



Aligning the Banking Sector with the Goals of the Paris Agreement

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IIGCC

The Institutional Investors
Group on Climate Change

About IIGCC

The Institutional Investors Group on Climate Change (IIGCC) is the European membership body for investor collaboration on climate change and the voice of investors taking action for a prosperous, low-carbon future. IIGCC has more than 300 members, mainly pension funds and asset managers, across 22 countries, with over €37 trillion in assets under management. Our mission is to mobilise capital for the low-carbon transition and to ensure resilience to the impacts of a changing climate by collaborating with business, policy makers and fellow investors. IIGCC works to support and help define the public policies, investment practices and corporate behaviours that address the long-term risks and opportunities associated with climate change. For more information visit www.iigcc.org and [@iigccnews](https://twitter.com/iigccnews).

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Introduction – why banks should be Paris-aligned¹

This document sets out investor expectations for banks to manage climate-related risks and opportunities by aligning their activities with the goals of the Paris Climate Agreement². It seeks to build upon other initiatives, such as PACTA and PCAF, by clarifying investors' positions and requests.

A core objective of the 2015 Paris Agreement is to make “*finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development*”³. In 2018, the Intergovernmental Panel on Climate Change (IPCC) published a special report⁴ showing the urgency of keeping warming below 1.5°C to avoid harmful – and often devastating – societal consequences, and of reaching net zero CO₂ emissions by 2050⁵ in order to do so.

The warming of the world's climate and policy responses to drive decarbonisation in line with the Paris Agreement creates an unprecedented challenge for banks. The Financial Stability Board has pointed to the multiple transitional, liability and physical risks that the sector faces across all its activities, and the vital importance that these are properly managed⁶. While a great deal of the focus has been on the lending activities of banks, other activities such as asset management⁷, investment banking and underwriting should not be overlooked. This will require a shift in the strategy of each organisation.

At a high level, banks need to reduce financing of fossil fuel and other activities that generate significant levels of CO₂, and increase funding of low carbon solutions to facilitate the transition towards net zero emissions by 2050. According to the IPCC, estimates of the investment required to keep warming below 1.5°C range from USD 1.6 trillion to USD 3.8 trillion annually between 2016 and 2050 for supply-side energy system investments alone. Most discussions of climate action focus on energy, industry and transport. A special report from the Intergovernmental Panel on Climate Change (IPCC) states unequivocally that land is critically important as well—both as a source of greenhouse gas emissions and as a climate change solution. There is also a need to invest in adaptation to build resilience, such as in urban infrastructure. The Global Commission on Adaptation finds that investing \$1.8 trillion globally from 2020 to 2030 could generate \$7.1 trillion in total net benefits⁸. These enormous shifts in capital away from fossil fuel-based activities towards the clean economy present both risks and opportunities for banks. Investors and the public need both a clear commitment that banks are shifting their strategies to align with achieving net zero emissions by 2050, and also better disclosure about how this is to be achieved.

This paper is broken down into three sections⁹:

Alignment with the goals of the Paris Agreement; Governance of Climate Risk; and Disclosure. The expectations outlined are offered from the perspective of international equity and fixed income investors and, thus, are pertinent to both listed and private banks located in all geographies.

1 Alignment with the Paris goals

Investors request that banks align their provision of finance with the delivery of the goals of the Paris Agreement and the achievement of global net zero carbon emissions by 2050. This means that banks should steadily eliminate their financing of fossil fuel and other misaligned activities not consistent with a 2050 emissions target, while increasing finance to zero and low-carbon solutions that are vital to its achievement.

Net zero Commitment by 2050 and interim targets

- **Investors request banks commit to becoming net zero by 2050.** Banks should address the emissions associated with their operations (Scope 1 and 2 emissions). However, because the bulk of their emissions are associated with their financial services, including commercial, project and retail lending, investment banking, securities trading, etc (Scope 3), the primary effort should be towards ensuring these indirect emissions are brought down to net zero by 2050.
- **A clear timeline with milestones and interim targets for getting to net zero emissions by 2050.** Investors ask that this is supported by steadily tightening conditions tied to financing activities (see below under Engagement and Collaboration).
- **Such policies should integrate the concept of a Just Transition in all regions,** by considering the negative economic and social consequences on particular workers and communities that are dependent on today's emissions intensive economy, keeping in mind that this must not call into question the importance of addressing climate change, which threatens humanity more broadly.

