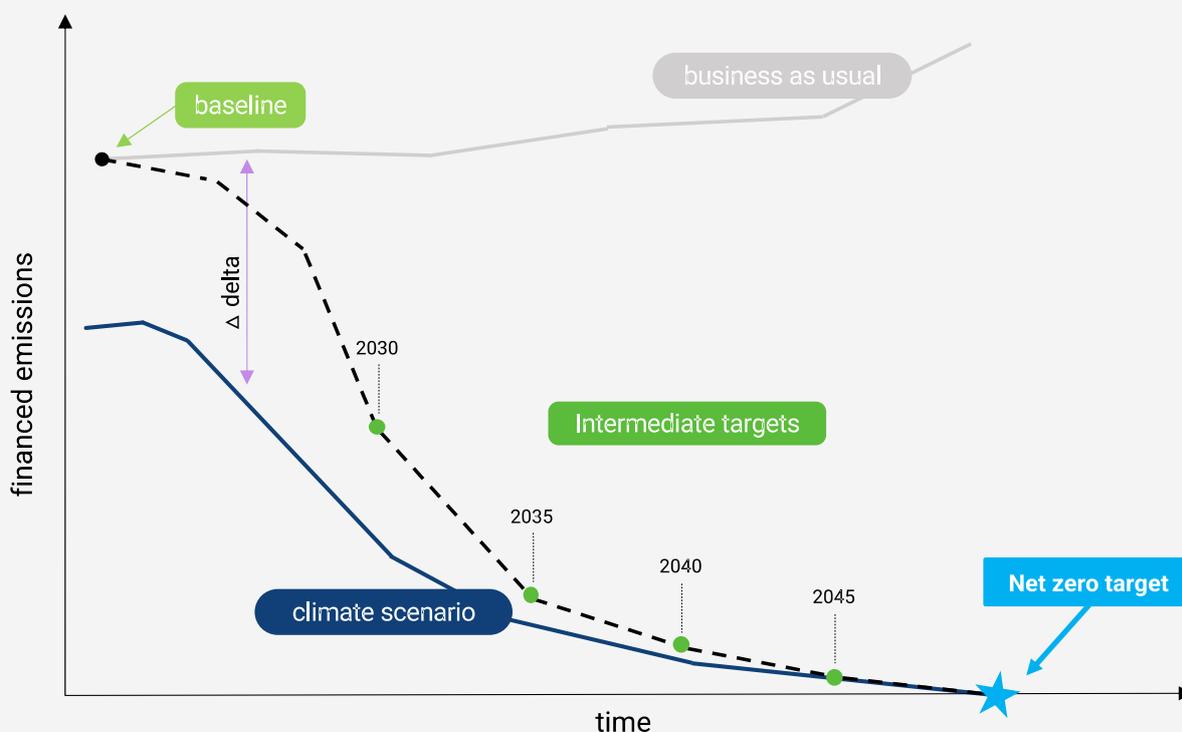
<input type="checkbox"/> <b>Target types</b>	Sector-specific absolute targets and/or intensity targets
<input type="checkbox"/> <b>Target year</b>	2030 or earlier
<input type="checkbox"/> <b>Baseline year</b>	No more than 2 years prior to the year in which the target is set (unless exceptional circumstances); should be determined and disclosed at least for each sector in which a target is set, but ideally for the full portfolio
<input type="checkbox"/> <b>Temperature goal</b>	X°C (net-zero by 20XX)
<input type="checkbox"/> <b>Scenario use</b>	Compatible with limiting warming below X°C, low to no overshoot, limited use of unproven technology
<input type="checkbox"/> <b>Scope</b>	Clients' Scope 1, Scope 2, and Scope 3 emissions, where significant, and where data allow
<input type="checkbox"/> <b>Portfolio coverage</b>	Share of total financed emissions covered by targets, or if not available, share of financial exposure covered by targets
<input type="checkbox"/> <b>Sectors</b>	Prioritising the following sectors based on absolute emissions or emissions intensity: agriculture; aluminium; cement; coal; commercial and residential real estate; iron and steel; oil and gas; power generation; and transport
<input type="checkbox"/> <b>Key Performance Indicators</b>	For example, % emissions reduction, % carbon intensity reduction, % of clients engaged, % of clients with transition plans, or tracking of finance directed to green projects

## Intermediate target example

Please note that this example makes a number of assumptions and represents only one of many options. We will work to provide examples showing a broader range of approaches over time.

