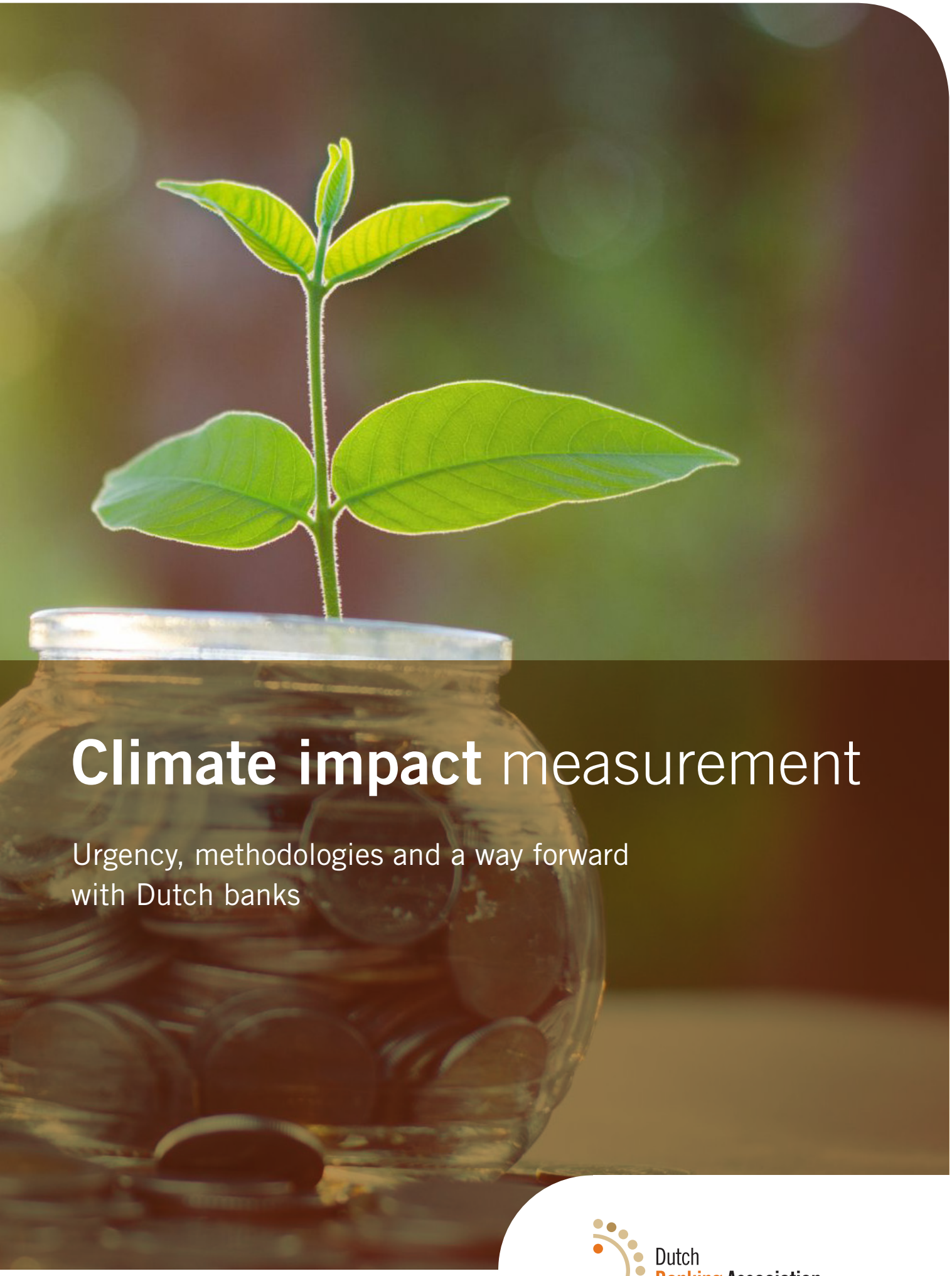

Climate impact measurement

Urgency, methodologies and a way forward with Dutch banks

Dutch Banking Association

This document is for banks interested in climate-impact measurement, climate management and reporting their portfolio. It contains background information, current initiatives, available methodologies and our way forward. Readers should bear in mind that it is intended to be a living document and departure point for further dialogue among all stakeholders concerned. It was drafted in collaboration with Dutch banks that are closely involved in the development of the methodologies mentioned.