Engagement, Collaboration and Withdrawal of Finance

- **Investors request banks set explicit conditions when providing financing tied to net zero commitments, with clear timelines and milestones for reducing emissions.** We ask that banks develop short- and medium-term greenhouse gas emission targets by sector/ geography to guide the conditions applied, and reduce financing of misaligned activities while scaling up green financing. These targets should cover scope 1 to 3 emissions and we ask that engagement activities and progress towards targets be reviewed and reported annually.
- **Establish transparent sector/industry emission pathways to guide financing policies¹⁰.** Prioritise sectors and industries more likely to be financially impacted by the energy transition, such as those identified by the Task Force on Climate-related

Financial Disclosures (TCFD): Energy; Transportation; Materials and Buildings; and Agriculture, Food, and Forest Products. Investors expect that activities already generally incompatible with the goals of the Paris Agreement are prioritised for curtailed financing. This includes coal mining, coal-fired power generation and oil sands extraction, but also those activities causing emissions through unsustainable deforestation and land use change, in both developed and emerging countries. Investors also ask banks to encourage TCFD disclosure from clients across all sectors, and require it at least from clients operating in critical sector groups, as defined above.

- **Avoid facilitating 'leakage' and over-reliance on unproven or un-costed negative emissions technologies / offsets.** Rather than carbon-intensive assets being sold on for continued use elsewhere, clients should be encouraged to either retire assets at end of life or before major capex decisions, or to retrofit with green technologies.
- **Collaboration with peers and industry actors** will ensure a common framework is used to assess and facilitate the decarbonisation of a sector. The Poseidon Principles illustrate such collaboration in shipping. We recognise the existence of other banking sector related climate initiatives and guidelines and will coordinate with them.
- **Investors also request banks set explicit criteria for withdrawal of financing to misaligned activities** that are benchmarked against sector/industry net zero pathways.

Scaling up Green Finance

- **Banks are asked to articulate strategies for scaling-up green finance with clear goals¹¹.** We also request this is supported by ensuring the cost of capital properly reflects falling risks as the world ratchets up support of the Paris goals. Investors believe scaling-up green finance should be additional to – not instead of – achieving absolute emissions reduction targets¹². For the avoidance of doubt, avoided emissions arising from green finance should not be used as an offset when calculating the bank's Scope 3 emissions.
- **Investors request special consideration is made of the need to support developing countries in the transition where relevant.** Banks should support low-carbon growth¹³ where it is most needed and develop innovative financial instruments, such as public-private blended finance initiatives, to drive innovation and fund climate solutions, whilst being mindful of the broader societal impact in the context of the shift to green finance.

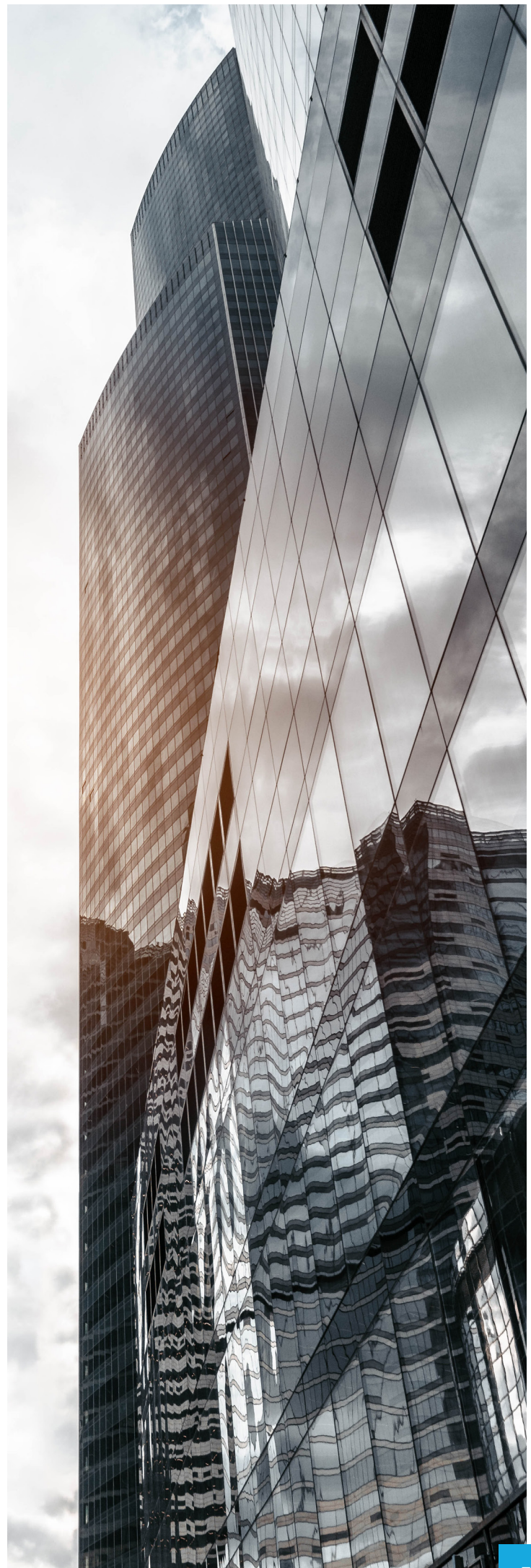
2 Governance of Climate Risks and Opportunities

