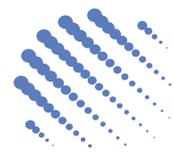


# IIGCC



Transition  
Pathway  
Initiative

Produced by IIGCC in consultation with TPI

# Net Zero Standard for Banks

June 2023



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# About IIGCC

IIGCC brings the investment community together to work towards a net zero and climate resilient future. We create the change the world needs by unlocking investor action on climate change.

Our work supports investors in generating returns for clients and beneficiaries, which in turn provides financial wellbeing for future generations. We work with our members to address climate risk and ensure they are well positioned to make the most of investment opportunities offered by climate mitigation and adaptation efforts, ensuring that their investments contribute towards a better world for us all to live in.

Our team collaborates with investors to create practical solutions that can make a real difference in tackling climate change – facilitating investment practices, policies and corporate behaviours that have real impact and deliver change that the world needs.

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For more information visit [www.iigcc.org](http://www.iigcc.org).

# Background

IIGCC's Banks Working Group was formed in April 2021, following the publication of an ambitious set of [investor expectations](#) that was supported by investors and their stewardship representatives with a combined US\$11 trillion in assets/advice. The expectations were sent to 27 banks and members of the working group have since used them to guide climate-related engagement with banks. IIGCC now supports investor engagement with a focus list of 20 banks in Europe, Canada and Asia.

Following investor consultation and the publication of a [pilot report](#), IIGCC has collaborated with TPI to refine and evolve the investor expectations into a *Net Zero Standard* ([here on in 'The Standard'](#)).

In parallel, TPI in consultation with IIGCC has developed a *Net Zero Banking Assessment Framework for Banks* ([here on in 'Assessment Framework'](#)) which can be [viewed here](#). The purpose of the Assessment Framework is to assess banks for alignment against 72 indicators based on the expectations in the Standard.

The Standard and Assessment Framework cover ten areas:

- 1. Bank commitments**
- 2. Targets**
- 3. Exposure and emissions disclosure**
- 4. Historical emissions performance**
- 5. Decarbonisation strategy**
- 6. Climate solutions**
- 7. Policy engagement (lobbying)**
- 8. Climate governance**
- 9. Just transition**
- 10. Annual reporting and accounting disclosures**

The same banks that received the Investor Expectations in 2021 will be assessed against 72 indicators in each of these areas. TPI will publish results in Q3 2023 and preliminary assessments will be shared with banks beforehand.



# Foreword

Banks are essential to the operation of the global economy. They support investment into real-world activities across economies through lending, securitisation, underwriting and advisory services. Aligning banks' activities with achieving net zero greenhouse gas emissions, consistent with the Paris Agreement's goal of limiting global temperature increase to well below 2°C, while pursuing efforts to limit the increase to 1.5°C is, therefore, key to delivering global decarbonisation. Banks are also important to ensuring financing to help economies adapt to the physical impacts of climate change.

In recognition of the critical role played by financial institutions, in the run-up to COP26 Mark Carney, former governor of the Bank of England, called for key players in the financial system to commit to aligning with the goals of the Paris Agreement. Global banks responded through the creation of the Net Zero Banking Alliance (NZBA), launched in April 2021. Convened by the UN, NZBA has now grown from 43 to 131 banks, representing around 40% of global banking assets<sup>1</sup>.

As shareholders in banks, investors also have an important part to play in supporting the transition of banks to net zero. Implementing a credible transition plan is sensible risk management for banks. As decarbonisation accelerates, continuing to finance long-term declining carbon-intensive industries risks rising defaults and loan losses. Likewise, a failure to consider shifting weather patterns or rising sea levels could leave banks with unexpected, impaired assets. Supporting this transition is also important in underpinning long term sustainable growth, and thus preserving shareholder capital across a wide range of economic sectors.

For these reasons, many investors are seeking commitments from banks who have not yet committed to net zero and for those who have, a credible plan of how this will be achieved, including critical assumptions and dependencies. Until now, however, investors have lacked guidance for understanding and assessing banks' alignment with the Paris Agreement goals. *The Net Zero Standard for Banks*, published by IIGCC along with the accompanying Assessment Framework published by TPI, seeks to fill this gap. Together, they build on two years of investor consultation, analysis and testing involving investor engagement as well as a pilot exercise with 27 global banks.

The Standard aims to be market leading, reflecting the urgency of the decarbonisation challenge before us. While the results of the pilot study underline the scale of change required for banks to align their financing with a 1.5°C pathway [see pilot results [here](#)], this is not to down-play the progress that has been made by leading banks. The Standard seeks to ensure we remain anchored to the outcomes we seek in line with our duties as investors: long term sustainable wealth creation in the context of the Paris Agreement's goals which seek to avoid devastating climate change.

As shareholders, creditors and representatives on behalf of their clients, investors have a responsibility to hold banks accountable for setting resilient long-term strategies and associated targets. We hope that this *Net Zero Standard for Banks* and the accompanying *Assessment Framework* will give us the information we need to encourage banks to step up on their climate commitments and to challenge inaction. We look forward to the progress we can make together and to taking on board further feedback and experience from engagement with banks and other stakeholders, as we seek to further evolve and improve on this guidance.

