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Banking on climate neutrality

The global banking industry's role in transitioning to a low-carbon economy

MAKING AN IMPACT THAT MATTERS since 1845

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Foreword

At COP 26, the 2021 United Nations climate conference, 190-plus nations agreed to boost the rate of their greenhouse-gas emission cuts. At the same time, financial institutions committed to align US$130 trillion of private capital with the goals of the 2015 Paris Agreement by 2050. The Paris Agreement calls for limiting global warming to 1.5 degrees Celsius over preindustrial levels.

One year later, where does the banking industry stand?

To find out, the International Banking Federation (IBFed) and Deloitte surveyed 39 bank executives and directors from Europe, Asia, Africa, Australia, and North America. We also interviewed representatives of nine banks, ten banking associations, and one international organization. The results are reflected in this report.

Environmental, social, and climate-related issues are materially impacting all sectors of the economy. Real economy sectors are busy finding ways to decarbonize their business according to net-zero commitments and related transition plans. While governments, governmental agencies and carbon-emitting industries need to drive effective solutions to climate change, banks—as financial intermediaries and central players of any economy—play an important role in supporting the transition of their clients in different real economy sectors.

Indeed, in their transition strategies, banks must consider not only the transition of their own operations but, more importantly, the emissions of their financed activities as well. Financed emissions represent around 75% of the carbon footprint for banks and are extremely difficult to measure. Nevertheless, they are an opportunity for banks to play a pivotal role in reaching net-zero throughout the economy.

To fulfil their role as financial intermediaries who can support the transition to climate neutrality, banks are increasingly evaluating business opportunities, risks, and ways to support and accompany clients on the journey to climate neutrality. Along the way, they are reviewing their own operating and business models to ensure that climate-related matters are adequately addressed in their own operations, as well as in their financing activities and engagement with clients. Banks must pay close attention to how capital is redirected and to the risk of potentially stranded assets that have, or will, be suffering from unanticipated or premature write-downs, devaluation, or conversion to liabilities. Considerations on stranded assets will play a significant role in the transition to climate neutrality of lending and investment portfolios.

The success of the transition depends on a collaborative, cross-sectoral, and cross-institutional approach to solutions that could benefit everyone. We hope the banking representatives who shared their observations with our research team inspire all who wish to progress on their own journey to a low-carbon future.

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Glossary

CCCA: Collective Commitment to Climate Action

COP: Conference of the Parties

EFRAG: European Financial Reporting Advisory Group

ESAP: European Single Access Point

ETS: Emission Trading Scheme

GFANZ: Glasgow Financial Alliance for Net-Zero

GHG: greenhouse gas

IEA: International Energy Agency

ILO: International Labour Organization

IPCC: Intergovernmental Panel on Climate Change

IRA: Inflation Reduction Act

NDC: Nationally Determined Contribution

NGFS: Network of Central Banks and Supervisors for Greening the Financial System

NZBA: Net-Zero Banking Alliance

PCAF: Partnership for Carbon Accounting Financials

SBTi: Science Based Targets initiative

SME: small and medium-sized enterprise

TCFD: Task Force on Climate-related Financial Disclosures

UNDP: United Nations Development Programme

UNEP FI: United Nations Environment Programme Finance Initiative

UNFCCC: United Nations Framework Convention on Climate Change

Introduction

The global sustainability landscape

For some banks, sustainability is at the heart of their strategic mission. For others, it is a regulatory, social, or business obligation. Either way, banks are aware of the challenges and opportunities that come with sustainability and are actively working on them.

Following the agreements reached at the Paris Conference of the Parties (COP) in 2015, banks are moved by their own mission, governments, and society to focus on how to support the decarbonization of the economy to reach climate neutrality. This can be done via the decarbonization of their own operations, but more importantly, in their role of financial intermediaries, through the financial and advisory services they provide to their clients. Banks are part of a complex ecosystem where stakeholders across all different sectors of the economy, including governments and companies, are planning, or starting to plan their decarbonization paths. Banks can and will play an important role in supporting these stakeholders by financing their transition.

What is climate neutrality?

According to the UN Framework Convention on Climate Change (UNFCCC):

> Climate neutrality refers to the idea of achieving net-zero greenhouse gas (GHG) emissions by balancing those emissions so they are equal (or less than) the emissions that get removed through the planet's natural absorption; in basic terms it means we reduce our emissions through climate action.[1]

In this view, net-zero does not mean the complete elimination of GHG emissions. It means limiting anthropogenic GHG emissions to an amount the planet can naturally absorb.

To facilitate the decarbonization and reach the expected targets, coordination is needed across all economic sectors. Since the Paris Agreement there has been an increase in the number of international and national initiatives to help various types of stakeholders – including banks – to facilitate their efforts. [2] But the plethora of initiatives can be hard to navigate, especially for banks with multinational operations. The guidelines, targets, and approaches coming out of these initiatives tend to vary. The initiatives also tend to reflect the economic, political, social, or cultural environment of the nations where they originate.

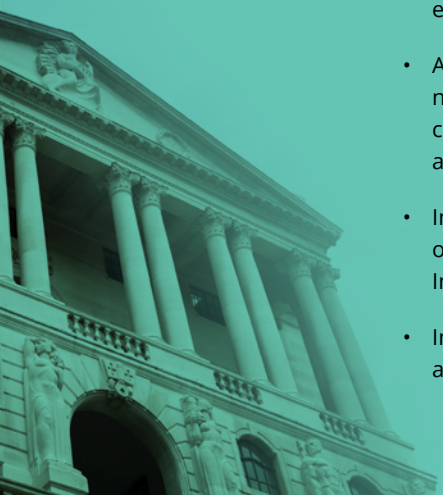
In addition, not all countries have currently integrated and structured sustainable finance activities. To the extent they do, regulations often have different focus areas and different levels of specificity.

The variety or lack of initiatives and regulations is an issue for banks. It means their measures of financed emissions may be less than complete or accurate, getting in the way of target setting and progress tracking according to harmonized measurement methodologies. Being able to access, assess, and compare data is fundamental, and readiness on this front seems to diverge across institutions and countries as well. And without credible data, banks could face difficulties providing transparency to clients who can then take the necessary and informed investment decisions relative to climate neutrality.

It is against this backdrop that we decided to explore the commonalities and differences that banks across the globe experience as they journey toward climate neutrality.

[1] A Beginner's Guide to Climate Neutrality | UNFCCC.

[2] Please refer to the Appendix for the list and description of initiatives we mostly refer to within this report.



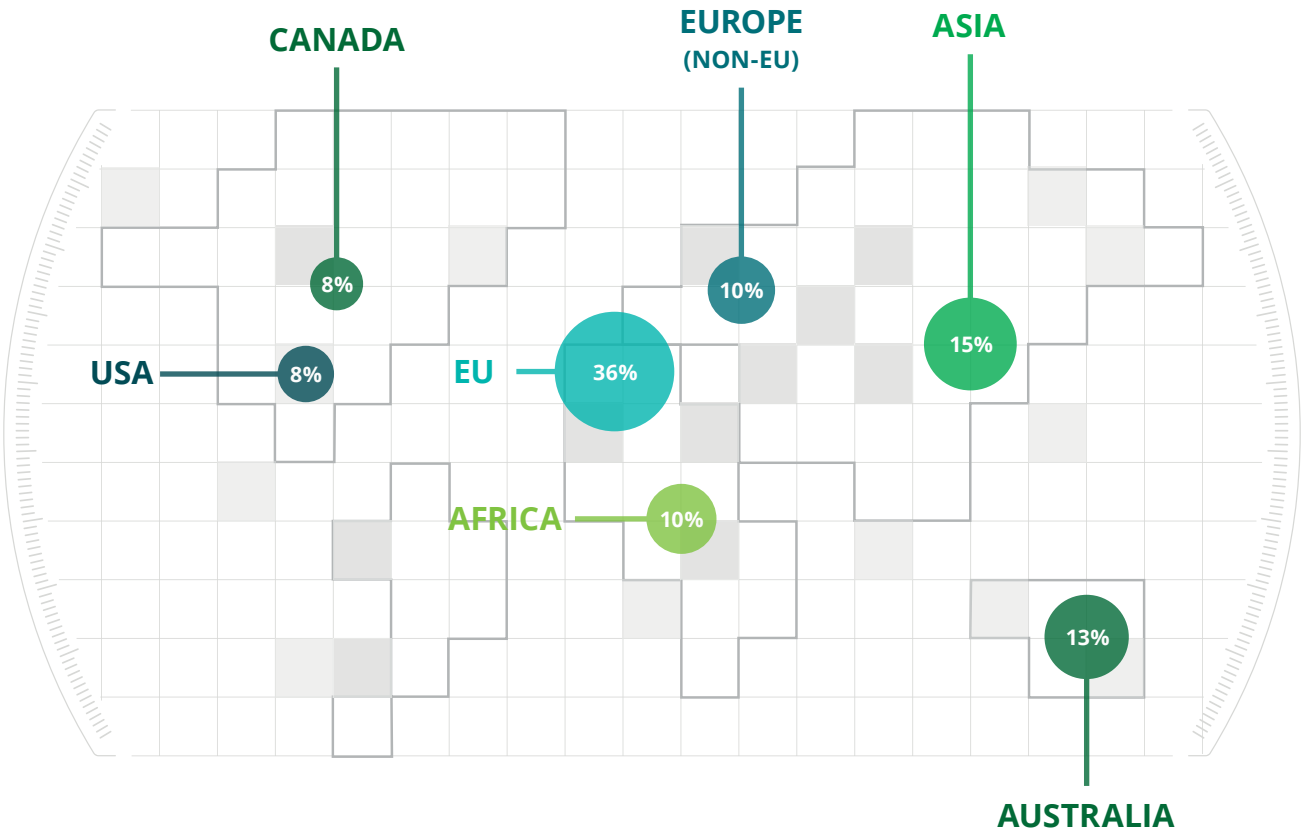
Research methodology

We pursued four avenues to gather insights for this report:

- Desk research to understand the current state of the climate neutrality transition, the efforts underway, and the socio-economic-political contexts of different jurisdictions.
- An online survey of bank executives and directors about how banks are tackling climate neutrality, what challenges they face, and what priorities they have. Survey input contributed to comparable insights. The survey included both open-ended, single-option and multiple-option questions.
- Interviews with sustainability specialists at banks to verify and deepen our understanding of certain hypotheses and findings identified via the desk research and the survey. Interviews were held between August and October 2022.
- Interviews with other subject matter experts in the banking sector, including industry associations and international organizations

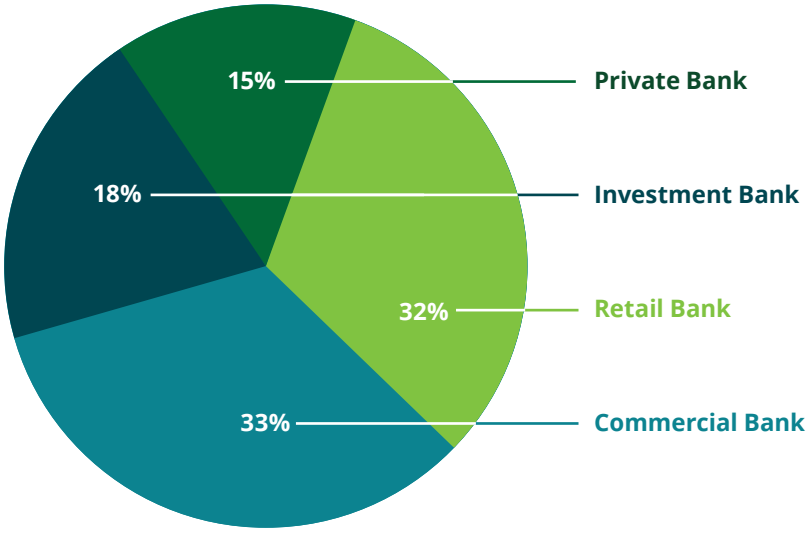
The survey took place between August 1 and September 15, 2022. Thirty-nine executives and directors responded from 21 countries. Follow-up interviews solicited insights into six countries outside the scope of the survey: Brazil, China, Columbia, Kenya, Mexico, and Turkey. All told, the survey covered seven geographical regions (Figure 1).

Figure 1: Survey respondents by geographical region



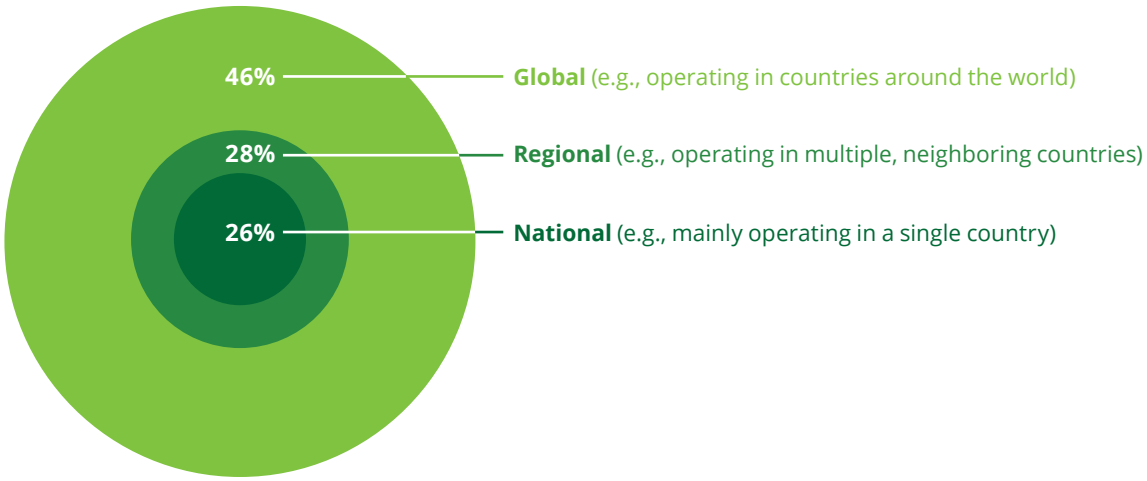
Respondents represent different sectors of banking activity, including retail, commercial, private, and investment banks (Figure 2).

Figure 2: Survey respondents by type of banking activity



A plurality of respondents represents global banks, with the remainder split about evenly between national and regional banks (Figure 3).

Figure 3: Survey respondents by geographic reach



Key findings

Our research has led to seven key findings about the banking industry's climate neutrality efforts.

1. There is major agreement among national jurisdictions on the need for a just transition to climate neutrality. 2050 is recognized by the Intergovernmental Panel on Climate Change (IPCC) and other scientific bodies as the date by which net-zero should be reached in order to limit the temperature rise below 1.5 degree and to align with the Paris Agreement. However, the timelines for reaching intermediary and final net-zero targets vary depending on the country or region. **Most banks are relying on different international and national initiatives to guide their work toward climate neutrality.** It may be challenging for banks to achieve net-zero targets earlier than what the economies in which they operate are prepared to achieve.

2. Mostly driven by their own mission, but also client demand, most banks globally are forging ahead with plans to support climate neutrality goals as they believe banks play an important role in the transition to a low-carbon economy. Banks must do so while managing the climate-related and environmental risks, the risk of devaluation of their assets into stranded assets, and the expectations of regulators. **For this reason, while most respondents across geographies believe that they should play a central role in the transition to climate neutrality, some specify that banks should not be considered drivers of the transition, but facilitators.** That includes focusing on the areas they can influence most to achieve positive impact.

