Principles for
Responsible Banking

Theory of Change for Climate Mitigation

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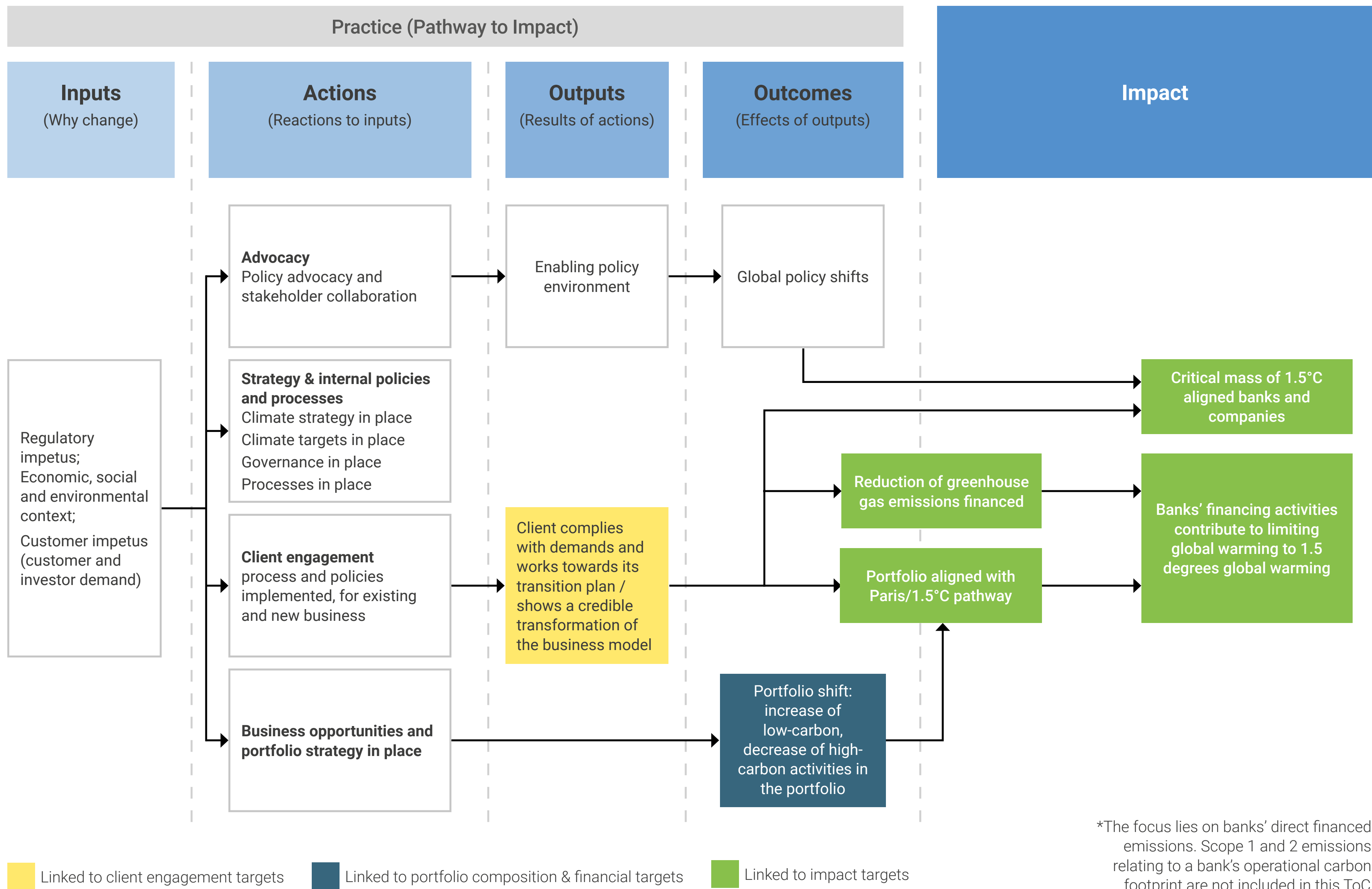