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**IIGCC Banks Working Group**

<sup>1</sup> [Members – United Nations Environment – Finance Initiative \(unepfi.org\)](https://unepfi.org/) (membership number as of 05-06-23)

# Net Zero Standard for Banks

## Introduction

This Standard sets out investor expectations for banks on the transition to net zero. It focuses on banks' financed and/or facilitated emissions, rather than emissions associated with their operations, as these are generally much larger and reflect greater business risks and opportunities.

The Standard complements the Net Zero Investment Framework (NZIF)<sup>2</sup> and is designed to support investors implementing net zero commitments. The expectations are stretching – consistent with limiting climate change to a 1.5°C pathway<sup>3</sup> – but also achievable with determined action by all actors.

We acknowledge that each bank's ability to meet these expectations will depend on the legal and regulatory environments in which they operate and their individual circumstances. These expectations are made on the basis that governments will follow through on their commitments to support a low-carbon and just transition at a pace consistent with achieving the goals of the Paris Agreement<sup>4</sup> including limiting climate change to 1.5°C (the "Paris Goals").

In some product categories or sectors that banks finance, net zero transition methodologies or related frameworks do not yet exist. As such, these expectations should not be seen as prescriptive for all banks or all circumstances. Rather, the Standard provides a compass for both investors and banks navigating towards net zero, including for engagement with public policymakers and data providers to build the necessary conditions for success.

## 1 BANK COMMITMENT

Banks should establish a comprehensive commitment to net zero by 2050 or sooner that is consistent with the Paris Goals, including limiting warming to 1.5°C. This commitment should cover all on- and off-balance sheet activities<sup>5</sup>, as well as operational emissions. Where this is not yet done, banks should explain or publish plans to expand the scope of commitments over time.

**Rationale:** Banks play a pivotal role in financing and facilitating<sup>6</sup> the real economy; their commitment to net zero is essential if global climate goals are to be achieved. Investors want to understand the extent to which a bank is committed to a net zero future – and thereby enhancing long term shareholder capital<sup>7</sup>. A comprehensive, strategic commitment across a banking group is essential to ensure aligned and coordinated action across all business divisions.



- <sup>2</sup> The Net Zero Investment Framework, published in March 2021, provides a high-level framework that supports investors to align their investments with the goals of the Paris Agreement. Banking is considered a high impact sector in the target setting methodology for "Listed Equity and Corporate Fixed Income". Consequently, full alignment assessment is required. The Banks Standard provides industry specific guidance to operationalise this assessment.
- <sup>3</sup> As identified by the IPCC in their Special Report on Global Warming of 1.5 degrees [www.ipcc.ch/site/assets/uploads/sites/2/2022/06/SPM\\_version\\_report\\_LR.pdf](http://www.ipcc.ch/site/assets/uploads/sites/2/2022/06/SPM_version_report_LR.pdf) [date accessed: 08/03/2023]
- <sup>4</sup> Article 2.1(a) of The Paris Agreement states the goal of "Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;". [https://unfccc.int/sites/default/files/english\\_paris\\_agreement.pdf](https://unfccc.int/sites/default/files/english_paris_agreement.pdf).
- <sup>5</sup> See PCAF for definitions of on- and off-balance sheet, p.9 <https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf> [date accessed: 08/03/2023]
- <sup>6</sup> "Facilitated emissions differ from financed emissions in two respects: they 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)" PCAF, p.3 <https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf> [date accessed: 08/03/2023]
- <sup>7</sup> For more information, see [https://www.ngfs.net/sites/default/files/medias/documents/ngfs\\_guide\\_for\\_supervisors.pdf](https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf) [date accessed: 08/03/2023]

## 2 TARGETS

Banks should establish a pathway of short, medium and long term targets for reducing real economy emissions associated with their on- and off-balance sheet financing activities that extends to at least 2050.

Investors recognise that often several types of targets are needed to support a bank's net-zero commitment, with a focus on real economy emissions reductions, such as: i) financed<sup>8</sup> and facilitated<sup>9</sup> emissions reductions; ii) increasing the share of financing/facilitation of companies with externally-verified 1.5°C targets<sup>10</sup> and credible transition plans<sup>11</sup> iii) specifically transition-linked financing and facilitation of carbon-intensive borrowers; and, where relevant, iv) expanding capital deployment for transition-enabling activities across sectors (e.g. green building renovation and retrofit supply chain, while ensuring socially inclusive access to capital<sup>12</sup>).

Where addressing their financed and facilitated emissions, banks should set sector-specific emissions intensity targets using a physical denominator<sup>13</sup>, including short, medium and long term targets and aligned with a 1.5°C pathway in each case. Intensity targets ensure that a bank is seeking to align its activities in each sector with climate objectives, independent of overall changes in the volume of activity and any shifts between sectors. Additionally, banks should set milestone targets for their financed emissions in terms of absolute emissions (net zero by 2050 and at least one interim target). While the long term trajectory for absolute emissions must be to net zero, investors acknowledge the need for transition-linked activities in 'hard-to-abate' sectors, which can lead to short term increases in absolute financed/facilitated emissions but can be important in delivering real economy decarbonisation. Targets should prioritise high-emitting sectors<sup>14</sup>.