3. Important as they are, banks are but one player in a national and regional ecosystem. Carbon-heavy sectors must do their part by innovating to reduce their carbon footprint. Meanwhile, to address uncertainties (primarily regulatory) and region-specific issues, **governments and other industries must respond with clearer guidance, harmonized methods, and coordination.**

4. In some jurisdictions, exclusion policies have been the main tool for mitigating banks' climate impact. These are no longer sufficient to achieve climate neutrality objectives. In the interest of transforming rather than divesting, **other mitigation actions include client engagement programs and sustainable finance through product and service innovation.**

5. While GHG emissions measurement is considered key to set targets and align on climate neutrality, we find that **Scope 3 emissions measurement is still a challenge for most banks** and corporates due to significant data limitations and the lack of harmonized methodologies (despite the emergence of initiatives such as the Partnership for Carbon Accounting Financials, or PCAF).

6. The current energy crisis will have an undeniable impact on banks' ability to plan and implement their climate neutrality work, because of the inevitable impacts on the entire ecosystem (governments and clients alike). In the short term, energy choices may temporarily revert to higher-emitting energy sources. But this does not change the overall trajectory of sustainability—in general, respondents say they remain committed to their previous commitments and priorities. In the medium to long term, **the energy crisis can be a strategic opportunity to accelerate more sustainable energy production and reduce dependency on emission-intensive energy sources.** Because of this, the road to climate neutrality may not be linear and banks may have to adapt the timing of their specific targets and plans for specific clients.

7. **A just transition to climate neutrality is necessary to maintain social cohesion.** In turn, the right level of social engagement is key to ensuring the transition is supported by all stakeholders. Developing countries will require financial and technological support from developed countries to achieve a just transition.

In the sections that follow, we take a closer look at each of these key findings. First, we discuss the extent to which the banking industry has committed to the transition to climate neutrality. Next, we review specific national and regulatory developments that may be influencing the actions banks choose to take. After that, we look at what is driving the climate neutrality commitments that banks are making along with the strategies and approaches banks are pursuing to achieve the transition. We conclude with an exploration of the challenges banks are encountering and the priorities they (and others) could set to successfully guide the way to climate neutrality.

The decision to commit: how are banks intending to achieve climate neutrality

Key insights

- Nearly all the banks surveyed have committed to transition to climate neutrality at some point, with most having committed to become net-zero by 2050
- Not every jurisdiction in which banks operate has committed to achieve climate neutrality, and specific plans can vary significantly from one jurisdiction to another
- Some inconsistencies are likely due to the structural "stumbling blocks" that countries face, and which can vary across the globe
- Regulations are emerging around climate neutrality and are similarly diverse, impacting both financial (sustainable finance) and real economy sectors
- National central banks have their own role in the journey to climate neutrality

Nearly all the banks surveyed have committed to transition to climate neutrality at some point, with most having committed to become net-zero by 2050

The majority (85%) of banks who participated in the survey confirmed they have committed to achieve climate neutrality at some point. The decision to align seems to be distributed across all regions, with banks from some countries only having flagged that they have not committed to achieve climate neutrality, but that they have plans to align (Figures 4 and 5). [3]

Figure 4: Commitments to achieve climate neutrality among surveyed banks

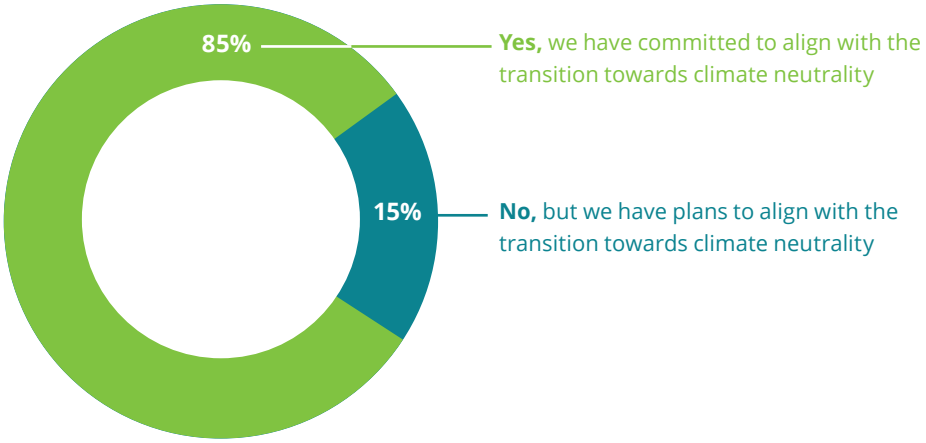
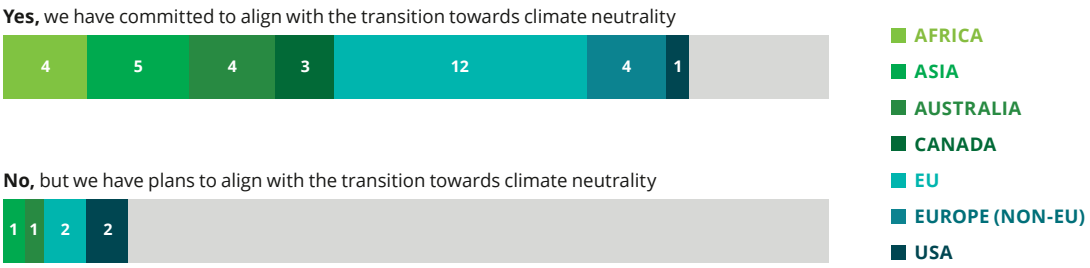


Figure 5: Commitments to achieve climate neutrality, by geographical region of surveyed banks



[3] Note: No respondent chose the option of "No, and we do not have any plans to address the transition towards climate neutrality," which was also possible within the survey question.

Most respondents (67%) have committed to achieving climate neutrality by 2050 in line with the Paris Agreement (Figures 6 and 7). It should be noted that among the "earliest" adopters, that is banks that committed to reach climate neutrality (net-zero) by 2035, one bank specified that they are "committed to be a net-zero emissions company by 2030 on the operations and investment side."

Figure 6: Extent of the commitments to achieve climate neutrality among surveyed banks

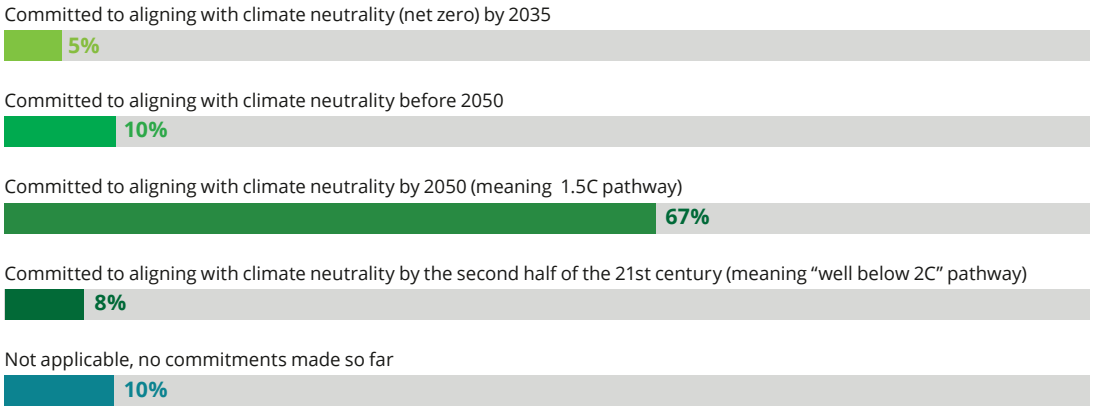
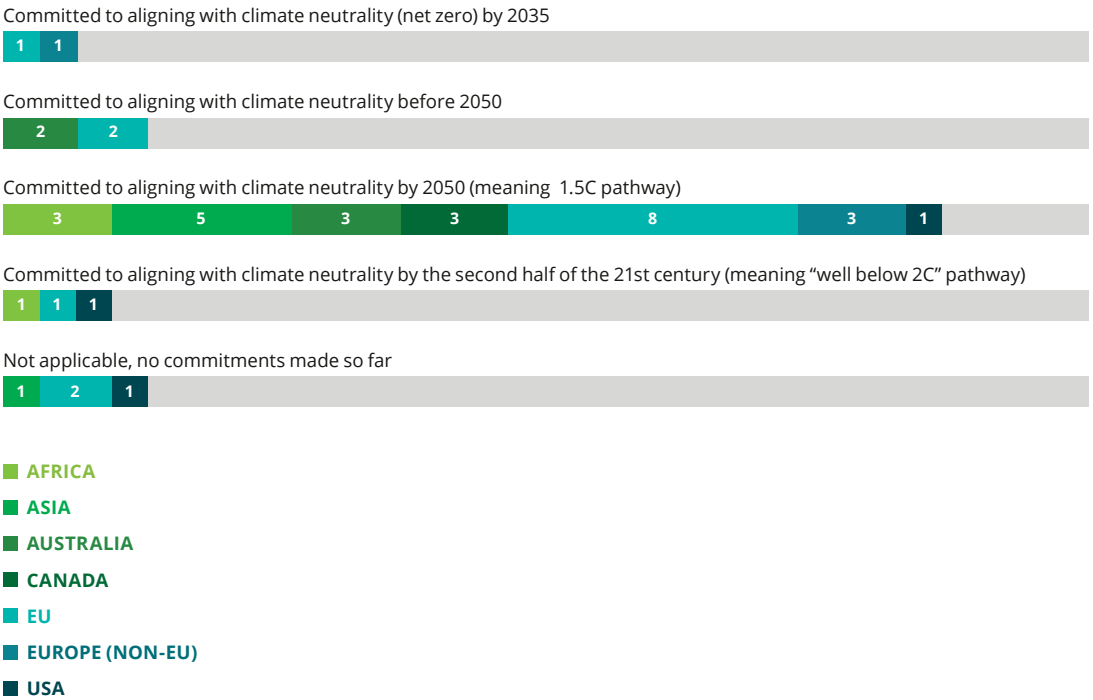
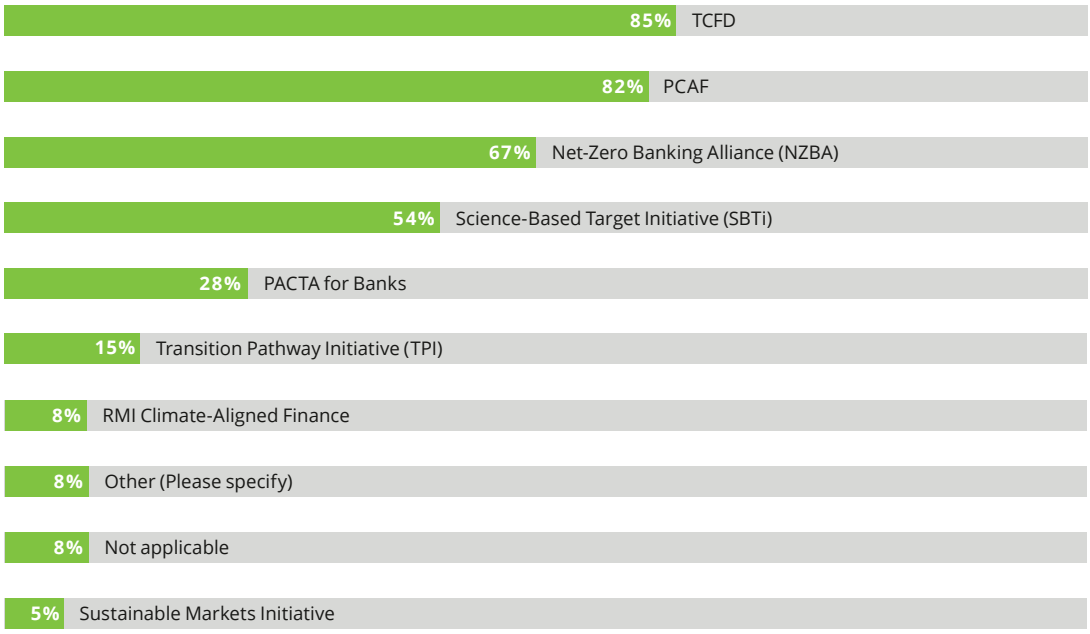


Figure 7: Extent of commitment to achieve climate neutrality, by geographical region of surveyed banks



To support these commitments, a variety of tools and methodologies are available for financial services firms to improve consistency of measurements for climate-related exposures. Looking at global banking initiatives, methodologies, and tools, the Task Force on Climate-related Financial Disclosures (TCFD) is the most frequently utilized initiative, followed by the PCAF, the Net-Zero Banking Alliance (NZBA) and the Science-Based Targets initiative (SBTi) (see Figure 8). Among survey respondents who provided additional comments, some banks indicated that they were part of the Collective Commitment to Climate Action (CCCA) by the United Nations Environment Programme Finance Initiative (UNEP FI), and that while not yet formally using the SBTi some respondents noted that they are planning to use it in the future.

Figure 8: Uptake by surveyed banks of global initiatives, methodologies, and tools that banks are using for the transition to climate neutrality



Not every jurisdiction in which banks operate has committed to achieve climate neutrality, and specific plans can vary significantly from one jurisdiction to another

Banks operate within country- and region- specific contexts, hence considering banks' efforts to transition to climate neutrality should be framed within jurisdiction specificities including the extent to which jurisdictions themselves have defined their commitments. **Although all the jurisdictions in which banks in our survey are headquartered have signed the Paris Agreement, it does not follow that they have committed to achieve climate neutrality or have defined a detailed policy trajectory.** This is the case even if the nation has ratified the treaty.

The Paris Agreement requires each nation to submit an updated Nationally Determined Contribution, or NDC, every five years. Also known as a national climate action plan, an NDC outlines the steps each country commits to take to reduce its GHG emissions and adapt to the effects of global warming. But a NDC can vary significantly from one jurisdiction to another. The UN itself notes, in its NDC Synthesis Report, that the aggregation of all NDCs does not add up to the action needed to fulfil the goals of the Paris Agreement.[4]

We highlight some specificities and differences below.

EUROPEAN UNION member states updated their NDCs in 2020 to reduce emissions economy wide by at least 55% by 2030 from 1990 levels. Following the EU Green Deal [5], the European Council endorsed the objective of achieving climate-neutrality by 2050 in line with the Paris Agreement. To facilitate decarbonization, the European Council also introduced the "Fit for 55" package, which includes a range of measures, including strengthening of the EU Emission Trading Scheme (ETS).[6] Recognizing the importance of methane as GHG contributor to climate change, the EU has also published a dedicated EU methane strategy and a proposal for reducing methane emissions in the energy sector.[7] In addition, the EU Green Deal also contains a specific forest strategy aiming at improving the quantity and quality of EU forests.[8] Finally, in response to the energy crisis, the EU adopted the RepowerEU Plan to end dependence on Russian fossil fuel as soon as possible.