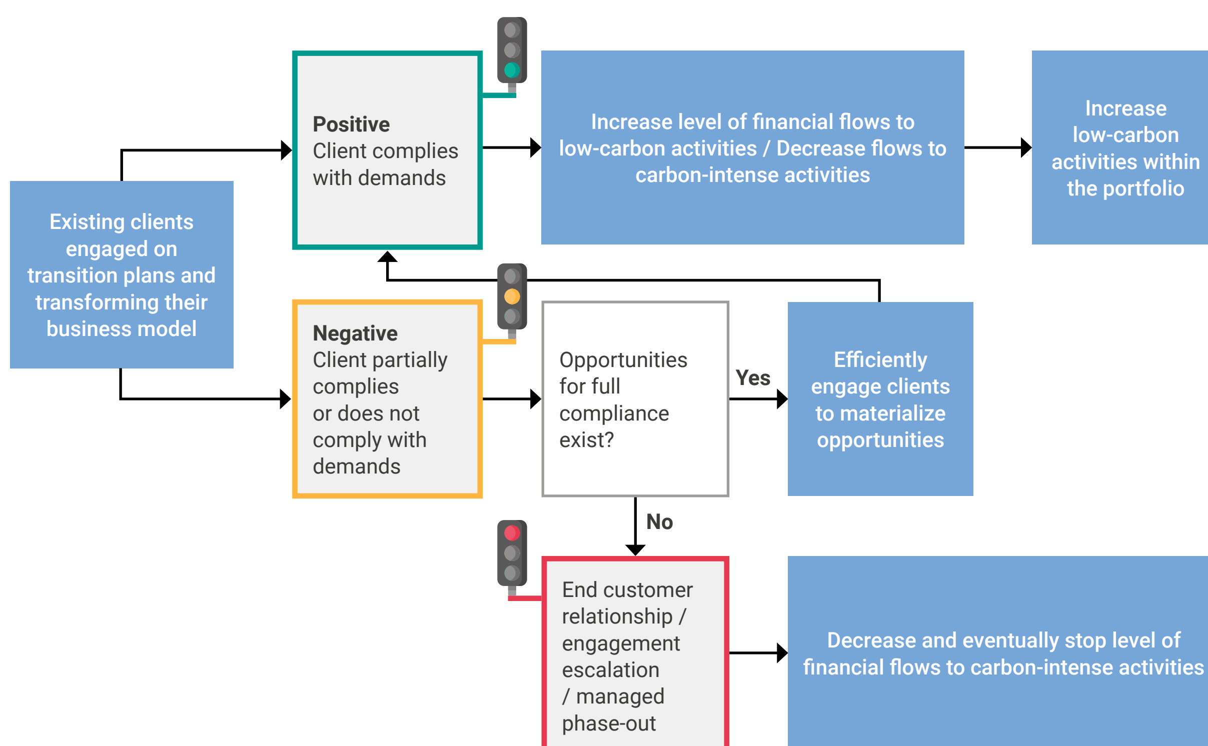
*The focus lies on banks' direct financed emissions. Scope 1 and 2 emissions relating to a bank's operational carbon footprint are not included in this ToC.

The Theory of Change shows the **pathway to impact** and considers the relationship between inputs, actions, outputs, and outcomes (all of these are also referred to as practice) in order to achieve impact.*

Different aspects on the **input level** can be considered as catalysts of change: regulatory impetus, customer and investor demand, as well as the environmental, social, and economic context that banks operate in.

Banks can take **different types of action** to react to this impetus: policy advocacy and stakeholder collaboration, installing a climate strategy (incl. climate targets) as well as developing and/or adjusting the necessary internal policies and processes (incl. sector policies, exclusion policies, data and lending and investment processes), implementing client engagement policies and processes, as well as developing business opportunities and a portfolio strategy.

These actions result in the following **desired outputs:** advocacy works leads to an enabling policy environment (e.g. driving for consistent regulation & disclosure, mandating ambitious action); and client engagement leads to clients complying with the bank's demands and working on their transition plans to transform their business models. In reality, clients would sometimes not (yet) or only partially comply with the bank's demand, in which case the following decision tree shows which actions a bank can take:



The described actions and outputs lead, on the one hand, to a reduction of greenhouse gas emissions as an **outcome**, by supporting and incentivising clients to shift towards low-carbon business models and thus decreasing the amount of greenhouse gases emitted by these clients (real economy greenhouse gas emissions). Increasing the share of low-carbon activities and decreasing the share of carbon-intense acitivities brings banks' portfolios into alignment with scientific pathways in line with the goals of the Paris agreement (banks' financed emissions). Portfolio alignment can, numerically, also

be reached by divesting from carbon-intense activities. However, in this scenario, emissions in the real economy would continue, which is why engaging clients is an important aspect and cannot be neglected on the pathway to impact.

The ultimate **impact** banks (as well as banks' stakeholders) are working towards is to limit global warming to 2 degrees, striving for 1.5 degrees, as set out in the Paris Climate agreement, therefore contributing to a reduction of greenhouse gas emissions. The collaboration of many stakeholders and, therefore, a critical mass of banks as well as real economy actors is needed.

Both practice (action, output and outcome) and impact performance need to be understood because practice is the conduit for achieving desired impacts (including targets). The pathway to impact allows to identify metrics and set targets which align with a bank's maturity. The indicators developed are all connected to a bank's impact and can be considered as steps towards measuring impact. Some of the practice indicators (on the action, output, and outcome levels respectively) are connected to portfolio composition and financial targets (highlighted in **blue**) or to client engagement19 targets (highlighted in **yellow**), which enable a bank's overall (impact) target (highlighted in **green**).