These targets should eventually cover all of a bank's business activities, including corporate lending, loans to sovereigns or public entities, underwriting, project financing, acquisition financing, asset-backed financing and asset management<sup>15, 16</sup>. Although methodologies for assessing emissions in capital markets facilitation activities are yet to be widely adopted, banks are nonetheless encouraged to pursue efforts to cover these activities with targets. Banks should additionally establish targets to reduce their operational emissions in line with a 1.5°C pathway.

**Rationale:** Bank targets establish levels of climate ambition and plot a decarbonisation trajectory that can be assessed for alignment against 1.5°C climate objectives. Short and medium term targets are moreover needed to operationalise long term goals. Investors want to measure the decarbonisation ambitions of their bank holdings in order to understand transition risk in their portfolios and help them to align their own financed emissions with net zero.

Investors encourage banks to set targets that incentivise real economy decarbonisation. This includes incentivising aligned, or transition-linked, activities in high-emitting sectors (recognising that taking on these clients/projects may cause a bank's absolute financed/facilitated emissions to rise, in the short-term).

Because banks play a varied role in the real economy through their on- and off-balance sheet activities, targets should ultimately cover all activities, though investors place greatest emphasis on those that are most material in their impact on real economy emissions – and associated with greatest climate-related risks. With regards to asset management entities of banks, investors highlight the role of stewardship activities, which include but are not limited to corporate and policy engagements, in driving targeted portfolio decarbonisation as a means for real economy emissions reductions<sup>17</sup>.

- 8 PCAF's methodology for Financed Emissions, 2022 <https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf> [date accessed: 08/03/2023]
- 9 PCAF's Proposed Methodology for Facilitated Emissions, 2022 <https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf> [date accessed: 08/03/2023]
- 10 For example, the TPI <https://www.transitionpathwayinitiative.org/> and SBTi <https://sciencebasedtargets.org/> are two providers [date accessed: 08/03/2023]
- 11 Key elements of transition plans include comprehensive and aligned emissions targets; credible strategies to deliver the targets (including quantified decarbonisation actions and capital allocation); engagement commitments to deliver their targets (including in value chain and climate policy); contribution to climate solutions (where relevant); and comprehensive emissions and accounting disclosures. Full details in IIGCC Investor Expectations of Corporate Transition Plans: From A to Zero, <https://www.iigcc.org/download/investor-expectations-of-corporate-transition-plans-from-a-to-zero-v2/?wpdmml=7459&refresh=642163e4b3c3a16799098860> [date accessed: 27/03/2023]
- 12 See for instance, <https://www.lse.ac.uk/granthaminstitute/publication/financing-a-just-transition-to-net-zero-emissions-in-the-uk-housing-sector/> [date accessed: 08/03/2023]
- 13 This is the sector relevant unit of production - refer to TPI's carbon performance methodology, p.6 <https://www.transitionpathwayinitiative.org/publications/100.pdf?type=Publication>
- 14 The high-emitting sectors that will be covered by TPI in the Assessment Framework currently include: Oil and Gas, Power, Coal Mining, Airlines, Shipping, Auto Manufacturing, Steel, Aluminium, Diversified Mining, Paper, Cement, Food, and Real Estate
- 15 As identified in the NZBA Supporting Notes for Guidelines for Climate Target Setting, p.18 <https://www.unepfi.org/wordpress/wp-content/uploads/2022/08/Supporting-Notes-for-Guidelines-for-Climate-Target-Setting.pdf> [date accessed: 24/01/2023]
- 16 See <https://www.netzeroassetmanagers.org/> [date accessed: 08/03/2023]
- 17 See for instance, <https://www.iigcc.org/resource/iigcc-net-zero-stewardship-toolkit/> [date accessed: 08/03/2023]

### 3 EXPOSURE AND EMISSIONS DISCLOSURE

Banks should disclose the financed and facilitated emissions associated with their business activities, including all activities in retail, corporate, and investment banking, mortgage lending, other capital markets and facilitation activities, and asset management (where applicable). Banks should also disclose total exposure to high-emitting sectors across business activities in terms of an appropriate financial metric (e.g. loan exposure). Disclosures should ideally be broken down by business activity and sector, e.g. in a matrix format. In real estate, banks should disclose loan/mortgage and capital markets activities exposure by building energy efficiency label<sup>18</sup>.

Banks should disclose financed and facilitated emissions on both an absolute and a sector-specific emissions intensity basis (with a physical unit as denominator). Banks should disclose the methods used to attribute emissions, and clearly state activities or sectors that are not covered. Where widely recognised, third-party methodologies exist<sup>19</sup>, banks should use these to calculate emissions disclosures (as opposed to using proprietary methods). Banks' emissions disclosures should be of a high quality, well supported by underlying reported asset-level emissions data, and preferably independently audited<sup>20</sup>. Where possible, banks should separately report the contribution of client-purchased offsets to financed/facilitated emissions disclosures.