Similar to the EU, **THE UK** communicated its new NDC in 2022, which commits the UK to reducing GHG by at least 68% by 2030, compared to 1990 levels. The UK Government's Climate Change Act 2008 sets out a policy framework to reduce domestic emissions and ensure the UK adapts to climate change.[9] The UK Climate Change Risk Assessment 2022 prioritizes eight risk areas for action in the next two years with risk to the viability and diversity of terrestrial and freshwater habitats, risks to crops, livestock, and commercial trees being among other priorities.[10]

As far as other European countries are concerned i.e., **COUNTRIES OUTSIDE OF THE EUROPEAN UNION** such as Belarus, Moldova or Caucasus countries, the majority signed the Paris Agreement in 2016 with Belarus and Albania also ratifying the Agreement the same year. Turkey made a climate policy shift ratifying the Paris Agreement in 2021 and committing to net-zero by 2053. The country is now preparing its long-term climate change strategy and action plan to enhance adaptation, financial sector regulators, supervisors and associations are moderately active in terms of climate change, focusing on guidance and education. For six countries (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine), the revision of the NDC was supported by the EU through the EU4Climate initiative, which was funded by the EU and implemented by the United Nations Development Programme (UNDP). The EU4Climate supports the six countries in the Eastern Partnership implement the Paris Agreement and improve climate policies and legislation (Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine).[11]

Following a strengthening of climate and environmental policy ambitions by the **US** government, the US re-committed to the Paris Agreement in 2021. Since then, the following elements are worth noting[12]:

- US NDC emissions reduction of 50-52% by 2030 from 2005 levels, implemented through the Inflation Reduction Act (IRA) signed into law in 2022
- Decarbonization of the power sector by 2030
- During COP 26 the US committed to Methane emissions reduction and action on forestry (however not on coal exit before 2030). Still at COP 26, the US also joined the "Beyond Oil & Gas Alliance" launched to elevate efforts and conversation on the alignment of oil and gas production with the Paris Agreement[13]
- The US and China issued their Joint Glasgow Declaration, emphasizing the importance of the climate challenge and climate-related efforts and identifying areas of joint cooperation[14]

CANADA revised its NDC in 2021 aiming at reducing emissions by 40-45% below 2005 levels by 2030 and reaching net-zero by 2050.[15] The same year, the Net-Zero Emissions Accountability Act was approved, enshrining climate neutrality into law.[16]

AUSTRALIA has passed legislation to reduce emissions by 43% by 2030 from a 2005 baseline. To support such ambition, Australia has a policy suite to support the legislated targets. As part of this, the legislation requires the government to provide regular status updates to the Parliament.[17]

CHINA aims to have CO2 emissions peak before 2030 and achieve carbon neutrality before 2060; to lower CO2 emissions per unit of GDP by over 65% from the 2005 level, to increase the share of non-fossil fuels in primary energy consumption to around 25%, to increase the forest stock volume by 6 billion cubic meters from the 2005 level, and to bring its total installed capacity of wind and solar power to over 1.2 billion kilowatts by 2030.[18]

INDIA has given a commitment of reducing the emissions intensity of the country's GDP by 45% by 2030 and derive about 50% electricity from non-fossil fuel-based energy resources by 2030. India has also committed to achieve net-zero by 2070 in COP 26. India has also recently added a new target of creating a carbon sink of 2.5 to 3 billion tons of carbon dioxide equivalent through additional forest and tree cover by 2030.

MEXICO has focused its public policies on poverty abatement, seeking to achieve an equitable sustainable development following the premise established in the National Development Plan 2019-2024 of "leaving no one behind, leaving no one out." As part of its NDC, Mexico determines unconditional contributions and conditional contributions. Unconditional contributions target a reduction of 22% of GHG emissions and 51% of black carbon emissions by 2030 as compared to the baseline business-as usual scenario. In addition, conditional contributions target a reduction of up to 36% of GHG emissions and 70% of black carbon emissions by 2030 compared to the business-as usual scenario. The strategy pursued includes adaptation components (e.g., resilient production system and food safety) and mitigation components (transport, power generation, residential and commercial, oil and gas, industry, agriculture, waste, land-use, and forestry).[19]

BRAZIL faces the challenge of pursuing efforts to mitigate emissions, while at the same time implementing adaptation actions to cope with the impacts of climate change in its territory. Brazil is committed to reduce its GHG emissions in 2025 by 37%, compared with 2005. Adaptation actions aim at reducing vulnerability in terms of water, energy, food, social, and environmental security. Additionally, Brazil commits to reduce its emissions in 2030 by 50%, compared with 2005. The 2050 target is to achieve climate neutrality.[20]

[4] https://unfccc.int/process-and-meetings/the-paris-agreement/nationally-determined-contributions-ndcs/ndc-synthesis-report/ndc-synthesis-report

[5] A European Green Deal | European Commission (europa.eu)

[6] Fit for 55 - The EU's plan for a green transition - Consilium (europa.eu)

[7] Methane emissions (europa.eu)

[8] Forest strategy (europa.eu)

[9] Climate Change Act 2008 (legislation.gov.uk)

[10] UK Climate Change Risk Assessment 2022 - GOV.UK (www.gov.uk)

[11] European Union for Climate in Eastern Partner countries: Armenia, Azerbaijan, Belarus, Georgia, Moldova, Ukraine (EU4Climate) | United Nations Development Programme (undp.org)

[12] USA | Climate Action Tracker

[13] Beyond Oil & Gas Alliance (beyondoilandgasalliance.com)

[14] U.S.-China Joint Glasgow Declaration on Enhancing Climate Action in the 2020s - United States Department of State

[15] Microsoft Word - Canada's Enhanced NDC Submission_FINAL EN (Aug. 16).docx (unfccc.int)

[16] https://laws-lois.justice.gc.ca/eng/acts/c-19.3/fulltext.html

[17] Australia's climate change strategies - DCCEEW

[18] "China," NDC Partnership.

[19] NDC-Eng-Dec30.pdf (unfccc.int)

[20] NDC revisada inglês FINAL - PDF (unfccc.int)

SOUTH AFRICA has a vision of achieving net-zero carbon emissions by 2050.[21] In 2021, South Africa updated its NDC and submitted it to the UNFCCC prior to COP 26. In the updated NDC, South Africa set a target of reducing emissions by at least 28% from the commitments made in the 2015 NDC. This target is for the year 2030 and the updated NDC makes no mention of a target for 2050. The Presidential Climate Commission, an independent, multistakeholder body established by President Cyril Ramaphosa to oversee and facilitate a just and equitable transition towards a low-emissions and climate-resilient economy, states that "Currently, there is not a sufficient analytical basis to place the 2030 NDC target in the longer-term context of South Africa's in principle commitment to reaching net zero CO2 emissions by 2050 in its Low-Emission Development Strategy (LEDS) submitted to the UNFCCC in 2020. Such work is currently ongoing. Reaching this goal will require very rapid decarbonization of the South African economy in the 2030s and 2040s."[22] Such decarbonization is dependent on transitioning to renewable energy, the cost of which is estimated at approximately $320 million, thus calling for the private sector to play an important role.[23]

Why is it relevant to note these specific details and differences across countries?

The reason is that banks that have a footprint across a number of countries are faced with the challenge of considering a myriad of different variables set by the different countries, including national positions and initiatives on the climate crisis and climate neutrality.

Some inconsistencies are likely due to the structural "stumbling blocks" that countries face, and which can vary across the globe

For developed and emerging nations alike, progress on climate neutrality is subject to **political conditions and related uncertainty.** Political developments such as elections can lead to abrupt changes on environmental policy. Certain stakeholders can have outsized and at times unpredictable influence on lawmakers, lobbying and even litigating to halt climate initiatives they believe are harmful to their interests. Macroeconomic shocks—inflation being a global example—can disrupt the transition and implementation of climate policy as policymakers tend to focus on immediate issues. The risk of climate neutrality being "sidelined" becomes even more likely in the case of major **geopolitical crises** which risks turning into armed conflict. For banks (especially systemic ones) that operate fully embedded in a country or regional ecosystem, a key challenge is to reconcile diverging objectives and financing demands from the public and other sectors without losing sight of their long-term objectives and commitments. While geopolitical crisis such as the recent energy related one could represent a disruption to the transition in the short term, in the mid- to long term it could also contribute to an acceleration of the transition to alternative sources of energies as governments will be seeking to increase their energy independence (see more in the "Spotlight" section).

A country's **economic structure** can also affect how it approaches climate neutrality. Climate negotiations under the UNFCCC process highlight the salience of this issue. **Many developing countries and emerging markets depend on support from developed countries to implement climate neutrality strategies, prompting interest in using public and private sustainable finance to support the transition.** It is acknowledged that trillions of dollars are needed for the world to meet the goal of the Paris Agreement and therefore it is critical that finances, such as the $100 billion pledged to developing nations, leverages and mobilizes private sector finance. In turn, this may influence the role of banks in the transition to net-zero; it also highlights that banks are a key to the transition and that partnerships and collaboration is critical to achieving net-zero goals.

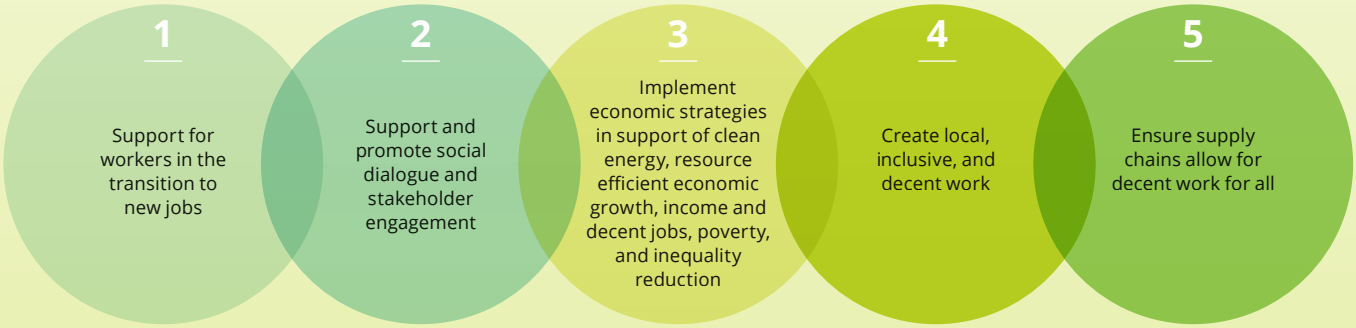
The economic, social, and political challenges mentioned above lead to the need to embark on a transition that is "just." Countries need to balance climate action and climate risk management with the effects of the transition on society and the economy. Transitioning too fast may lead to the stranding of assets and more worryingly to job losses. This type of effects can be enhanced in resource-intensive countries and emerging markets.

"Just transition" explained:

"A Just transition means greening the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities, and leaving no one behind."

– International Labour Organization (ILO)[24]

The importance of just transition was recognized at COP 26 when a Just Transition Declaration was signed committing signatories to strategies that ensure that workers, businesses, and communities are supported as countries transition to greener economies. The Declaration is aligned with the 2015 Guidelines previously issued by the International Labour Organization[25] and include the following principles:



While the Declaration was signed by more than 30 countries, the necessity for just transition may be more or less significant and central depending on the country economic and social specificities.

Like the differences in NDCs and nationally set targets, these country-specific differences also impact banks' plans to align with climate neutrality. **To be able to achieve a real impact, banks cannot avoid considering political, social, and economic variables that are deeply ingrained in the countries in which they operate given that these variables will influence social and cultural trends and thus banks' clients' demand.**

[21] South Africa's Low-Emission strategy 2050 (LEDS) p.21
[22] SOUTH AFRICA'S NDC TARGETS FOR 2025 AND 2030
[23] It-all-hinges-on-Renewables_5th-Sept.pdf (nbi.org.za)
[24] Frequently Asked Questions on just transition (ilo.org)
[25] COP26: ILO welcomes COP26 Just Transition Declaration

Regulations are emerging around climate neutrality and are similarly diverse, impacting both financial (sustainable finance) and real economy sectors

Regulations around climate neutrality are as diverse as the nations producing them. For banks engaging to achieve climate neutrality, there are two types of regulatory developments to watch.

The first type of regulation revolves around financial regulation. This includes mainly

- Regulation to address **greenwashing:** the definition of what could be considered sustainable (taxonomy) and requirements for disclosure
- Regulation to address **governance and due diligence**
- Regulation to address **risk**: incorporation of primarily climate risk in the risk management and supervision, complemented by supervisory exercises such as climate stress test or scenario analyses

A few examples from different countries:

- The EU Sustainable Finance Disclosure Regulation for investment processes and products, the Corporate Sustainability Disclosure regulation for listed undertakings and legal requirements for banks for disclosures on ESG risks, all complemented by the EU Taxonomy related disclosure obligations
- The UK's sustainability disclosure requirements, including legal requirements to disclose climate risk in line with TCFD guidance, and leadership on climate risk management from the Bank of England
- The disclosure regulation introduced by the Tokyo Stock Exchange
- The initiative by South Korea to introduce disclosure regulations by 2030
- The National Instrument Disclosure of Climate-related Matters proposed by the Canadian Securities Administrators
- The Central Bank of Kenya's guidance that includes a requirement to "develop an approach to disclosure on the financial risks from climate change."[26]
- The Green Finance Guidelines for Banking and Insurance Sectors by the China Banking and Insurance Regulatory Commission.[27] China has also introduced guidelines on environmental information disclosure as well as a green finance assessment plan for financial institutions. The quarterly assessment results are included in the rating of financial institutions, as well as the central bank's other policies and prudential management tools.[28]
- Ongoing efforts in South Africa to issue disclosure regulations.
- In the absence of regulations, in India the capital markets regulator and the central bank have taken note of the need for sustainable finance in the aftermath of extreme weather events. Accordingly, in July 2022, the central bank issued a discussion paper on Climate Risk and Sustainable Finance and invited the comments from various stakeholders. In August 2022, the capital markets regulator issued a "Consultation Paper on Green and Blue Bonds as a mode of Sustainable Finance" and invited comments from various stakeholders. The paper deals with debt instruments specifically aimed at raising investments in green projects. These projects include renewable and sustainable energy, clean transportation, climate change adaptation, sustainable waste management and others.

The other type of regulatory development is related to real economy sectors, covering a huge variety of general and sector-specific policies that aim to drive down emissions. Examples include carbon pricing systems and sector-specific mandates like bans on certain polluting industries and incentives to support research and development in new technologies.

Ultimately,

"It is important that sustainable finance regulations and sector policies align."

– Antoni Ballabriga Torreguitart, BBVA

This is because on the one hand it is clear and widely agreed that financial flows need to be directed towards sustainability-oriented solutions, and for this purpose sustainable finance regulations are necessary in order to understand what actually classifies as sustainable and to transparently communicate with clients and investors. On the other hand banks' efforts to reorient financial flows may be hampered if the economic sectors relevant to them do not have supportive policies. A member of the Japanese Bankers Association told us how "some banks expect reduction targets and pathways at specific sectors from the perspective of ensuring accountability."

National central banks have their own role in the journey to climate neutrality

Because of the role central banks play in ensuring price stability, and because of how – through 'transmission channels' – climate-related and environmental risks can influence businesses, assets, and price (among others), central banks can be an important actor in the transition to climate neutrality as 'supporter' of the overall market.

Examples:

The **Bank of England** undertook its first climate "biennial exploratory scenario" in 2021, exploring the financial risks posed by climate change for the largest UK banks and insurers.

The **European Central Bank** recently finalized the climate risk stress test of more than 100 significant banks from the EU. It was a learning exercise for both banks and supervisors to assess the sector's preparedness for managing climate risk and identifying best practices for dealing with this risk effectively.

Both the Bank of England and the ECB work closely with organizations like the **Basel Committee on Banking Supervision and the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) on a coordinated international approach to climate change.** This is important as harmonization will help foster a common understanding of key concepts and promote consistency in approaches, and comparability of results both within and across jurisdictions.