- **The whole board of directors is accountable for ensuring a bank's strategy is aligned with the net zero commitment.** Investors would like to see a sub-committee to the board, either a new or existing committee such as the Risk Committee, tasked with overseeing the strategy in more detail – including ensuring climate risks and opportunities are embedded into financial planning, enterprise risk management as well as ongoing monitoring of progress against targets – and engaging with internal and external stakeholders. The incorporation of Net Zero commitments into Articles of Association or related governing documents would also be supported.
- **Boards and senior executives should have the requisite skill sets and knowledge to oversee the bank's climate strategy.** Directors require full access to internal and external research and advice to support them in their role of overseeing the climate strategy. Investors request educational programs be developed for staff to better understand how physical and transitional climate risks impact the bank, and the growth in green finance opportunities. A cultural shift is needed at all levels of the company to truly embed a successful net zero strategy. Banks should also set out where responsibility for climate-related risks and opportunities lies within the organisation below board level and the processes for managing them, including where accountability lies at the executive and senior leadership level'.
- **Investors ask that Remuneration Committees ensure variable remuneration is aligned with delivery of the Net Zero commitment and interim targets.** For example, by implementing a 'Paris-underpin' such that performance-related pay is only awarded once the Remuneration Committee affirms that performance is aligned with delivering the net zero commitment and its associated progress timeline. Appropriate clawback provisions could also be considered.
- **We also ask Audit Committees to ensure the financial statements consider material climate risks associated with a move towards net zero emissions by 2050 and Risk Committees to ensure climate risk is effectively integrated in all the key risk categories.** Investors request that Audit Committees be mindful of the guidance provided by relevant standard setting bodies, for example, that recent guidance provided by the International Accounting Standards Board on incorporating climate risks be adhered to, including testing banks' loan loss provisioning and fair value accounting for climate risks¹⁴. The Audit Committee should also ensure the auditor incorporates climate risks into the audit process, and alerts shareholders where there are inconsistencies. Where directors choose not to use Paris-aligned assumptions in their accounts, investors ask that they undertake sensitivity analysis to Paris-aligned assumptions.
- **Investors call for advocacy to be aligned with the Paris Agreement.** Where external policy outreach is undertaken, banks should proactively support government policies aligned with the Paris Agreement.