While the above is feasible now for large corporate clients, there will be challenges in capturing the necessary data at the level of mid-market corporate clients and small to medium enterprises (SMEs). In these cases, banks should estimate or help clients measure their emissions to support a comprehensive understanding of the emissions associated with the bank's activities.

In certain capital markets facilitation activities (such as advisory services) where methodologies are not currently widely in use<sup>21</sup>, it may be difficult to disclose emissions; banks are nonetheless encouraged to pursue efforts to do so and to support methodological development.

Banks should also disclose operational emissions, including those from owned but unleased real estate assets<sup>22</sup>. Any offsetting purchased by the bank should be disclosed separately from financed/facilitated emissions and should not be counted towards these emissions targets<sup>23</sup>. Any offsets that are used should be certified by a credible third party, with full details on schemes used.

**Rationale:** Banks typically have a broad range of business activities providing different services. Investors seek clarity on the emissions a bank is financing and facilitating across these activities in order to understand a) the extent of the bank's transition risk, and b) the bank's role in enabling greenhouse gas emissions, leading to further physical risk due to climate change. Further, emissions disclosures ensure a firm footing for measurement of progress against targets (historical emissions performance).

Investors request that banks use widely recognised third-party methodologies for emissions disclosures, where available, because this enables standardised comparison. Understanding that gross emissions reductions should drive the vast majority of net decarbonisation, investors also seek to understand the full contribution of offsetting measures to a banks' emissions disclosures (including offsets purchased by the bank and by its clients).



- 18 Sectoral targets for mortgage / real estate related lending and capital markets activities (covered bonds, mortgage/real estate securities) should ideally draw on the science-based and investor supported CRREM curves for different types of buildings (Carbon Risk in Real Estate Monitor [www.crrem.org](http://www.crrem.org)) [date accessed: 08/03/2023]
- 19 E.g. methodology for Financed Emissions, 2022 <https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf> [date accessed: 08/03/2023]
- 20 See PCAF Global GHG Standard for tiers of disclosure quality, p.72 <https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf> [date accessed: 08/03/2023]
- 21 See p.18 <https://www.unepfi.org/wordpress/wp-content/uploads/2022/08/Supporting-Notes-for-Guidelines-for-Climate-Target-Setting.pdf> [date accessed: 08/03/2023]
- 22 Where banks have operational control of real estate assets, these assets contribute to operational emissions. <https://carbonaccountingfinancials.com/files/consultation-2022/202205-public-consultation-real-estate.pdf> [date accessed: 08/03/2023]
- 23 As per, <https://sciencebasedtargets.org/resources/files/Financial-Sector-Science-Based-Targets-Guidance.pdf>, [date accessed: 11/04/2023]

## 4 HISTORICAL EMISSIONS PERFORMANCE

Banks should report annual progress towards all their stated emissions targets. This performance should be expressed using the same metric as the target, thereby enabling investors to directly track both annual and performance-to-date against these targets. Where possible, the major contributors to progress should be quantitatively disclosed and the contribution of offsets and/or M&A (both at the bank or asset level) should be clearly set out.

**Rationale:** Investors want to see if banks are decarbonising and if progress is aligned with the trajectory implied by their targets. This provides valuable information as to the credibility of both the decarbonisation strategy and governance structures and therefore is an important basis for engagement.



## 5 DECARBONISATION STRATEGY

To deliver on their targets and commitments, banks should independently establish and disclose their own individual protocols and strategies specific to each business activity. The precise approach adopted will vary by bank, but the underlying expectation is that banks should support their clients to align their strategies with a 1.5°C pathway. This will involve planning for both phasing out financing of inconsistent activities which present particular risks (covered here) while pivoting financing towards climate solutions (see 6. Climate Solutions). Both will build banks' resilience as economies transition. More specific commitments are expected for particularly carbon-intensive activities or otherwise harmful activities, which have been identified as generally inconsistent with the Paris Goals, indicating heightened financial risks. Based on current scientific understanding, and subject to any exceptions that are demonstrated to be consistent with a 1.5°C pathway, banks may wish to consider policies covering the details of how they will avoid financing or facilitation of:

- New coal-fired power stations and new coal mines, and phase out financing of the use of unabated thermal coal by 2030 in advanced economies and 2040 globally<sup>24,25</sup>
- New long lead-time, upstream, conventional oil and gas projects;<sup>26</sup> projects which fail to adopt necessary standards of methane emissions management;<sup>27</sup> certain categories of new or existing unconventional sources of oil and gas<sup>28</sup> including ultra-deepwater oil, heavy oil and tar sands; and measures to ensure that financing/facilitation of unabated gas-fired power infrastructure can be consistent with the electricity sector reaching net zero emissions by 2035 in advanced economies and 2040 globally<sup>29</sup>
- Commodity-driven deforestation<sup>30</sup> or other natural ecosystem conversion as soon as possible, and no later than 2025<sup>31</sup>

Across all resource-related (e.g. fossil fuel, raw materials) finance and facilitation, banks should additionally have policies that offer appropriate robust protections to socially and/or environmentally sensitive areas<sup>32</sup>.