The **People's Bank of China (PBC)** has been taking the lead in formulating green finance standards in China, including taxonomy, disclosures, evaluation, carbon accounting, etc. It has also introduced monetary policy instruments to facilitate green loans. At the global level, the PBC has co-chaired the G20 Sustainable finance Working Group which completed the G20 Sustainable Finance Roadmap and has been comparing green finance taxonomies with the European Commission since 2020.[29]

Finally, the NGFS is in the process of launching an **initiative to further support blended finance opportunities,** tackling any regulatory or practical challenge that may currently be present.[30]

[26] https://www.centralbank.go.ke/wp-content/uploads/2021/10/Guidance-on-Climate-Related-Risk-Management.pdf

[27] CBIRC

[28] China to Assess Banks' Green Finance Performance – ESG Investor
Transcript of Governor Yi Gang's Interview by CGTN (pbc.gov.cn)

[29] Green Finance Supports Achieving Carbon Emissions Peak and Carbon Neutrality (pbc.gov.cn)

[30] "Blended Finance for the Net-Zero Transition" - Opening Remarks by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at the Transition Finance towards Net Zero Conference on 4 October 2022 (mas.gov.sg)

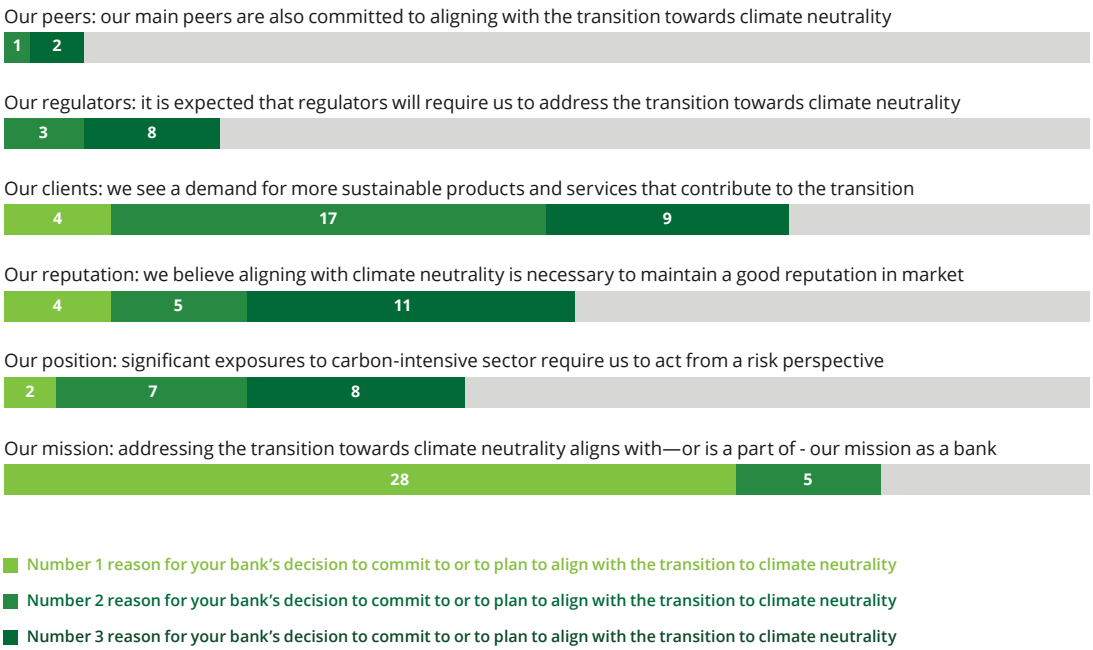
Drivers of commitment: why have banks committed to achieve climate neutrality

Key insights

- Moved by their mission, most surveyed banks are committing to achieve climate neutrality under their own initiative without external triggers
- Stakeholders are also pushing banks to achieve climate neutrality, including clients demanding more sustainable finance products and services

When asked why banks support the transition to climate neutrality, the two top reasons identified were that climate neutrality is central to the bank's mission, and that the bank's clients are demanding more sustainable products and services (Figure 9).

Figure 9: Main reason for surveyed banks to commit to, or plan to align with, the transition to climate neutrality

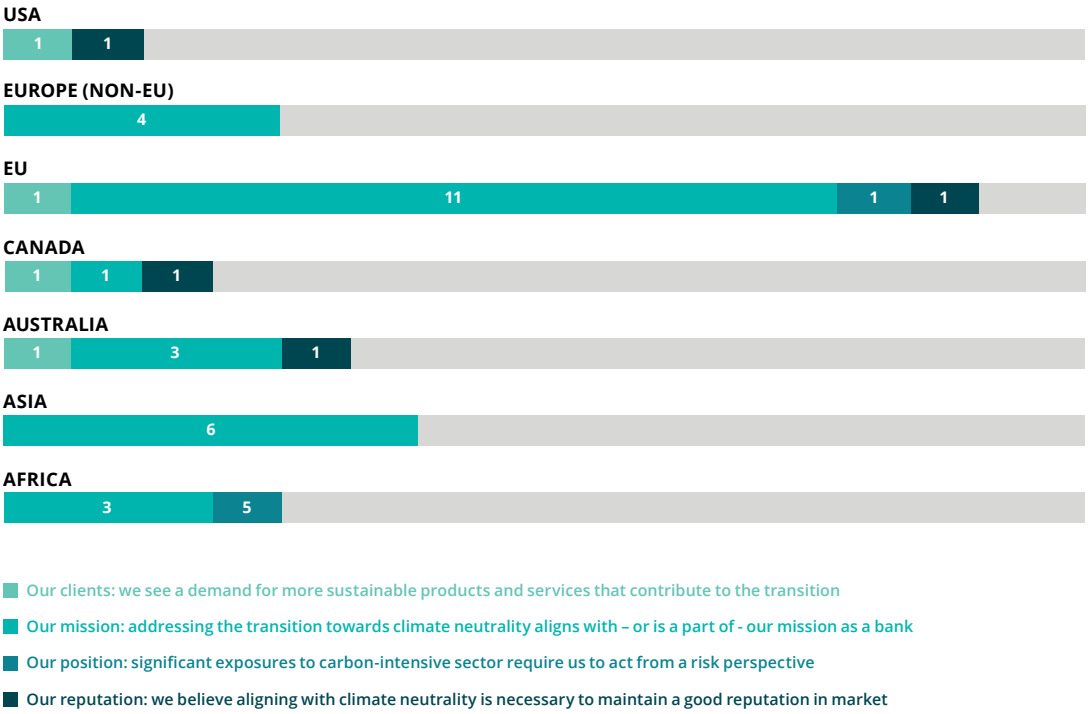


The results vary by respondent location. **Client's demand** as the top trigger for committing to the transition seems most common in certain geographies compared to others (less common for example among survey respondents based in non-EU European countries, Africa, and Asia). Instead, committing because of the **bank's mission** seems to be the number one reason among European, Asian, Australian, and South African banks surveyed. **Reputational considerations as well as considerations about the bank's exposure to carbon-intensive sectors** seems to be the next most popular top trigger for committing (Figure 10). Especially when it comes to European countries (EU and non-EU) the fact that their banks appear to be first and foremost moved by their mission may illustrate two potential scenarios:

1. either these are also countries where the topic of sustainability is so 'ancestrally' ingrained in the vision and strategy that it has naturally trickled down to the companies operating therein, including banks;
2. or some of the banks surveyed in these countries may have been the forerunners, one-sidedly deciding to make sustainability as a whole and climate transition specifically a part of their DNA, a trend which may have then motivated the respective governments to start defining initiatives and bringing more structure to the banking industry. The latter approach was for example the case of Brazil, as mentioned by the Itaú Unibanco representative during the interviews.

Interestingly, even though sustainability has for a long time been considered a risk matter and thus may have been treated in certain countries (and relatedly by the banks therein) with a risk, compliance and regulatory approach, **the regulators never appeared as the top reason for committing to the transition, among the survey respondents**.

Figure 10: Top reason for committing to—or planning to align with—the transition to climate neutrality, by geographical region of surveyed banks



Moved by their mission, most banks are committing to achieve climate neutrality under their own initiative without external triggers

Most bankers say they are **forging ahead under their own initiative.**

"Acting aligns with our mission of feeding into prosperity not off it. We are therefore committed to supporting our customers and communities to mitigate, adapt and respond to climate change while also ensuring that we help our customers and the communities in which we operate, to continue to grow and be successful."

Sally Shepherdson, Bendigo and Adelaide Bank

"It has always been in our DNA to take part in the big challenges and stakes of our society,"

– Groupe BPCE

A clear mission can drive the entire organization to adapt and adjust where and as necessary, including within risk management, development of new instruments and net-zero commitments.

Stakeholders are also pushing banks to achieve climate neutrality, including clients demanding more sustainable finance products and services

"Initially, the demand was for "labelled" sustainable finance. Corporates appreciated having sustainable finance products like sustainability-linked bonds or loans. It was a way to show willingness to engage voluntarily. Now the scope is broader as many clients engaged in a decarbonation path and have committed to net-zero, so the demand is different. Now we're talking about topics requiring a systemic and holistic view, and we see that solutions come from cross sectorial value chains."

– Société Générale

Clients are starting to change their attitudes toward climate neutrality "not only by setting goals, but also by gradually moving into a specific strategic planning and implementation phase." as reported by the Japanese Bankers Association. The position is also shared in Latin America: more and more clients believe they need to engage on the investments side to become more sustainable themselves and in Mexico and Colombia in particular, the appetite for sustainability is increasing, combining not only the topic of climate but also of natural capital and inclusive growth, as reported by the BBVA executive.

However, client demand depends on the nature of the firm. In the UK, banks report offering green-linked retail financing products (like green mortgages), but often see limited take-up from clients amid a lack of appetite to undertake the actions the product requires. **More research will be needed on how potential changes in other sectoral policies, such as regulatory measures in other industries or changes in tax policies, can affect the demand for sustainable finance.** While the demand from large companies has increased in some segments, banks perceive a lack of demand in many segments as well as in retail. Analyses of consumer behavior will be key to understanding possible drivers.

Regardless of the demand, banks may have a sense of responsibility for their clients' sustainability performance. "If we want to address this climate issue, the main impact that we could have as a bank is not only by reducing our own emissions. We have to address the financed emissions. So, the emissions of our customer," a Group BPCE respondent said.

"I need to have options to offer against what I am phasing out. People cannot go hungry for the purpose of getting more sustainable products."

– Fabio Luiz Guido, Itaú Unibanco

Some interviews revealed a visible difference in the approach of private and state-owned banks in some jurisdictions, especially in terms of coal financing decarbonization but also the diverging influence of shareholders. While in Europe for example shareholders action can push banks' climate ambition, in some jurisdictions, for example in the US, shareholders' influence can lead to the opposite of demand. Taking the example of community banks in fossil fuel-dependent regions, such communities need ways to enable a just transition for those who earn their living in the fossil fuel sector.

Ultimately, "We're seeing the banking sector starting to embrace the concept of just transition. However, the roles of government, corporates or public are still being defined," a respondent from the UN's ILO explained, adding "the ILO actively collaborates with academia and industry actors to extend guidance on the operationalization of just transition support strategies to the financial sector."

Strategy: how do banks position themselves in the journey to climate neutrality

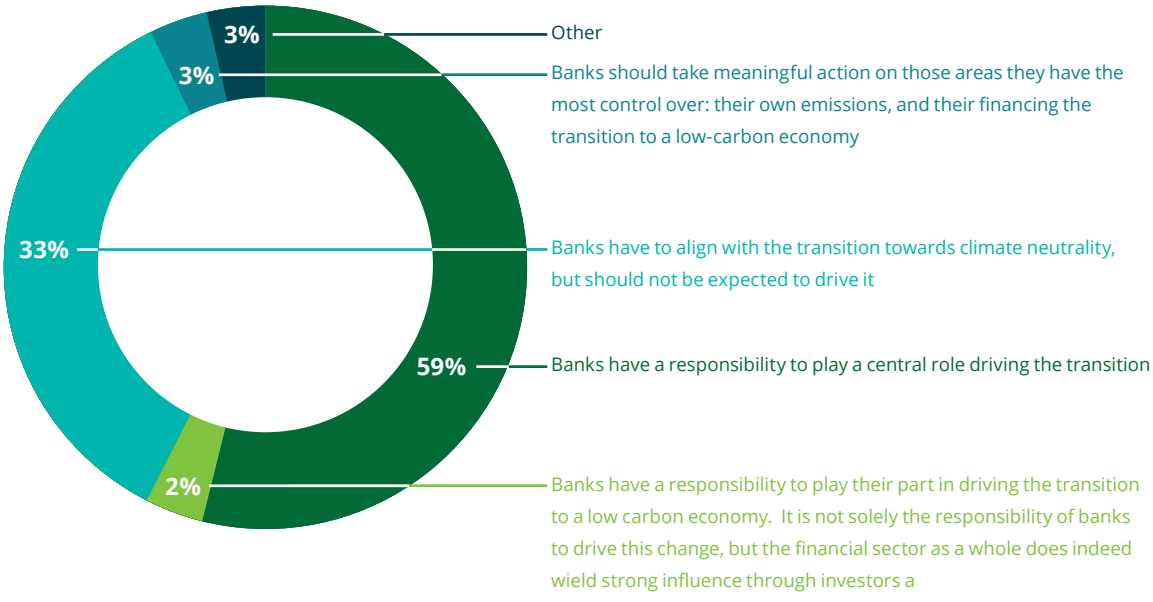
Key insights

- Most respondents say banks must help drive the transition to a low-carbon economy while a considerable number of banks believe they should facilitate the transition but should not be drivers of the climate policies
- A bank's role in achieving climate neutrality may depend on the nature of its activities, where it operates, and who its clients are, and the maturity of the real economy sectors they are active in within their portfolios

Most respondents say banks have a responsibility to help drive the transition to a low-carbon economy

However, a third of respondents say that while banks must get on board with the transition to climate neutrality, they should not be expected to drive it (Figures 11 and 12).

Figure 11: How surveyed banks view their role in the transition to climate neutrality



"We would prefer to use the word 'promoting or facilitating' instead of 'driving,' as we depend on the actions taken by other stakeholders such as governments and our clients," one respondent commented. Another respondent added that alignment is not enough: "Banks have a responsibility to play a central role promoting the transition through engagement with all their stakeholders, especially their clients and governments."

Some banks take an even more expansive view. A member of the Banks Association of Türkiye noted that since banks "provide financing to the biggest emitters and most polluting projects, they play an important role in shaping the entire economy." The decision that banks take will therefore impact and influence a wider community beyond their own clients.

A bank's role in achieving climate neutrality may depend on the nature of its activities, where it operates, who its clients are, and the maturity of the real economy sectors they are active in within their portfolios

In markets where capital markets are not well developed and/or where most external financing is coming from banks, such as in the EU, banks can play a significant role in the transition.

Our survey reveals that **the majority of respondents operate in real economy sectors which have some form of pathways for decarbonization** (Figures 12 and 13). Only 10% of respondents say that there are no clearly defined pathways for the sectors represented in their portfolios. However, it should be noted that:

- sector prioritization is recommended by international initiatives such as the NZBA
- two of the four banks who opted for "No" are also among those who have not yet committed to achieve climate neutrality (but have plans to do so).

"Banks in general can play a fundamental role in the transition in Latin America due to the lack of well-developed local capital markets. Today, close to 80% of the economy's financing comes from banks. That creates a special role for banks to ensure there is a transition. And this is valid not only for big corporates and big projects, but also small and mid-size enterprises."