3 Disclosure

- **We request companies disclose their climate governance, strategy, risk management approach and metrics and targets to be in line with the recommendations of the TCFD^{15, 16}.** Where possible, this should be integrated into the Annual Report and Accounts to shareholders and be independently assured. Investors ask that banks conduct robust scenario analysis. Scenario analysis can be used to test resiliency of the bank to climate-related financial risks and the alignment of the activities to 1.5°C pathway. For example, scenario analysis can be conducted using the recommendations of the NGFS taking into account three scenarios: a smooth transition to 1.5°C which will form the basis of the net-zero strategy and will be the scenario of reference, a disorderly transition to 1.5°C and a higher temperature scenario outcome of +3°C of warming¹⁷. Disclosure should include how the bank will amend its strategy to deliver its commitment to be Paris-aligned and the associated financial implications.
- **Investors ask banks to assess and disclose the greenhouse gas emissions associated with their financing activities, including lending, underwriting, investments, etc¹⁸.** Monitoring such emissions will help achieve emissions reduction targets.
- **Ratios of ‘green’ and ‘non-green’ finance may be useful in demonstrating alignment to the Paris Goals, but should be balanced and understandable.** To enable standardisation and comparison, banks should work to provide disclosure according to a global taxonomy¹⁹ and explain how such classification is being applied to their products. Example metrics could include the amount and proportion of high carbon assets relative to total assets and the amount of financing connected to climate-related opportunities.
- **We request that published accounts, including audited and unaudited interim accounts, incorporate material climate risks associated with achieving net zero emissions by 2050²⁰.** Shareholders should have visibility over the exposure of banks’ loan and trading books to climate risks – both transitional and physical. Where assumptions used are not Paris-aligned, we encourage directors to disclose in the notes to the accounts how such assumptions would impact the reported numbers.
- **Investors ask that auditors alert shareholders where accounts are not Paris-aligned.** If not provided by directors, the auditor should offer supplementary disclosures to indicate the potential sensitivity of the financial statements to using Paris-aligned assumptions. The auditor should attest to the consistency between the narrative disclosures on climate risks with the assumptions underpinning the financial statements.



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Endnotes

- 1 This investor expectations document is part of IIGCC's Paris Aligned Investment Initiative which is working toward developing a comprehensive approach for aligning investment portfolios with the Paris Goals and is intended as a first step for determining how banks can be considered 'Paris aligned' as part of the recently launched Net Zero Investment Framework.
- 2 Other actors of the financial system such as stock exchanges, insurers and ratings agencies also play a critical role in the delivery of the goals of the Paris Agreement. This paper focuses on banks in the first instance.
- 3 Article 2.1c – see: https://unfccc.int/sites/default/files/english_paris_agreement.pdf
- 4 <https://www.ipcc.ch/sr15/>
- 5 Specific timelines for reaching net-zero may vary by region, for example in developing markets.
- 6 <https://www.fsb.org/work-of-the-fsb/policy-development/additional-policy-areas/climate-related-financial-disclosures/>
- 7 The IIGCC Paris Aligned Investment Initiative seeks to help institutional investors implement their ambitions to reduce carbon emissions and increase investments in climate solutions in line with the Paris goals.
- 8 GCA 2019 <https://gca.org/global-commission-on-adaptation/report>
- 9 This framework is aligned with that used by Climate Action 100+.
- 10 There are several initiatives underway to establish sector/industry net zero pathways, notably the Science-based Target Initiative.
- 11 Emerging frameworks, such as the EU taxonomy, will increasingly be used to classify what constitutes 'green' or 'sustainable' finance.
- 12 Green bonds are one tool for achieving this, voluntary guidelines are provided by the Green Bond Principles (GBP) from the International Capital Market Association (ICMA)
- 13 Low carbon growth should not be interpreted as a free-pass to include enhanced gas infrastructure investment as this would also amount to lock-in of carbon-intensive infrastructure.
- 14 <https://www.ifrs.org/news-and-events/2019/11/nick-anderson-ifrs-standards-and-climate-related-disclosures/>
- 15 Bank-specific guidance is provided in the TCFD Annex: <https://www.fsb-tcfd.org/wp-content/uploads/2017/12/FINAL-TCFD-Annex-Amended-121517.pdf>
- 16 Additional disclosure requirements will also need to be adhered to, such as EU Guidelines on Climate-related Disclosures (part of the NFRD) for EU banks.
- 17 These scenarios are in line with the recommendations of the Network for Greening the Financial System https://www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_scenario_analysis_final.pdf
- 18 The Partnership for Carbon Accounting Financials (PCAF) – a finance industry collaboration – is developing one potential framework for measuring carbon emissions embedded within banks underlying loans and other financing activities.
- 19 The EU taxonomy for example is aimed at providing a classification system to identify economic activities that support the transition to a low-carbon economy.
- 20 Please refer to IIGCC, "Paris-aligned audited accounts: investor expectations", 2020 for more detail.

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