24 IEA, 2021 <https://www.iea.org/commentaries/key-lessons-for-phasing-out-co2-emitting-coal-plants-from-electricity-sectors> [date accessed: 08/03/2023]

25 As per IEA NZE, A Roadmap for the Global Energy Sector, p.26 [https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroBy2050-ARoadmapfortheGlobalEnergySector\\_CORR.pdf](https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroBy2050-ARoadmapfortheGlobalEnergySector_CORR.pdf) [date accessed 08/03/2023]

26 "In the NZE Scenario, declining fossil fuel demand can be met through continued investment in existing production assets without any need for new long lead time oil fields" p352, IEA WEO 2022, Net Zero Emissions by 2050 scenario – <https://iea.blob.core.windows.net/assets/830fe099-5530-48f2-a7c1-11f35d510983/WorldEnergyOutlook2022.pdf> [date accessed 08/03/2023]

27 The Oil & Gas Methane Partnership 2.0, developed by the UN Environment Programme contains best practice guidelines here: <https://ogmpartnership.com/>

28 Certain categories of new or existing unconventional sources of oil and gas are generally likely to be inconsistent with 1.5°C pathways due to their high costs, often related to their high energy and carbon intensity of production under carbon pricing scenarios – see e.g. <https://www.mckinsey.com/industries/oil-and-gas/our-insights/the-big-choices-for-oil-and-gas-in-navigating-the-energy-transition>

29 As per IEA NZE, p. 117 [https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroBy2050-ARoadmapfortheGlobalEnergySector\\_CORR.pdf](https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroBy2050-ARoadmapfortheGlobalEnergySector_CORR.pdf) and WEO 2022, p. 137: "Electricity sectors in advanced economies reach net zero emissions by 2035 in the NZE Scenario, and globally by 2040." <https://iea.blob.core.windows.net/assets/830fe099-5530-48f2-a7c1-11f35d510983/WorldEnergyOutlook2022.pdf> [date accessed 08/03/2023]. For more details on decarbonising the electricity sector see IIGCC/CA100+ sector report: <https://www.climateaction100.org/wp-content/uploads/2021/10/Global-Sector-Strategy-Electric-Utilities-IIGCC-Oct-21.pdf> [date accessed: 10/05/2023].

30 As per <https://racetozero.unfccc.int/wp-content/uploads/2021/11/DFE-Commitment-Letter-.pdf> [date accessed: 08/03/2023]

31 Including natural savannahs, grasslands, peatlands and wetlands, p.20 "Commitments should be timebound, with an ambitious target date and timebound milestones. The AFI recommends that companies set or strengthen their commitments to no-deforestation and no conversion supply chains to include a target date that is as early as possible and no later than 2025." [https://accountability-framework.org/wp-content/uploads/2022/09/AFI-LUC-and-Emissions-Guidance-09\\_2022.pdf](https://accountability-framework.org/wp-content/uploads/2022/09/AFI-LUC-and-Emissions-Guidance-09_2022.pdf) [date accessed: 08/03/2023]

32 As a guide, see these databases of protected areas <https://www.protectedplanet.net/en/thematic-areas/wdpa?tab=WDPA> [date accessed: 08/03/2023]; <https://www.landmarkmap.org/data/> [date accessed: 24/01/2023] and others

The above is not intended to be exhaustive or preclude financing that would enable alignment with a 1.5°C future (e.g. decarbonising steelmaking, retiring coal assets, or carbon capture and storage). Investors wish to have clear disclosures on how banks are approaching these particularly sensitive activities and have reassurance that any financing would not contravene the broader commitment to align with a 1.5°C pathway.

The mechanisms through which banks will achieve their decarbonisation strategy will inevitably vary by business activity and bank, and will depend on relevant legal and regulatory obligations or restrictions. Investors expect to see clear disclosures as to the approach adopted and how this will deliver the targeted decarbonisation, together with key assumptions and critical dependencies. Potential mechanisms include, where relevant:

- Client engagement to request credible 1.5°C-aligned transition plans, and regular review of credit relationships on this basis<sup>33</sup>
- Developing sector specific initiatives to work with stakeholders across value chains and drive decarbonisation in hard-to-abate sectors
- Support for low carbon technologies and solutions, including green renovation of buildings and retrofit supply chains in real estate<sup>34</sup>
- Financing covenants and conditions holding borrowers to the standards of a policy covering the issues bulleted above (p.9) in both project and corporate finance
- Exclusions that prohibit project finance and underwriting of inconsistent activities
- Entity-level corporate finance exclusions based on whether or not corporates derive material revenues from inconsistent activities (e.g. a stated threshold percentage of revenue)
- Provision of safeguards<sup>35</sup> within mergers and acquisitions advisory on transfers of high-carbon assets (e.g. coal mines) away from public capital markets
- Asset management decarbonisation plans, in line with the Net Zero Investment Framework (NZIF)<sup>36</sup>

In all cases, investors expect banks to integrate just transition principles (see 9. Just Transition below).