– Antoni Ballabriga Torreguitart, BBVA

Figure 12: Presence of clearly defined pathways for sectors represented in surveyed banks' portfolios

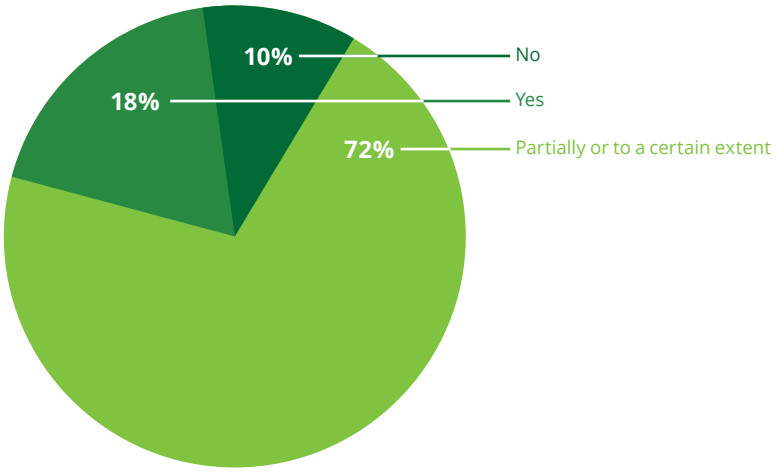
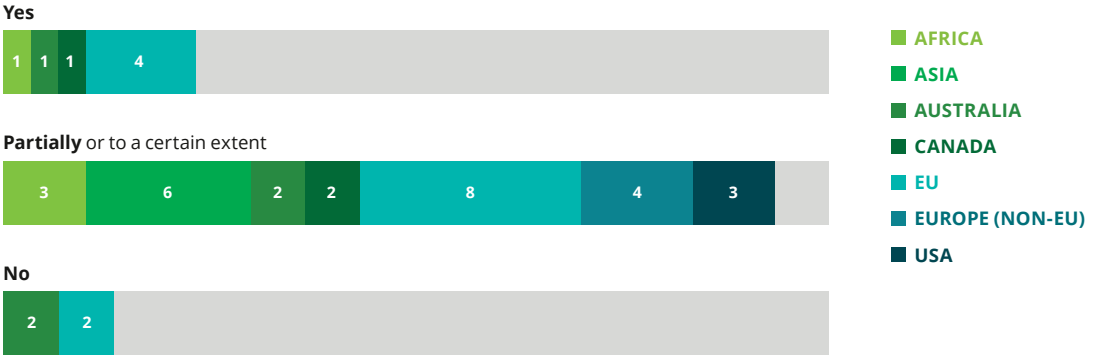


Figure 13: Presence of clearly defined pathways for sectors represented in surveyed banks' portfolios, by geographical region of surveyed banks



We asked respondents to consider the sectors that are relevant to their bank, and identify which ones have a clearly defined pathway to climate neutrality.

The top three sectors are power and utilities, oil and gas, and thermal coal (Figure 14).

Pathway to climate neutrality/sectoral pathway: interest and definition

Transitioning to net-zero requires the use of transition pathways based on scientific evidence in the strategy and target setting processes of both financial and non-financial institutions.

Sectoral pathways are relevant for banks in particular for the creation of net-zero transition plans, the alignment of their portfolios, and for engagement with companies.

Sectoral pathways "provide the link between the science of the remaining carbon budget and the detailed steps that a specific sector could take to reduce GHG emissions to a particular level in a specified timeframe (e.g., technology development and/or adoption, regional variations, the retirement of assets, market changes, policy levers, energy mix)".[31]

Pathways should typically include a benchmark on the pace and the timing of GHG emissions reductions needed in a specific sector and identification of the interdependencies between sectors, leading to define underlying changes that drive the specified transition.

On the other side, the **top sector with a limited pathway to carbon neutrality—or none at all—is agriculture.** The **real estate sector is second,** with the **aviation** and **manufacturing tied for third** (Figure 15).

Figure 14: Top three sectors with a clearly defined pathway to carbon neutrality, among surveyed banks

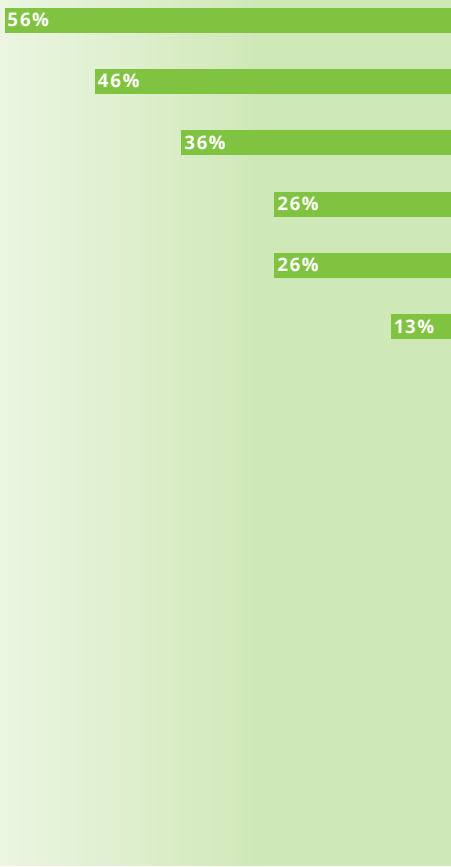
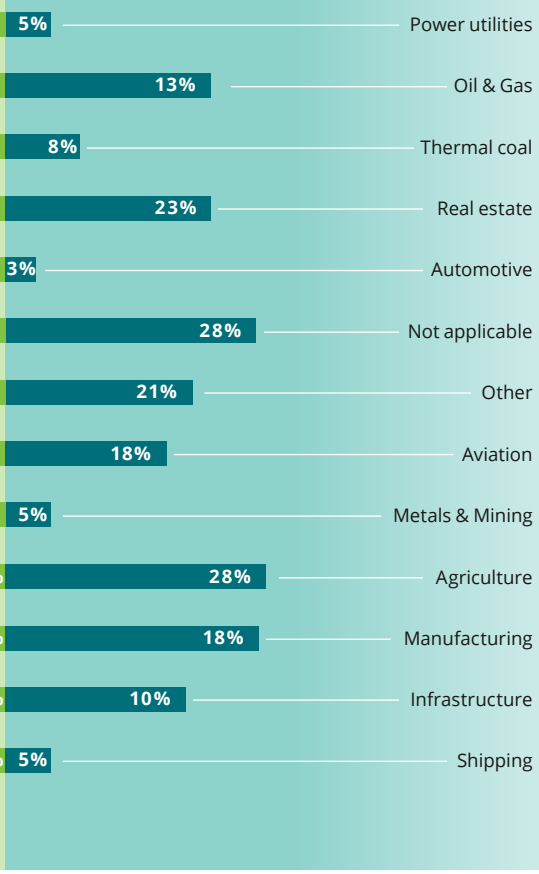


Figure 15: Top three sectors with limited or no pathway to carbon neutrality, among surveyed banks



In their response, surveyed banks also indicated sectors that had not been listed in the survey (e.g., financial sector, IT). In addition, one UK respondent indicated that while aviation, steel, and cement do not have or have only partially a pathway to carbon neutrality, the bank has worked with scientists to develop pathways and scenarios to reach net-zero by 2050 for these sectors. Comments raised within the survey showed that some surveyed banks perceive that the **impact on small and medium-sized enterprises (SMEs) is not yet properly included within pathways.**

Beyond that, as another respondent pointed out, **"scenarios with an appropriate level of regional granularity are necessary to define targets in all sectors."** The issue of data and proper GHG emissions measurement is addressed later in this report.

[31] https://assets.bbhub.io/company/sites/63/2022/06/GFANZ_Guidance-on-Use-of-Sectoral-Pathways-for-Financial-Institutions_June2022.pdf

Approaches: what are banks doing to progress towards climate neutrality

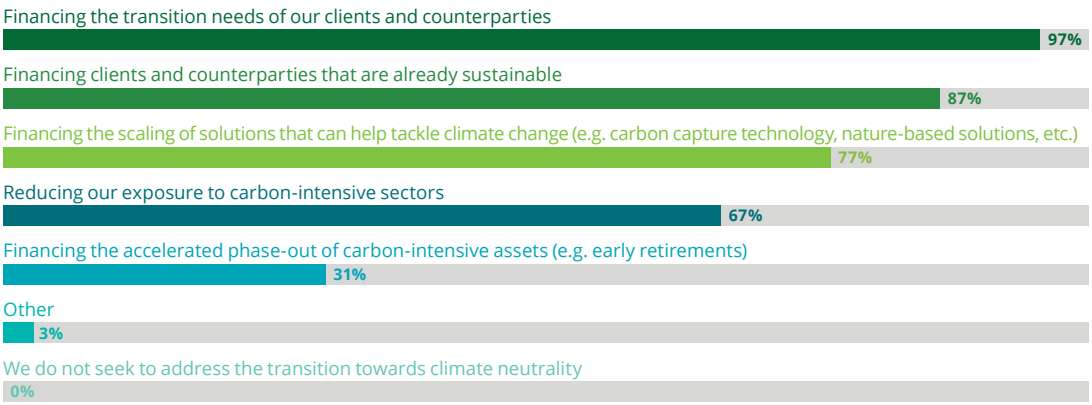
Key insights

- The main avenue surveyed banks are following to address the transition to climate neutrality is helping their clients and counterparties achieve their own climate neutrality
- Among banks that have already set targets for climate neutrality, most are targeting to phase-out sectors, reduce GHG emissions, or increase sustainable finance lending activities
- The most common sector to have targets attached is the thermal coal sector, with the oil and gas and power utilities sectors tied for second
- The most common financing activities that are covered by targets (if any are set) by the surveyed banks are large corporate lending and project finance
- While engagement policies and related new financial services and products are becoming the key focus of banks to achieve their climate neutrality, exclusion policies remain part of the mix mitigation strategies for some banks in some jurisdictions
- Most banks we surveyed indicate that they are still working on their plan to transition to climate neutrality while some are already in the implementation phase

The main avenue surveyed banks are following to address the transition to climate neutrality is helping their clients and counterparties achieve their own climate neutrality

Nearly all (97%) respondents say they are working on **financing the transition needs of their clients and counterparties.** Another large majority, 87%, responded that they **finance clients and counterparties that are already sustainable.** The third-most common method, indicated by 77% of respondents, is to **finance the scaling of solutions**—such as carbon capture technology—that can help fight against climate change (Figure 16). While the latter – financing scaling of solutions – has been chosen by many respondents, the lack of a higher percentage for this financing approach may be due to the difficulty for banks to invest in climate technologies. This topic is further explored in the section on Challenges & Priorities.

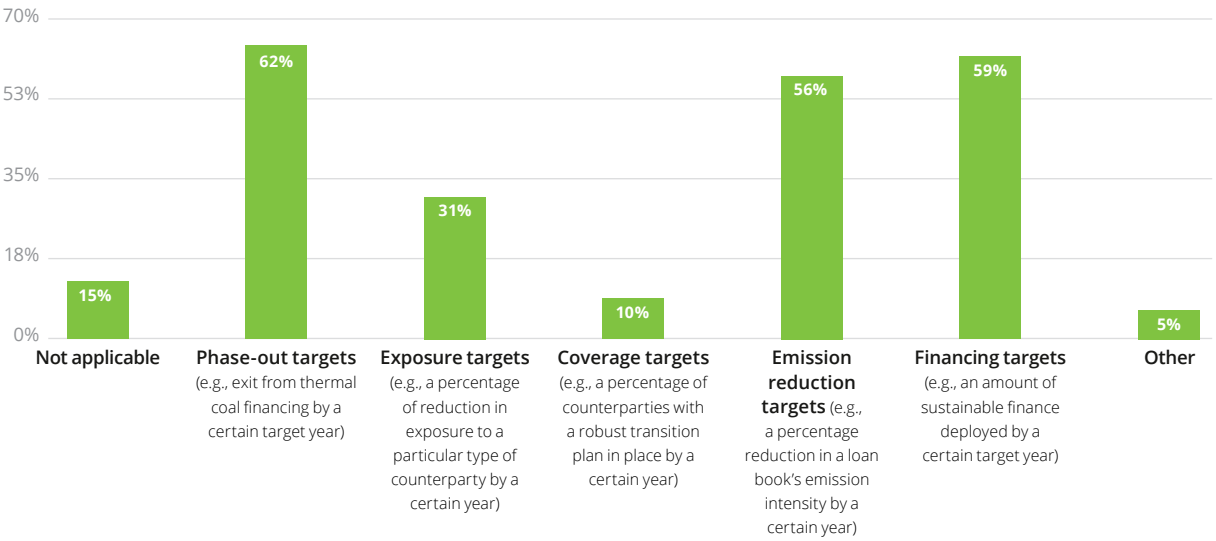
Figure 16: How surveyed banks are addressing the transition to climate neutrality



Among banks that have already set targets for climate neutrality, most are targeting to phase-out sectors, reduce GHG emissions, or increase sustainable finance lending activities

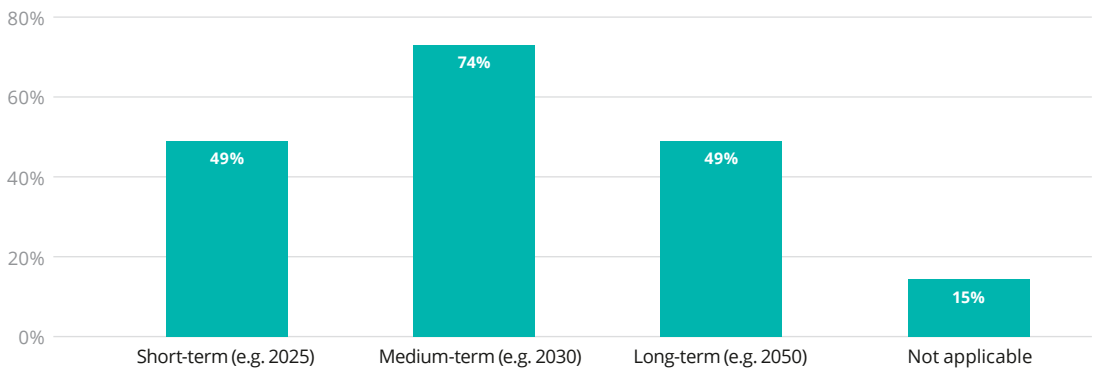
Many of the banks we surveyed have set targets for aligning their financing activities with the transition to climate neutrality. Of that group, 62% say they have set **phase-out targets**, such as exiting from thermal coal financing by a given year. Nearly as many (59%) say they have set **financing targets**, such as providing an amount of sustainable finance by a given year, while 56% have **emission reduction targets** such as a percentage reduction in the emission intensity of their loan book by a given year (Figure 17).

Figure 17: Targets that surveyed banks have set to align financing activities with the transition to climate neutrality



As for the timing of their targets, most banks (74%) are looking at the **medium term**—such as by 2030 (Figure 18). This finding aligns with the insight regarding the type of commitments made to achieve climate neutrality (see Figure 4) as well as 2030 being the deadline year of initial intermediary targets NZBA signatory banks have committed to set. **Nearly half of the banks have short-term and/or long-term targets as well.** For many banks, this is in recognition of the need not just for long-term (e.g., 2050) targets, but also for rapid and sharp reduction in financed emissions in the short- and medium- term in order to meet the goals of the Paris Agreement.