Our bank has chosen a 2020 baseline for its targets. We measured the absolute financed emissions baseline of our corporate lending portfolio as of 2020-year end, focusing on USD37.4 billion of assets (equating to a coverage of 82 per cent of our in-scope assets of USD45.6 billion), with emissions of 27.2 Mt CO<sub>2</sub>e. We began by setting targets in our two most carbon-intensive sectors, covering 66% of our overall absolute financed emissions baseline. This is in line with the priorities of the countries we are active in. Though not all jurisdictions have net zero by 2050 targets, we will work with companies in those countries to overcome the associated challenges. We had to use proxies and sector averages in the real estate sector but will look to improve data availability over time as we strengthen client disclosure criteria. In line with the IEA NZE2050 scenario, our bank commits to reducing its financed emissions by 72% by 2030 in power generation from a baseline of 11.4 Mt CO<sub>2</sub>e and by 54% by 2030 in real estate down from 6.7 Mt CO<sub>2</sub>e.

We have developed sectoral policies regarding energy efficiency standards, and plan to phase out financing of coal by 2025 and gas by 2030. We have also defined financing criteria for new mortgages. In the next round of targets, our bank aims to set further targets in oil and gas, transport, and agriculture, which will bring our portfolio coverage of targets up to 89% of measured financed emissions or 72% of assets in USD based on 2020 data.



# Glossary

**Climate change mitigation** refers to the reduction of GHG emissions to limit the warming effect. CO<sub>2</sub> is the most common GHG, but gases like methane or nitrous oxide also contribute to warming. Carbon dioxide equivalent (CO<sub>2</sub>e) describes different GHGs aggregated into a common unit which standardises them to the climate impact of CO<sub>2</sub>.

**Climate change adaptation** refers to changes in behaviour and the system to increase the capability of society to live with increasing temperatures. Both mitigation and adaptation are essential as reducing the warming effect will ease the pressure to adapt in the future. However, mitigation efforts will only show their effect decades later, so changes that are already taking place will need to be adapted to.

**Paris alignment** is a way of supporting climate mitigation as it considers the impact the bank is having on climate and by extension society and seeks to align with what the latest climate science deems necessary to meet the goals of the Paris Agreement. It goes beyond risk management and necessitates the use of alignment-specific tools and methodologies, though existing work on climate risk can be utilised. Banks can leverage their client relationships, increase financing of climate solutions, and reduce exposure to carbon intensive sectors, including fossil fuels, to reduce their portfolio's carbon footprint.

**Net-zero emissions** are where there is an overall balance between emissions of GHGs produced and GHGs taken out of the atmosphere.

**Financed emissions** refer to the emissions of the clients the bank finances. To give an illustrative example: If my bank lends to Company A the equivalent of 10% of Company A's assets, my bank is responsible for 10% of that Company's GHG emissions. Say Company A emits 100 tonnes CO<sub>2</sub>e. This means that 10 tonnes CO<sub>2</sub>e (10%) are directly attributable to my bank's portfolio. The same logic applies to Companies B, C, D, etc. in the same sector. The sum of all these emissions (excluding wider discussions around attribution rules and double counting) would be my **financed emissions**.

**Facilitated emissions** are off-balance sheet (representing services rather than financing) and they can take the form of a flow activity (temporary association with transactions) rather than a stock activity (held on book).

**Climate scenarios** are projections of possible future GHG emissions depending on estimates of factors such as, e.g., future policies, population levels, economic activities, social values, and technological change. Normative scenarios assume certain changes are made to mitigate emissions, which means the outcomes are only achievable if those actions are taken, whereas exploratory scenarios build on past trends and assume no significant changes.

# Resources

- The World Wide Fund for Nature (WWF) introduces the [concept of net zero for financial institutions](#);
- The Financial Services Task Force (FSTF) provides a comprehensive [practical guide to net-zero alignment](#);
- The [Race to Zero lexicon](#) introduces key terms related to net-zero targets;
- The core [Partnership for Carbon Accounting Financials](#) (PCAF) and [Science-based Targets Initiative](#) (SBTi) documents include extensive glossaries and detailed guidance on measuring your financed emissions and setting targets;
- The [Paris Agreement Capital Transition Assessment](#) (PACTA) methodology helps banks measure alignment of their portfolio with climate goals using physical asset-level data;
- The [2 degree investing initiative](#) (2dii) Evidence for Impact work supports banks in thinking about effective climate strategies that lead to real-world outcomes.
- The Portfolio Alignment Team (PAT) has put together a resource on the key considerations and options in the alignment journey;
- The [RMI IMPACT+ Principles](#) help banks identify what matters most in setting effective climate strategies;
- UNEP FI offers a [training course](#) on climate change and the Task Force on Climate-Related Financial Disclosures (TCFD).

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United Nations Environment Programme Finance Initiative (UNEP FI) is a partnership between UNEP and the global financial sector to mobilise private sector finance for sustainable development. UNEP FI works with more than 450 members—banks, insurers, and investors—and over 100 supporting institutions—to help create a financial sector that serves people and planet while delivering positive impacts. We aim to inspire, inform and enable financial institutions to improve people’s quality of life without compromising that of future generations. By leveraging the UN’s role, UNEP FI accelerates sustainable finance.

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