As stated in 3. Emissions Disclosures, carbon offsets should not be used to count against financed/facilitated emissions. Any offsetting used against operational emissions should be minimised in favour of gross emissions reductions, but where offsetting is used, emphasis should be placed on long-term carbon removal<sup>37</sup>.

Banks should provide a clear plan, with milestones, as to how they will achieve their net zero goals across financing and facilitated emissions, and operational emissions, together with critical assumptions and dependencies for the successful delivery of the strategy and achievement of their targets. These would be expected to include advances in public policy and regulation, progress and breakthroughs in technology innovation and changing consumer demand. This plan should be embedded into the bank's strategy, as set out to shareholders in the statutory Annual Report and Accounts (see below on 10. Annual Reporting and Accounting disclosures).

**Rationale:** For a bank's targets or commitments to be considered credible, they must be supported by a detailed decarbonisation strategy. It is essential that this strategy covers all areas of activity in which banks play a significant role in the real economy.

Banks often play a significant role in financing new long-lived infrastructure which, if carbon intensive, could prove inconsistent with 1.5C pathways. Such assets are at heightened risk of becoming impaired, or 'stranded', before the end of their anticipated operating life, resulting in financial risks for banks and their investors. It also risks locking in carbon-intensive operations, making decarbonisation both more difficult and also likely more disorderly when it comes<sup>38</sup>. The above examples provide a non-exhaustive list of such assets and banks should review carefully individual projects for their consistency with 1.5C pathways.

A strong decarbonisation strategy goes hand-in-hand with ensuring that banks are well positioned to support and benefit from the growth of climate solutions, while avoiding transition risks. We turn to this in the next section.

33 See for instance, <https://www.cisl.cam.ac.uk/business-action/sustainable-finance/banking-environment-initiative/client-engagement-reshaping-the-bank-client-relationship-to-accelerate-the-transition-to-a-net-zero-economy> [date accessed: 08/03/2023]

34 See, for example, [www.bankersfornetzero.co.uk/wp-content/uploads/2022/05/Tooling-up-the-Green-Homes-Industry\\_FINAL.pdf](http://www.bankersfornetzero.co.uk/wp-content/uploads/2022/05/Tooling-up-the-Green-Homes-Industry_FINAL.pdf) [date accessed: 08/03/2023]

35 For example, standards requiring that purchasers are committed to 1.5°C-aligned production curves, have financial means to cover decommissioning and rehabilitation, and are committed to a just transition.

36 Please see the Net Zero Investment Framework for guidance: [https://www.parisalignedinvestment.org/media/2021/03/PAIL-Net-Zero-Investment-Framework\\_Implementation-Guide.pdf](https://www.parisalignedinvestment.org/media/2021/03/PAIL-Net-Zero-Investment-Framework_Implementation-Guide.pdf) [date accessed: 08/03/2023]

37 As per Oxford Offsetting Principles: <https://www.smithschool.ox.ac.uk/sites/default/files/2022-01/Oxford-Offsetting-Principles-2020.pdf> [date accessed: 08/03/2023]

38 Fisch-Romito et al. 2021. Systematic map of the literature on carbon lock-in induced by long-lived capital. Environmental Research Letters, 16. <https://doi.org/10.1088/1748-9326/aba660>

## 6 CLIMATE SOLUTIONS

Investors expect banks to help accelerate the transition by providing finance, services, and expertise to 'climate solutions', which includes all forms of low carbon technologies and associated infrastructure necessary to build a low carbon economy.

There are a wide variety of ways for banks to do this. Banks should clearly set out their approaches to evaluating the environmental credibility of initiatives, projects and businesses financed or otherwise supported. Banks should aim to scale up climate solutions financing<sup>39</sup> and provide clear reporting on the uptake of financing and services towards climate solutions and resulting impact. Further, banks should pursue efforts to improve industry standards and transparency in climate solutions activities, such as improved taxonomies.

**Rationale:** The transition to net zero requires a substantial acceleration in the flow of capital to low carbon technologies and infrastructure. Banks have a central role to play in this through the deployment of capital and services, and in doing so will help to mitigate climate risk, address finance-related bottlenecks and create investment opportunities. Investors encourage and recognise banks' activities in this area, but equally want to ensure that these activities are transparent and held to rigorous standards.



## 7 POLICY ENGAGEMENT

Banks should establish a clear, group-wide position to conduct lobbying activities in line with the goal of limiting warming to 1.5°C and assign board level responsibility for oversight of lobbying approach and activities. Banks should clearly disclose the outcomes of any lobbying activities on policy issues material to climate change.

Further, banks should evaluate whether the associations, alliances, and coalitions they are a part of lobby in line with 1.5°C climate objectives. Banks should disclose annually which trade associations they are a member of and what roles they play within them. Banks should conduct reviews of their trade associations' positions on climate change and associated policy issues, and disclose actions taken as a result of these reviews where any material misalignment is identified<sup>40</sup>.