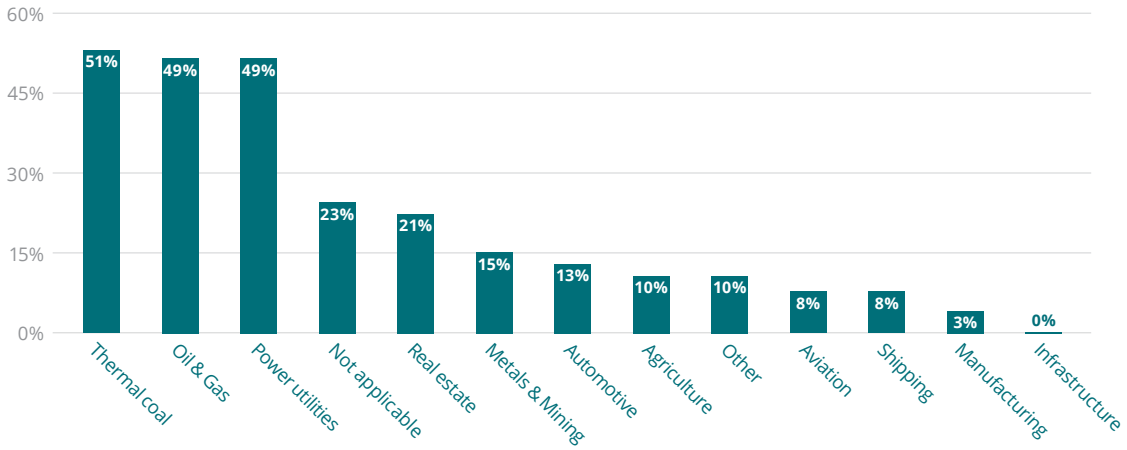
Figure 18: Time horizon for surveyed banks' targets



The most common sector to have targets attached is thermal coal, with oil and gas and power utilities tied for second.

About half of all respondents chose at least one of these three sectors (Figure 19).

Figure 19: Sectors that surveyed banks have targeted to align with the transition to climate neutrality



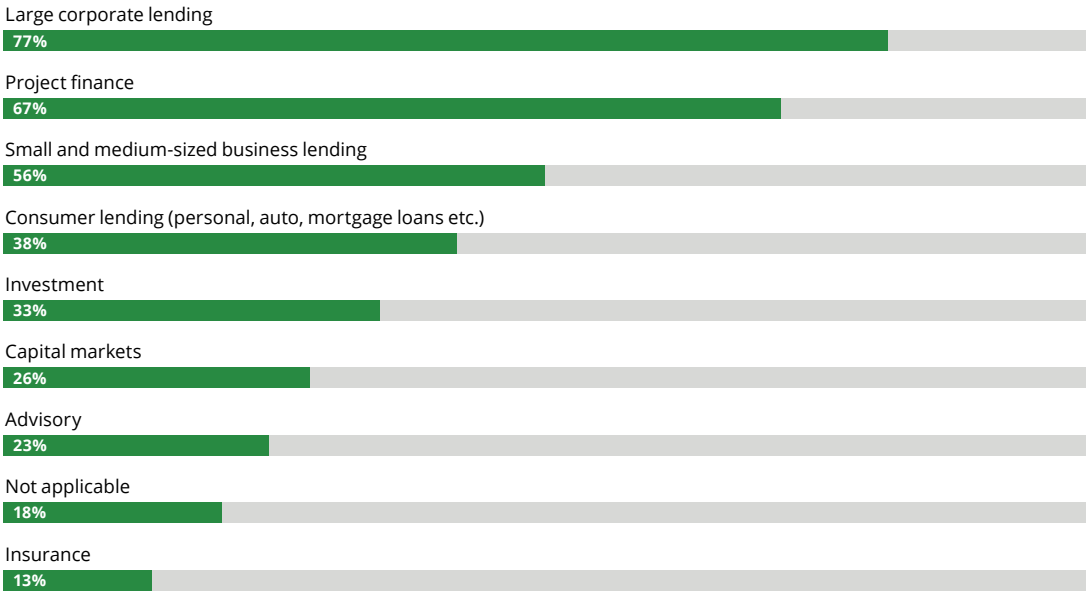
The most common financing activities that are covered by targets (if any are set) by the surveyed banks are large corporate lending and project finance

Based on the survey, today banks are able to apply targets mainly to large corporate lending and project finance (Figure 20). This insight is closely connected to other evidence of our research:

- Banks are only one of the many actors – including large corporates – within a complex ecosystem that is working towards climate neutrality
- As such, to fulfil the transition, collaboration across the value-chain is key, a topic later explored in this report

The survey shows that **increasingly targets are being set for SMEs as well**, evidence of the impact that such projects can have on achieving climate neutrality globally. However, as we see later, while SMEs can bring important impact on the ground, the right data, and methodologies in order to properly include them in the transition are still complex to find.

Figure 20: Which financing activities of the surveyed banks are covered by climate neutrality targets



While engagement policies and related new financial services and products are becoming the key focus of banks to achieve their climate neutrality, exclusion policies remain a part of the mix of mitigation strategies for some banks in some jurisdictions

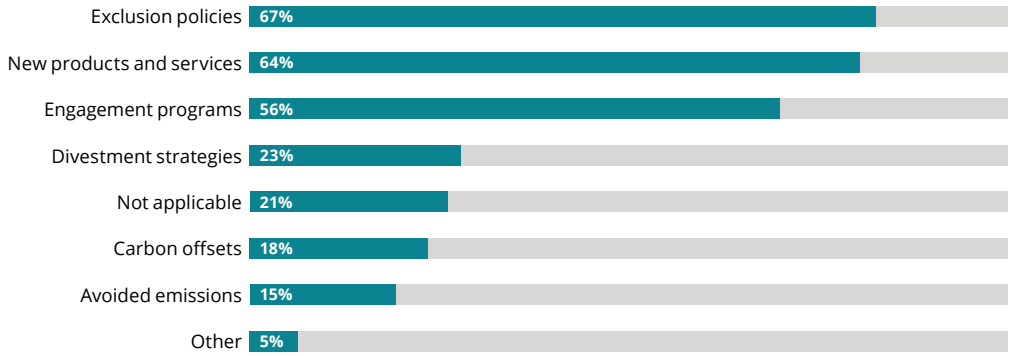
To ensure that the climate transition is duly integrated within bank's portfolios, setting targets is not enough. **Targets need to be matched with a concrete approach to ensure that services offered to clients and the way portfolios are built are aligned with the set targets.** These mitigation strategies need to hold within the more overarching strategy of the bank when servicing its clients and should be integrated holistically within the bank, including in the risk management.

Mitigation strategies explained:

EXCLUSION	**A policy whereby the bank will exclude certain securities or counterparties in the definition and management of portfolios for its clients. It allows de facto to focus only on the "good" companies that – as per established criteria – are aligned with the transition set by the bank.**
ENGAGEMENT	**A framework for the bank to engage with counterparties and clients in order not to exclude them immediately (if an exclusion policy were in place and the counterparty fell in scope of the criteria set) but rather accompany them on the pathway that will allow them and the bank as a whole to fulfil the transition.**
NEW PRODUCTS AND SERVICES	**The definition of products and services that can cater to the climate neutrality transition. These can be for example products that are "ESG" as per existing regulations, labels and criteria, services that have integrated a net-zero alignment methodology, etc.**
DIVESTMENT	**The exit by the financial institution from investments that are deemed contradictory with the objective of the transition.**
CARBON OFFSETS	**Investing in projects and programs that allow to reduce or remove CO2 emissions.**

The most common mitigation strategy based on our survey is still the definition and use of **exclusion policies** (67%) followed by the development of **new products and services** (64%). **Engagement programs** are the third-most common strategy at 56% (Figure 21), **but these are expected to move up as reaching the objective of the climate neutrality throughout the economy will require engagement of all sectors, including the most emitting ones.**

Figure 21: Surveyed banks' mitigation strategies to align financing activities with the transition to climate neutrality



Exclusion policies "are only going to get stricter and stricter over time. Exclusion policies are already applied when it comes to fossil fuels, but a few more may be expected on the upcoming taxonomy topics." – Filip Ferrante, KBC Group

Although exclusion policies remain a pillar of some banks' mitigation strategies, **engagement programs** are sometimes viewed more favourably as they enable a whole-of-economy transition. "In France, exclusion was at the top of the list for several years, prohibiting or capping the use of the most emissive sources of energy (coal, non-conventional oil, and gas)." according to the French Banking Federation. "But exclusion is now complemented by a more comprehensive approach of alignment, that ensures the effective and global carbon transition of the economy." While, as framed by the Paris Agreement, banks and other economic actors are aligning to climate neutrality because of scientific arguments (the need to maintain global temperature rise to below 1.5 degrees Celsius), a business angle can be taken when approaching climate neutrality. This 'business' approach translates via engagement programs with clients, programs which should be tailored to ensure the right value is delivered for and with the client.

Development of **new products and services** was pointed out by several interview participants as one of the top priorities as banks are "financing specific areas that are positive on the transition plan" through a new products policy. The increasing interest in retail-focused savings products was also mentioned by the UK Finance representative: "There's a lot of interest in banks offering those products and doing so in a way that provides confidence to customers that they are delivering on their sustainability objectives."

Among green retail products for example, the most popular are green cards, green car loans, green mortgages, green home equity loans. Green car loans for example are especially popular in Europe and Australia and carry lower interest rates than regular car loans. The interest rate should be at least 0.25% lower than average car loan, and can go up to 0.50% lower, or even more in special cases. Another example could be green mortgages, which give the consumer lower interest rate than market rates; typically, a break on interest rate is between 0.125% and 0.25%. To be considered as a green mortgage, homes provided should be more energy efficient or have more energy efficient appliances. The bank can also lend money for costs of switching a house to green power.[32]

As explained by an executive of a Belgian bank, the option of **divestment strategies** is

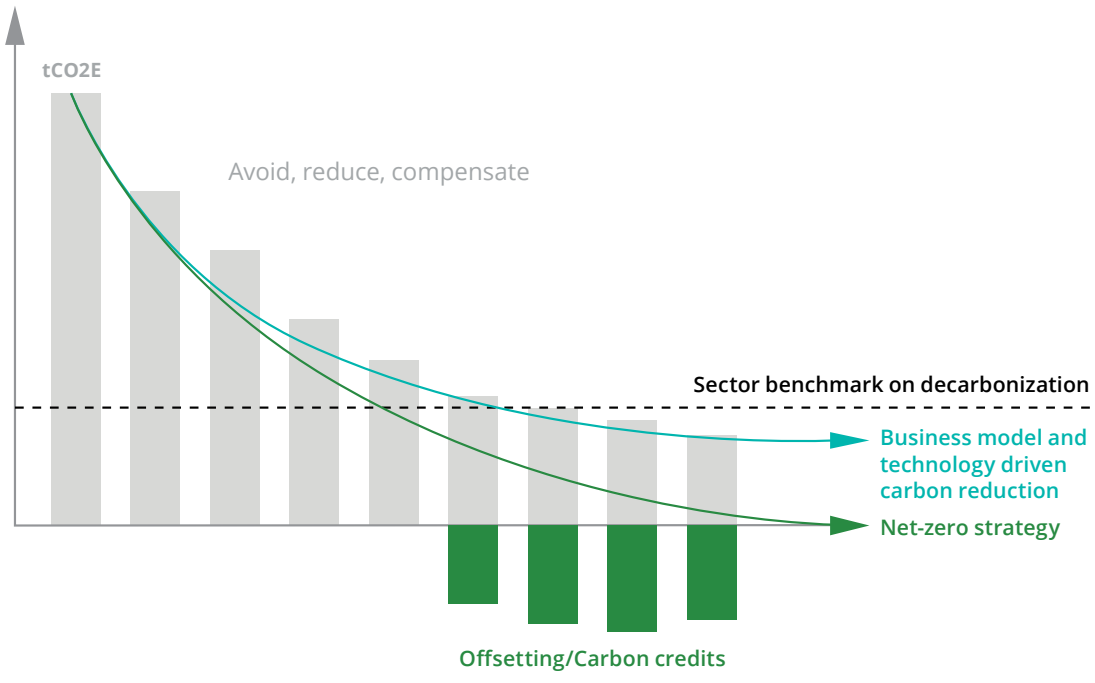
"to make sure that the bank aligns its own investments with what they tell their customers. It's a role for the Treasury Department to manage. In turn, Treasury can have a massive influence on the bank's profit and loss, so it's important to work on building the right portfolio."

Carbon credits or offsets are also a possible mitigation strategy although not one that is as widely prioritized, according to survey respondents. Carbon offsets are fundamental if the objective of the client is a full carbon neutrality transition, as it allows to tackle those areas of the value-chain for which companies do not have a direct influence so carbon offsets can help with "residual emissions". As mentioned by a French bank that was interviewed:

"For clients who want to adopt a complete carbon neutrality strategy, offsetting has to be included. So, the bank helps them to define the right carbon offsetting strategy, also putting them in contact with relevant partners."

A concrete example of how banks can be involved is the project "Carbonplace" launched last year by a group of financial institutions to develop a new technology platform, to provide infrastructure to enable the reliable, secure, and scalable trading of voluntary carbon credits[33]. The initiative will help create a more liquid market for carbon offsets and help clients to manage risks associated with climate costs.

Figure 22: Offsetting is part of the transition to climate neutrality

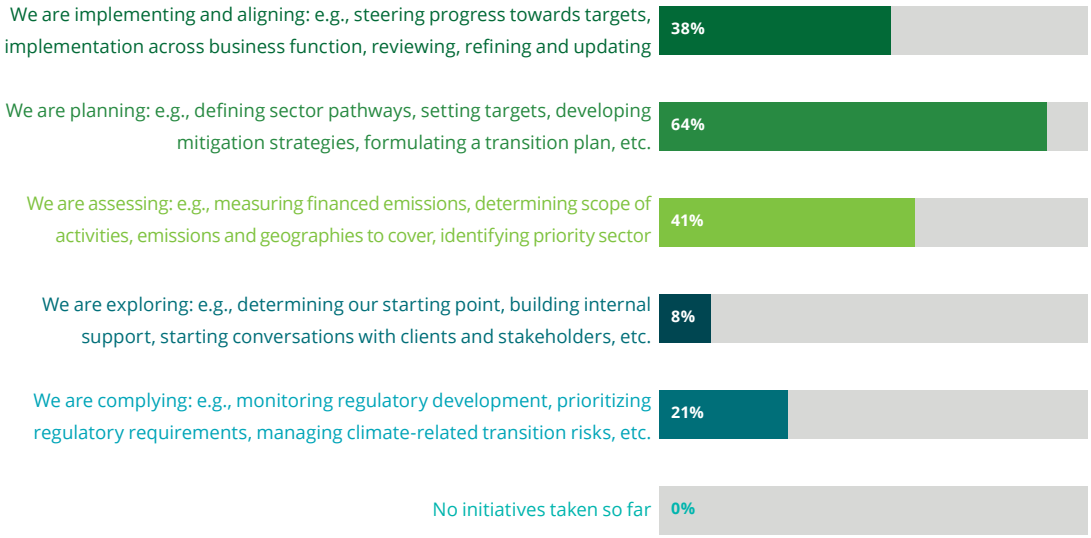


However, solutions for carbon offsetting are partially available or not viable.
At the same time, making use of carbon offsets in the right way requires proper knowledge of which carbon offset solution to apply and how. This requires external assurance of quality both on the supply side ('which suppliers can we trust') and demand side ('what is an appropriate carbon neutrality claim to make when purchasing carbon credits'). Gaining this knowledge can ultimately bring some positive synergies between the bank and its very clients. For example, an Australian bank which was interviewed explained how they only recently discovered that some of their clients who are active in farming could provide carbon offsets in which to invest.