Banks should provide industry expertise to support the development of sound and effective regulation that can support the net zero transition.

**Rationale:** Stronger climate policies are needed in both the financial sector and the real economy to support the achievement of the Paris Goals. Due to their central role in the economy, banks exert considerable influence over policymaking. Given this, investors want to understand if the lobbying activities of banks are aligned with net zero.

Banks' role in policy engagement extends beyond their own lobbying activities to those of the trade associations, alliances and coalitions that they are part of, as well as other organisations such as think tanks or advocacy bodies that they support financially or otherwise. Investors also want to understand the policy engagement implications of these relationships.

Regulation is most effective when it is built on a solid understanding of the industry it pertains to. By working cooperatively across the industry and with policymakers, banks can assist in the development of more effective climate-related regulation, providing more certainty to market participants and investors.

39 The IEA NZE scenario sets out investment gap to aligning with a 1.5°C future. "The NZE expands annual investment in energy from just over USD 2 trillion globally on average over the last five years to almost USD 5 trillion by 2030 and to USD 4.5 trillion by 2050" p.81 <https://www.iea.org/reports/net-zero-by-2050> [date accessed: 08/03/2023]

40 These expectations are consistent with the Global Standard on Corporate Climate Lobbying: <https://climate-lobbying.com/about/> [date accessed: 08/03/2023]

## 8 CLIMATE GOVERNANCE

Banks should ensure that there is dedicated and expert oversight of delivery of their transition strategy at the board level and should establish strong oversight policies. Board-level committees should ensure they cover climate as part of their responsibilities, for instance committees responsible for audit, risk, remuneration, nomination and governance.

Banks should put in place incentive structures to encourage achievement of transition plan goals, and amend or remove incentives that run contrary to those goals; executives should not be rewarded for actions that result in climate harm. Such structures should at least apply across senior executives/heads of business divisions, and preferably be extended deeper into the business.

Banks are expected to allocate sufficient resource and train employees to achieve transition plan goals<sup>41</sup>. Below board level, training for the broader workforce is a vital strategy to advance a cultural shift towards greater climate awareness and action. To support the cultural transition in line with a net zero future, banks should consider how longer term, climate-related metrics can be integrated throughout the organisation.

**Rationale:** Delivering a transition to net zero requires banks to integrate climate considerations into strategy and operating activities. Investors want to understand what oversight measures and incentive structures exist to drive these plans forward.

## 9 JUST TRANSITION

Banks should identify potential social impacts associated with their net zero strategy and set out how they intend to help address these by maximising social benefits of the transition, and minimising potential harms<sup>42</sup>.

Banks should consider both the impacts associated with the growth of transition-related activities (e.g. impacts on communities due to mining of critical metals), and the impacts associated with the decline of carbon-intensive activities (e.g. loss of jobs due to retirement of coal mines).

Banks should publish policies that support 'Just Transition'-related outcomes across different activities, e.g. Just Transition-related requirements in covenants and conditions, and pre-investment screening. To assist with this, banks should appropriately incorporate relevant recommendations in the ILO Guidelines for a Just Transition<sup>43</sup>, and engage with clients to help ensure adherence to the UN Declaration on the Rights of Indigenous Peoples<sup>44</sup>, including the right to free, prior, and informed consent.

**Rationale:** The transition to a net zero economy, while undeniably beneficial for the world overall, will significantly impact local economies and communities. Ensuring that it is 'just' requires that principles of equity and sustainable development are incorporated; it does not imply slowing the pace of decarbonisation. This includes that workers and local communities are respected and empowered.

The decarbonisation agenda and development of climate solutions will generate new jobs that can contribute to social inclusion and poverty alleviation. This in turn can support environmentally sustainable, competitive economies. Investors encourage banks to support these objectives through Just Transition policies.



41 NGFS, 2019 (p.30) [https://www.ngfs.net/sites/default/files/medias/documents/ngfs\\_first\\_comprehensive\\_report\\_-\\_17042019\\_0.pdf](https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf) [date accessed: 08/03/2023]

42 See for instance, <https://www.lse.ac.uk/granthaminstitute/publication/financing-climate-action-with-positive-social-impact-how-banking-can-support-a-just-transition-in-the-uk/> [date accessed: 08/03/2023]

43 International Labour Organisation: Guidelines for a just transition towards environmentally sustainable economies and societies for all [https://www.ilo.org/wcmsp5/groups/public/@ed\\_emp/@emp\\_ent/documents/publication/wcms\\_432859.pdf](https://www.ilo.org/wcmsp5/groups/public/@ed_emp/@emp_ent/documents/publication/wcms_432859.pdf) [date accessed: 08/03/2023]

44 See [https://www.un.org/development/desa/indigenouspeoples/wp-content/uploads/sites/19/2018/11/UNDRIP\\_E\\_web.pdf](https://www.un.org/development/desa/indigenouspeoples/wp-content/uploads/sites/19/2018/11/UNDRIP_E_web.pdf) [date accessed: 08/03/2023]

## 10 ANNUAL REPORTING AND ACCOUNTING DISCLOSURES

### TCFD Reporting

Banks should comply with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and include TCFD reporting in their annual report. In keeping with TCFD guidance, this should cover the four pillars of the TCFD recommendations: governance, strategy, risk management, and metrics and targets<sup>45</sup>. As noted above, this should incorporate a detailed articulation of the decarbonisation strategy.