Most banks we surveyed indicate that they are still working on their plan to transition to climate neutrality, while some are already in the implementation phase

Given these targets, mitigation strategies, and methodologies, where do banks stand today? Most (64%) say they have **begun to define pathways, set targets, develop mitigation strategies, and other aspects of planning.** Another 38% say they have **moved on to implementation**. And 41% say they are **still in the assessment phase**—such as identifying priority sectors, measuring financed emissions, or determining the scope of activities, emissions, and geographies to cover (Figure 23). It should be noted that this question was a multiple-choice question, to fully represent the complexity of respondent banks' current situations.[34]

Figure 23: Where surveyed banks currently stand in the transition to climate neutrality



[32] (PDF) Green Banking -Green Financial Products with Special Emphasis on Retail Banking Products (researchgate.net)

[33] Three banks join initiative for voluntary carbon market platform | Reuters

[34] When looking at the distribution of the "most advanced" answer - "We are implementing and aligning" - a specific trend does not appear. For example, where regulatory pressure is already higher, does not seem to correlate with the trend for banks already implementing the transition to and aligning with climate neutrality

Challenges & priorities: what do banks need in their journey in order to successfully reach climate neutrality

Key insights

- While clients are willing to allocate their finance to climate neutrality, a gap exists between the client demand and the actual range of products available to invest in
- Scope 3 emissions measurement remains a challenge for many banks
- There is a belief that technologies can play a central role in the transition, but innovative technologies can be expensive and risky to invest in
- The transition to climate neutrality can benefit from industry and cross-industry collaboration

While clients are willing to allocate their finance to climate neutrality, a gap exists between the client demand and the actual range of products available to invest in

Generally speaking, there is indeed significant capital waiting to be allocated to green investments. However, **there are not enough investment opportunities in the market due to the high complexity of sustainability products and the different regulatory constraints and criteria (e.g., taxonomy) they need to comply with.** A possible way to close this investment gap is by supporting a larger deployment of transition bonds and sustainability-linked loans, i.e., products that focus on progress towards the objective rather than on the objective already having to be achieved (e.g., green bonds). The proceeds would then be used to fund a firm's transition to reduce their carbon emissions. Overall, the hope is that **as jurisdictions continue to organize and structure their actions to meet their commitments under the Paris Agreement, opportunities for investment will become more concrete and numerous.**

Scope 3 emissions measurement remains a challenge for many banks

Scope 1, 2 and 3 emissions explained:

SCOPE 1	direct emissions from owned or controlled sources
SCOPE 2	indirect emissions from the generation of purchased energy
SCOPE 3	all indirect emissions (not included in scope 2) that occur in the value chain of the reporting company

SCOPE 3
A CLOSER LOOK:

For corporates, Scope 3 measurement is mostly about supply chain. For banks, Scope 3 financed emissions cover the emissions that occur along the entire value chain of business activities, including those of counterparties linked to lending portfolios.[35]

The GHG protocol[36] sets different categories designed to calculate Scope 3 emissions. Category 15 is designed primarily for financial institutions. For purposes of GHG accounting, this standard divides financial investments into four types: equity investments, debt investments, project finance, managed investments, and client services.

[35] Banks must get better at disclosing climate risks, ECB assessment shows (europa.eu)

[36] Corporate-Value-Chain-Accounting-Reporing-Standard_041613_2.pdf (ghgprotocol.org)

Accessing and being able to manage and evaluate data is necessary in order for banks to continue working towards the climate transition.

The availability, quality, and comparability of data continues to be a major challenge. Only 23% of survey respondents say they have insights into all of their financed emissions, and even in that group, nearly everyone says they are still overcoming significant data limitations (Figures 24 and 25).

Figure 24: Extent to which surveyed banks are measuring Scope 3 financed emissions

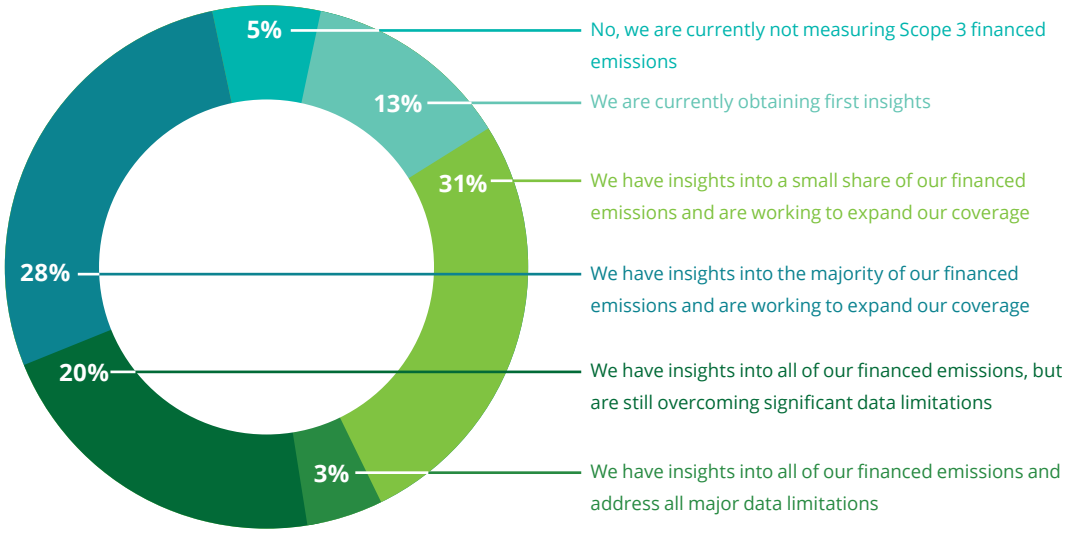
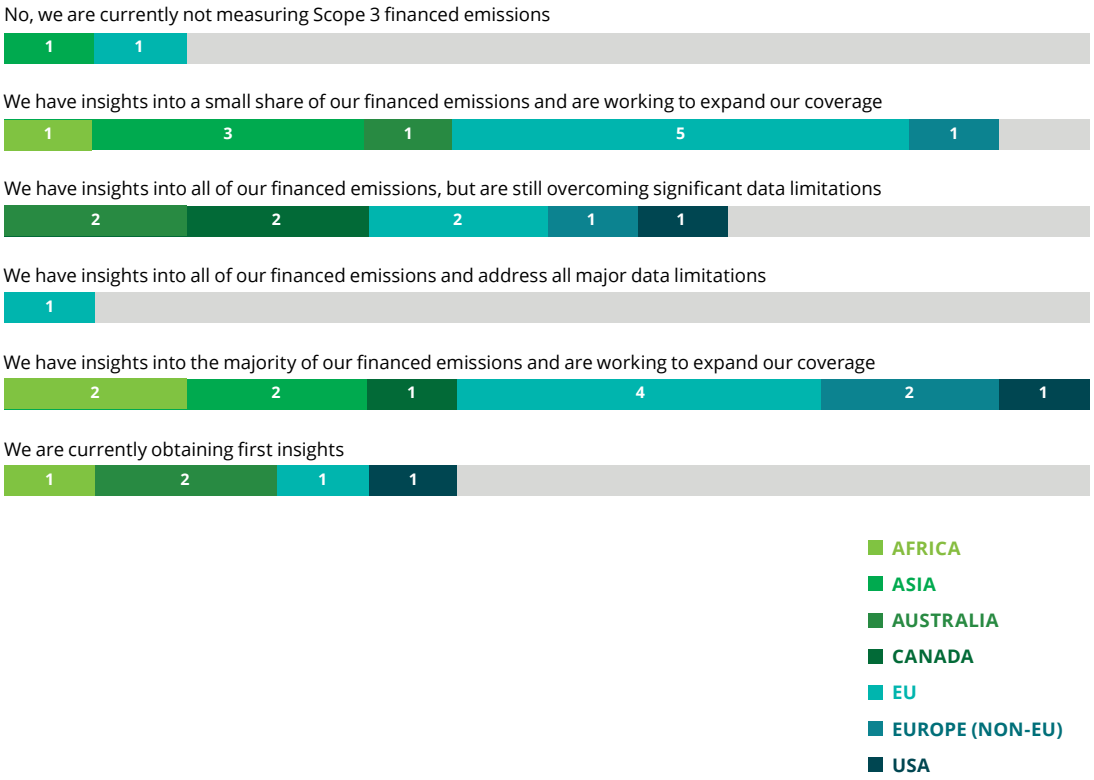
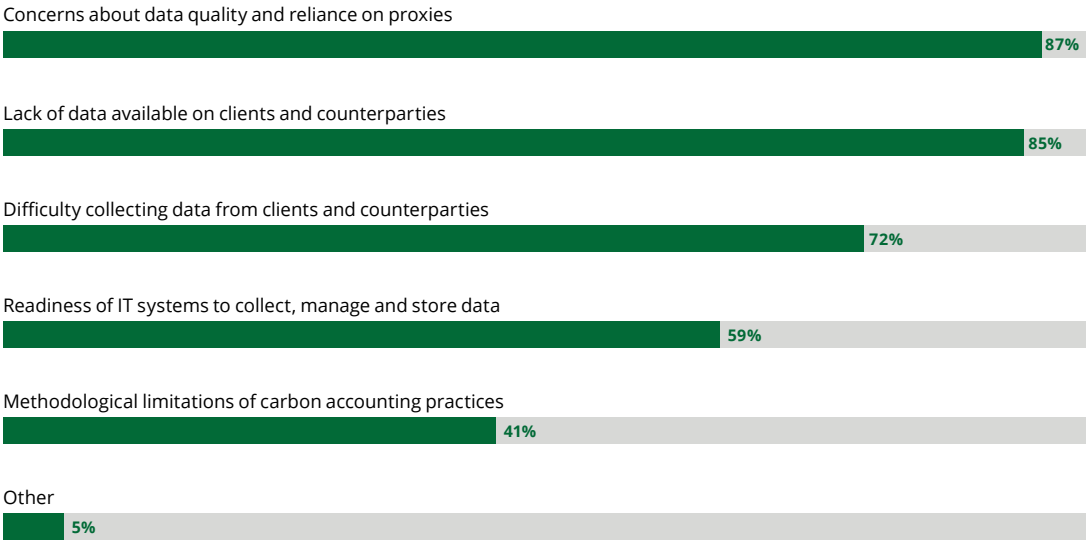


Figure 25: Extent to which surveyed banks are measuring Scope 3 financed emissions, by geographical region of surveyed banks



The biggest obstacle, according to respondents, are **concerns about data quality and reliance on proxies** (87%). But the **lack of available data from clients and counterparties is almost as large an issue,** affecting 85% of respondents (Figure 26).

Figure 26: Main challenges faced by surveyed banks in measuring Scope 3 financed emissions



The biggest obstacle, according to respondents, are **concerns about data quality and reliance on proxies** (87%). But the **lack of available data from clients and counterparties is almost as large an issue,** affecting 85% of respondents (Figure 26):

- The concerns about **data quality and reliance on proxies** can be mostly explained by the fact that using secondary data or industry-average emissions factors presents issues. It may raise questions on reliability and accountability of the disclosures and measurements as well as reputational concerns
- The second obstacle, **lack of available data** relates to the fact that banks struggle to collect relevant and sufficiently granular primary data from their clients and counterparties and to manage the amount of data needed to calculate Scope 3 emissions.

Addressing obstacles to Scope 3 measurement is particularly relevant in order to achieve climate neutrality given that at for banks and asset managers, Scope 3 "financed emissions" are by far the largest component of their total GHG emissions.

"Missing data and non-standard measurement methods are difficult challenges for financial institutions," the Japanese Bankers Association member notes.

As mentioned by the Groupe BPCE executive, "data availability and a common methodology for measurement across all banks globally, are a vital ingredient for progress."

This is also true to enable clients' engagement as well as target setting; as mentioned by a Belgian bank we interviewed "setting targets is very closely linked to the topic of IT and data, because it is a very cumbersome process if it is to be done diligently."

That likely explains why data availability and IT system readiness is tied with measuring the financed emissions footprint as banks' second most common top priority.

Banks need a common language with clients to understand and plan transition. Only with data can banks conduct risk assessments, spot opportunities and support companies in their transition. Only through the collection of data can companies quantify their progress on their goals and have data to drive and inform their decisions. **The data issue must be addressed at a collective level with the help of public authorities and international organizations because it is not efficient to deal with the lack of data on a company-by-company basis.**

Top-down guidance is thus needed in this area: "A policy framework is needed," a member of the Kenya Bankers Association added. "Without data, it's extremely difficult to act and to plan."
While good initiatives are underway – including the UNEP data hub or the ESAP in the EU – **banks need more public databases to become accessible to financial institutions and investors from all parts of the world as financial markets are global.**

Data is especially hard to collect from SMEs. "Banks need data from SMEs because SMEs could make up a big part of their Scope 3 emissions," the UK Finance executive explains. This is due to the value-chain approach: "Not only portfolio emissions but also value-chain emissions. So, there is a clear need to get that data, but SMEs mostly do not collect that data and there's no standard template to collect data." The topic is however increasingly in the spotlight of regulators and authorities: in the EU for example, the European Financial Reporting Advisory Group (EFRAG) is working on a – for the moment simplified and voluntary – reporting standard for non-listed SMEs.

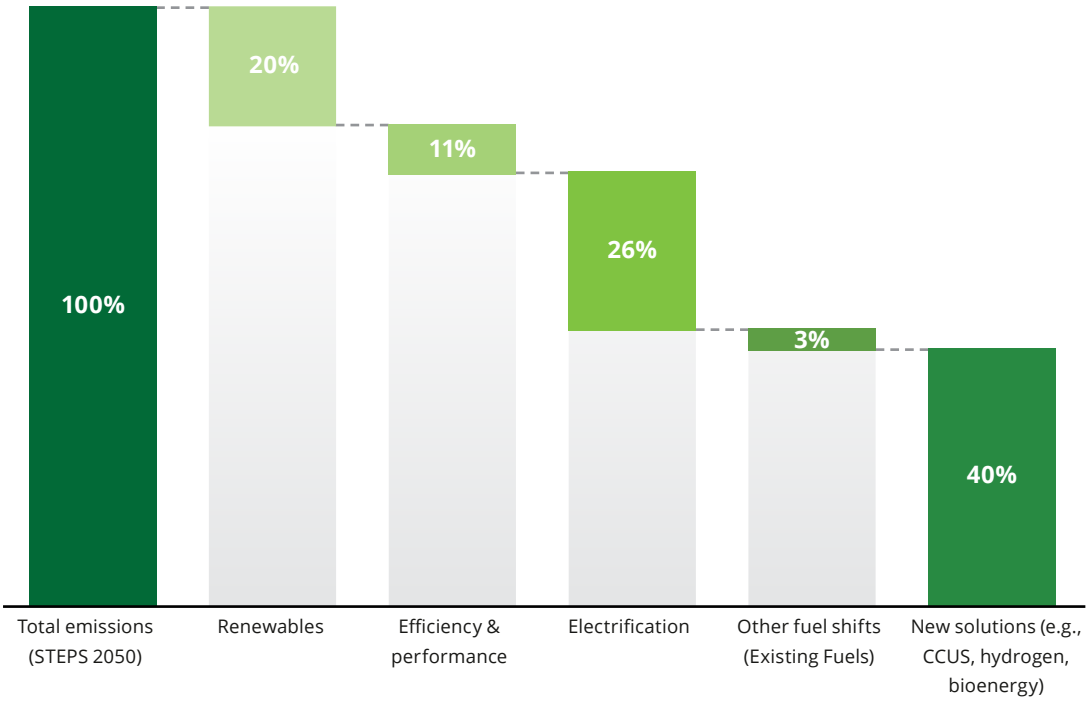
Digitizing the data that banks can collect is also an issue. The Groupe BPCE and La Banque Postale executives explained during interviews that they are building a data platform to source the data, clean it up, and make it available to each business unit. The purpose is to inform a proprietary metric that business lines can use to identify the environmental, social, and territorial impact of their loans and investments.[37]

However, banks agree that lack of data is not a showstopper for taking action. As mentioned by the Suncorp respondent: "a baseline for Scope 3 financed emissions has been defined for 97% of the portfolio" at the bank and will be disclosed publicly in line with the PCAF guidance. But, the respondent adds, it "is not what is needed in order to act."