In keeping with local prudential regulation, banks will be increasingly undertaking climate stress testing analyses of their balance sheets. We expect this to gather pace as recommendations from the Network for Greening the Financial System (NGFS) are reflected in national oversight regimes<sup>46</sup>. Investors have an interest in the results of this work. This would also normally feed into financial statement assumptions and disclosures (see below).

### Climate accounting and auditing

In keeping with existing accounting standards and local laws, banks' financial statements should be consistent with their climate commitments and TCFD reporting. They should ensure all material climate risks are reflected in critical accounting assumptions and judgements, including expected impacts from the physical effects of climate change, accelerating decarbonisation and their own climate-related commitments<sup>47</sup>.

Investors expect banks to disclose all critical quantitative assumptions, including those that have been modified to reflect material climate factors. Banks should ensure their forward-looking assumptions (for instance relating to credit loss provisioning) consider how climate change will impact future economic growth, asset valuations and financing conditions. It is likely that future economic conditions will be impacted by climate change, so investors would expect assumptions to change to reflect this.

Banks should provide sensitivity analyses in the Notes to their Accounts to provide visibility for how climate-related scenarios (such as those proposed by the NGFS<sup>48</sup>) would impact banks' financial positions. These sensitivities should include a 1.5°C scenario as well as testing the financial impacts of physical risk in higher warming scenarios.

The Audit Committee should task external auditors with testing management assumptions and judgements for consistency with climate-related disclosures, material climate-related impacts and the credibility of the 1.5°C sensitivity provided in the Notes to the accounts. Any issues should be flagged in the auditors' report to shareholders.

**Rationale:** The disclosures outlined above are essential to ensure that financial climate-related risks are not hidden in banks' balance sheets. Climate-related risks – affecting a widening range of sectors and economies – are material to banks, and are increasingly being underlined by prudential authorities such as the Financial Stability Board<sup>49</sup>. Many regulators are undertaking detailed climate stress testing to better understand banks' exposure and resilience to climate risks.

Investors have set out their expectations for improved disclosure on how climate risks are being considered in company accounts, including disclosures on the implications of a 1.5°C pathway for capital positions<sup>50</sup>. For banks, investors do not currently have visibility of regulatory assessments of bank-level exposures but expect any material climate risks to be properly reflected in banks' financial statements in line with existing laws and accounting standards.

45 <https://www.fsb-tcfd.org/publications/> [date accessed: 08/03/2023]

46 [https://www.ngfs.net/sites/default/files/medias/documents/ngfs\\_guide\\_for\\_supervisors.pdf](https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf) [date accessed: 08/03/2023]

47 See: IASB, <https://www.ifrs.org/news-and-events/news/2020/11/educational-material-on-the-effects-of-climate-related-matters/> [date accessed: 08/03/2023]; FRC, [https://www.frc.org.uk/getattachment/65fa8b6f-2bed-4a67-8471-ab91c9cd2e85/FRC-TCFD-disclosures-and-climate-in-the-financial-statements\\_July-2022.pdf](https://www.frc.org.uk/getattachment/65fa8b6f-2bed-4a67-8471-ab91c9cd2e85/FRC-TCFD-disclosures-and-climate-in-the-financial-statements_July-2022.pdf) [date accessed: 08/03/2023]; ESMA, [https://www.esma.europa.eu/sites/default/files/library/esma32-63-1320\\_esma\\_statement\\_on\\_european\\_common\\_enforcement\\_priorities\\_for\\_2022\\_annual\\_reports.pdf](https://www.esma.europa.eu/sites/default/files/library/esma32-63-1320_esma_statement_on_european_common_enforcement_priorities_for_2022_annual_reports.pdf) [date accessed: 08/03/2023]

48 See NGFS guidance: <https://www.ngfs.net/> [date accessed: 08/03/2023]

49 <https://www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/> [date accessed: 08/03/2023]

50 IIGCC investor expectations for Paris-aligned accounts: <https://www.iigcc.org/download/investor-expectations-for-paris-aligned-accounts/?wpdmdl=4001&refresh=63d00fdb343c11674579931> [date accessed: 08/03/2023]; A statement calling for Paris-aligned accounts was released by the Principles for Responsible Investment (PRI), the UN Environment Programme Finance Initiative (UNEP FI), the Chair of the Steering Group of the UN Convened Net-Zero Asset Owner Alliance initiative, Institutional Investors Group on Climate Change (IIGCC), Investor Group on Climate Change (IGCC), the Asia Investor Group on Climate Change (AIGCC), and the UK's Pensions and Lifetime Savings Association on 16th September 2020: <https://www.unpri.org/accounting-for-climate-change/public-letter-investment-groupings/6432.article> [date accessed: 08/03/2023].



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