There is a belief that technologies can play a central role in the transition, but innovative technologies can be expensive and risky to invest in

While the challenges around data are clear, climate action cannot wait for perfect data. Whatever the strategy that is undertaken by the banks to align with climate transition, banks recognize the **importance of technology and innovation.** Indeed, as the figure below shows, an important amount of GHG emissions will have to be reduced via new technologies and hence related R&D and innovation:

Figure 27: Global emissions reduction to Net-zero 2050, CO2 emissions reduction by type of abatement measure, 2050 (GTCO2-e, %)[38]



[37] "La Banque Postale announces new milestones for its community ambitions," La Poste Groupe, July 1, 2021.

[38] International Energy Agency

New technology can help certain sectors and actors transition to climate neutrality, potentially avoiding a too drastic "plug-out" approach and thus supporting a more just transition. Some of the challenges that new technology can help to tackle are the below hardest abatement challenges, which vary across sectors:

Figure 28: Example of hardest abatement challenges new technologies can focus on to aid the transition

SYSTEM	CHALLENGES
ENERGY SYSTEM	Long-term energy storage
	Grid infrastructure & capacity
MOBILITY SYSTEM	Long haul / heavy freight
	Aviation fuels
AGRICULTURE SYSTEM	Synthetic fertilizer & soils
	Livestock & manure mgmt.
MANUFACTURING & INDUSTRIAL SYSTEM	Green steel, cement, aluminium
	Clean hydrogen and derivatives
NEGATIVE EMISSIONS SYSTEM	Carbon capture
	Direct Air Capture (DAC)
ALL	Circularity
	Supply chain

At the same time, it should be pointed out that R&D in new technologies should duly account for the pressure these can put on the demand for raw materials and on production processes in general, given that generally clean technologies may make more intensive use of minerals than their fossil fuel counterparts.

When it comes to sustainability and the climate transition, we should distinguish between two categories of technologies. One consists of **existing technologies that need investment to scale up,** such as renewable energy and new methods of mobility (e.g., eco-friendly vehicles). The other category is for **emerging technologies that require investment to launch, and then scale** (e.g., hydrogen and carbon capture).

Based on the interviews performed it appears that most banks are willing to support clients with new technologies by investing in them, however they also recognize the **higher risk that is often associated with financing innovation.** Sustainable technologies are expensive to invest in, partly because they tend to be long-term projects but also because of the specific expertise they may require.[39] Because of this higher risk, banks may be reluctant to invest – despite their belief in the value that technology can bring to the transition.

For this reason, some of the banks interviewed (for example in Latin America) propose a **stronger involvement by the public sector – alone or together with the private sector in partnerships for example – to at least partially absorb the first loss of a potential investment.** Public private partnerships and risk sharing schemes could help the whole ecosystem to be incentivized towards developing and supporting new technologies.

Another means of supporting innovation for the transition can be by partnering with or otherwise supporting startups. An example was given by a French bank which holds events and campaigns for startups to propose their ideas within a forum.

The transition to climate neutrality can benefit from industry and cross-industry collaboration

Due to the global nature of the climate crisis and needed transition efforts, collaboration was deemed key by most banks we interviewed. Two types of collaborations were discussed and are already observed in practice:

- Collaboration within the banking industry
- Collaboration along the value-chain, i.e., with real economy players

Within the banking industry, collaboration can help both to finance and conduct specific carbon mitigation projects which may be too overwhelming for one bank alone, and to develop common methodologies and frameworks that can help the industry as a whole and foster harmonization. After all, "these are topics that need to be managed by all banks and where coordination is necessary so that when banks speak to the market, they speak with a single voice. Coordination is needed and useful not only to defend the banking sector's position on regulations but to also reach a practical approach, based on common definitions," as stated by the French Banking Federation.

[39] "Blended Finance for the Net-Zero Transition" - Opening Remarks by Mr Ravi Menon, Managing Director, Monetary Authority of Singapore, at the Transition Finance towards Net Zero Conference on 4 October 2022 (mas.gov.sg)

Examples of collaborations within the banking industry:

- In Brazil, Itaú Unibanco, Bradesco and Santander joined forces to define a plan around the three issues deemed most challenging for their region: environmental conservation, investment in sustainable infrastructure, and guaranteeing basic human rights in the Amazon. To ensure the implementation of the 10-point plan, the banks took the initiative to connect with the government and collaborate with public initiatives. The plan is governed by a board composed of, among other, scientific experts.[40]

- Banking associations can also play a role. The French Banking Federation, representative explained for example that French banks worked together for several months to define a common approach to measure their portfolio's carbon footprint (their baseline) and set decarbonization targets aligned with a net-zero trajectory (their alignment targets). She confirmed "this common approach, which includes using common data and calculation principles, constitutes a robust contribution to operationalize the banks' commitments." The banking association in South Africa is part of a financial industry wide forum, known as the Climate Risk Forum (soon to be known as the Sustainable Finance Initiative) that has already developed a taxonomy[41] and is in the process of developing a benchmark climate scenario for stress testing.[42] The Japanese bank-led study group has developed guidelines for transition finance, with Asian banks and other global banks.[43]

However, some of the respondents believe that it would be preferable if the guidance on methodology came from a more global actor and not just from their national ecosystem. This is the expectation they have from joining international initiatives such as the NZBA. Such top-down, global guidance is still pending. In the meantime, the hope is that via some of the existing climate stress testing exercises that are being launched by different central banks, banks can learn about which methodology is best suited to their climate transition efforts.

Along the value-chain, participating in forums where different stakeholders across real economy and financial sectors along the same value-chain can speak can be beneficial to the transition as all actors together can think of and design holistic solutions that benefit the ecosystem as a whole:

"We are actively engaged with our various clients throughout the chains given that these topics concern long-term assets requiring massive capex financing. We very much wish to contribute to alliances as well, since they are key to progress as relevant technology is still evolving and actors need to join forces to accelerate concrete developments and ease decision process."

– Société Générale

Spotlight on the energy crisis

While reaching climate neutrality already posed challenges before the energy crisis, the question we asked is whether and how the energy crisis would impact progress towards climate neutrality or ultimately accelerate the transition to clean energy.

Based on desk research[44] as well as interviews, we have reached the following conclusions. While the exact effects of the energy crisis have yet to be determined, the **short term** and long-term effects have to be distinguished. In the short term, an increased use of higher emitting sources of energy is observed in many countries as an emergency solution. Analysts' **long-term positions,** however, seem to be more optimistic. The International Energy Agency (IEA) believes that the energy crisis sparked by Russia's invasion of Ukraine is likely

to speed up rather than slow down the global transition away from fossil fuels and toward cleaner technologies like wind, solar and electric vehicles. The IEA believes that this crisis can be used to strategically reorient energy production towards less carbon intensive, more sustainable forms of production. This is true for developed countries e.g., France which have committed not to reverse their commitments, and less developed resource-rich countries such as those in Africa who could use this opportunity to develop their economies.

Short term: potential return to more emissive fuels

- A return to cheaper but more GHG emissive fuels, such as thermal coal, is likely and has already been observed, for example, in Germany.
- In the UK, the government has asked some coal power plants to slightly extend their lives to ensure energy security. EDF has, for example, been asked to consider extending its West Burton coal plant.[45]
- In the US, the short-term trend is also towards increased fossil fuel production to try and curtail rising domestic prices and to support European supply diversification.
- Some interviewed banks explained they might need to *temporarily* revise the timelines for reaching climate neutrality targets for some of the sectors they are involved in and clients they service but this will not affect their overall commitments and 2050 targets. It is likely that some banks might also need to waive for a defined and short period of time prior commitments on excluded sectors.

Long term: analysts believe that this crisis can be used to highlight the weaknesses of current energy production and strategically reorient it

- For Europe, the cost of switching to clean energy by 2050 will be $5.3 trillion, according to a new BloombergNEF report. Its European Energy Transition Outlook 2022 report, which attempts to model the future in a time of crisis, proposes two clean energy pathways for Europe.
- In March 2022, the IEA published a 10-point plan to reduce the EU's dependence on Russian natural gas. The main objectives of this 10-point plan, consistent with the EU's climate ambition, are accelerating investment in clean and efficient technologies, through different levers including "Accelerating the deployment of new wind and solar projects" or "Accelerating energy efficiency improvements in buildings and industry".
- In developing countries such as those in Africa, the current surge in energy prices underscores the urgency and benefits of accelerating the development of energy sources which would have the double benefit of being cheaper and cleaner. With solar, other renewables, and emerging sectors such as critical minerals and green hydrogen, the transition to global clean energy holds new promise for Africa.
- Many economies have a strong capacity to continue to support global action on the transition to carbon neutrality. China, for instance, provides one-third of the world's wind turbines, 70% of the world's solar photovoltaics, and three-quarters of the world's lithium-ion battery manufacturing capacity.
- This longer-term view was confirmed in the interviews:

"The current geopolitical-induced energy crisis is putting a lot of the clients on high alert. They'll have to become way less dependent on fossil fuels. We've seen in our discussions with clients that clients are either themselves actively looking or finding opportunities to change their habits."

– Filip Ferrante, KBC Group

[40] Bradesco, Itaú Unibanco and Santander announces joint plan to promote sustainable development of the Amazon

[41] SA Green Finance Taxonomy - 1st Edition.pdf (treasury.gov.za)

[42] More info: https://sustainablefinanceinitiative.org.za/

[43] "Publication of the Final Report of the Asia Transition Finance Study Group," MUFG Bank, September 26, 2022.

[44] Sources: Bloomberg, Project Net Zero, IEA" 10-Point Plan to Reduce the European Union's Reliance on Russian Natural Gas", IEA "Global energy crisis shows urgency of accelerating investment in cheaper and cleaner energy in Africa "

[45] Can the global energy crisis accelerate Net Zero? | Platform for Climate Action | Project Net Zero

Concluding thoughts

With this report, the IBFed and Deloitte aimed to shed light on the **structural differences that banks face in the transition to climate neutrality— by jurisdiction, sector, business model, and more.** We explored **what is driving banks** to commit to climate neutrality, the strategies they have adopted, and the progress they have made so far. We also shared bank executives' views on the challenges and priorities they see ahead of them, including how they can work together and with governments on a unified response to decarbonizing the global economy.

Our report closes with the following concluding thoughts:

Committing. There is major agreement across the world on the need to transition to climate neutrality, with timelines varying across countries.

Understanding the responsibility. Worldwide, banks understand and confirm they have a role to play in the transition to climate neutrality.

Identifying new banking services and strategies. Transition plans and strategies vary among the banks we heard from. While some trends—like engagement strategies and dialogue with clients—are coming into sharper focus, other trends will likely emerge in the future as the ecosystem continues to mature (think investment in carbon offsets or the development of new products and services).

Collaborating. Banks are key to the transition, but only one among many moving parts in a national, regional, and global ecosystem. To be successful, banks will need continued cross-sectoral collaboration, support from the public sector, harmonization of methodologies, and global approaches and improvements of data availability in all jurisdictions.

Being ready and agile. The banking sector (and the ecosystem as a whole) should remain ready and agile, to adapt to possible further unexpected disruptions so it can achieve climate neutrality over the long term. This report gave a spotlight to the energy crisis, but other (related) crises may arise or already be in act. Resilience becomes the key to keeping the climate transition on track.

Appendix

Organizing to tackle climate change

A number of different agreements, coalitions, and standards at the international level have formed around mitigating the impact of climate change. Key examples are listed below, keeping in mind that individual countries have also launched their own national initiatives to help their companies and institutions organize themselves to reach climate neutrality targets.

INITIATIVE	SHORT DESCRIPTION
Paris Agreement	In 2015, representatives from 196 nations gathered in Paris to adopt an historic treaty on climate change. The Paris Agreement aims to limit global temperatures to no more than 1.5 degrees Celsius above what they were in the preindustrial era. Achieving that goal means reducing greenhouse gases, or GHGs, by 45% as of 2030 and offsetting them completely—resulting in net-zero emissions—by 2050.
Greenhouse Gas Protocol (GHG Protocol)	The Greenhouse Gas Protocol, or GHG Protocol, sets accounting standards for reporting corporate GHG emissions. The standards break emissions down into three categories: • Scope 1 includes the GHG emissions that a company makes directly—for example, while running its boilers and vehicles; • Scope 2 includes the emissions a company makes indirectly—like the electricity or energy it buys for heating and cooling buildings; • Scope 3 includes the emissions that the organization is indirectly responsible for up and down its value chain—for example, from buying products from its suppliers, and from its products when customers use them.
Intergovernmental Panel on Climate Change (IPCC)	The United Nations Intergovernmental Panel on Climate Change, or IPCC, is a volunteer group of scientists who study climate change and make recommendations to government policymakers. One recommendation is to create inventories of GHG emissions that occur within a given territory.
The United Nations Environment Programme Finance Initiative (UNEP FI)	The United Nations Environment Programme Finance Initiative, or UNEP FI, is a partnership between the United Nations and the financial sector to address ESG challenges. In 2019, UNEP FI issued a framework for the development of a sustainable banking industry based on six principles: 1. Alignment of the bank's business strategy with individuals' needs and society's goals 2. Impact and target setting relative to the bank's activities, products, and services 3. Encouragement of sustainable practices among clients and customers 4. Consultation with relevant stakeholders to achieve society's goals 5. Effective governance and a culture of responsible banking 6. Transparency and accountability

Glasgow Financial Alliance for Net-Zero (GFANZ)	The Glasgow Financial Alliance for Net-Zero, or GFANZ, is a UN-chaired group that coordinates efforts across the financial industry to speed the transition to a net-zero global economy.
Net-Zero Banking Alliance (NZBA)	The Net-Zero Banking Alliance, or NZBA, is a GFANZ initiative to accelerate the implementation of decarbonization strategies in the banking sector.
Network for Greening the Financial System (NGFS)	A network of central banks and supervisors who on a voluntary basis exchange best practices on climate and environmental risk management in the financial sector, with the overarching goal of contributing to the mobilisation of finance towards more sustainable options.
Science Based Targets initiative (SBTi)	The Science Based Targets initiative, or SBTi, is a collaboration of the Carbon Disclosure Project, the United Nations Global Compact, the World Resources Institute, and the World Wide Fund for Nature. It translates the Paris requirements into tangible emission-reduction goals for businesses.
Partnership for Carbon Accounting Financials (PCAF)	The Partnership for Carbon Accounting Financials, or PCAF, seeks to develop a common standard for assessing and disclosing climate impacts using science-based targets. PCAF worked with the GHG Protocol to develop the Global GHG Accounting and Reporting Standard for the Financial Industry.
Taskforce on Climate-related Financial Disclosures (TCFD)	The Financial Stability Board established the Task Force on Climate-related Financial Disclosures, or TCFD, to provide uniform climate reporting that companies can use to inform lenders, insurers, investors, and other stakeholders.

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