Inhoud

1 Climate action by banks

Call to action

The Paris Agreement sets out a global action plan to put the world on track to avoid dangerous climate change by limiting global warming to well below 2°C and pursuing efforts to limit it to 1.5°C. This requires rapid and far-reaching transitions in energy production and usage, land use, industry, buildings, transport and urban planning.

Numerous companies are committed to working individually and in partnership with governments to mobilise the technology, investment and innovation needed to transition to a sustainable carbon-neutral economy and to align with the Paris Agreement.

Banks have an important role to play, too, as corporate citizens, in scaling and accelerating this transition and aligning finance flows with a climate-resilient pathway. One of the driving forces behind change is the growing expectations of stakeholders. Investors, rating agencies and governments are demanding that banks respond to climate-related risk and cooperate on the transition to a low-carbon economy, and are evaluating the bank's efforts. Moreover, there is an increasing realisation in society, and more specifically among banks, that addressing climate change is the right thing to do to. Furthermore, this realisation allows banks to mitigate the risks of climate change in their portfolios and capitalise on the many opportunities the transitions present.

Banks have an important role to play in scaling and accelerating a transition to a carbon-neutral economy and making finance flows consistent with a pathway towards climate-resilient developments.

Important climate initiatives for the banking sector

In addition to the Paris Agreement, there are several important international and national pledges and initiatives that outline the joint commitment and the way banks can help facilitate their clients in the transition to a low-carbon economy and managing climate risks. The most notable pledges and initiatives are outlined below:

Climate pledges and initiatives involving Dutch banks

Task Force on Climate-related Financial Disclosures (TCFD)
In April 2015 the G20 asked the Financial Stability Board (FSB) to consider climate risk. The FSB identified the need for better information to support informed investment, lending, and insurance decisions and to improve understanding of climate-related risks. The TCFD was therefore established. The TCFD developed recommendations for climate-related financial disclosure that includes climate governance, strategy, risk management, and metrics & targets.

Science Based Targets initiative (SBTi)
The SBTi is a global initiative to help companies and financial institutions to set science-based emission targets in order to reduce their climate impact. For the financial sector this will include the development of target-setting methods for their investment and lending portfolios. Forty-five financial institutions (and counting) have publicly committed themselves to setting science-based emission targets. SBTi is a collaboration between CDP, the World Resources Institute, the World Wide Fund for Nature, and the United Nations Global Compact.

Financial sector commitment to the Dutch Climate Agreement
Financial institutions in the Netherlands have formulated their joint commitment to the Dutch Climate Agreement, with the aim of supporting the government's ambition to reduce the carbon emissions of the Netherlands by 49% in 2030 and 95% in 2050. All signatories are expected to measure and externally report the impact of their lending and investments on climate change and to develop their own climate action plan. In addition, signatories are encouraged to signal structural impediments in financing to resolve issues together.

EU Taxonomy
The European Commission set out an action plan on financing sustainable growth to bridge the gap between climate and finance. One of the key challenges that the Commission defined is the lack of a common definition of 'sustainable investment'. The Commission aims to address this through the establishment of an EU classification system of all economic activities to define what is and is not considered a sustainable activity. The end-product is a clear and detailed EU classification system ('taxonomy') for sustainable activities that addresses the current lack of common standards and shared understanding of the term.

Principles for Responsible Banking
Over 100 banks in 49 countries have signed the Principles for Responsible Banking, representing over $47 trillion. These principles provide the framework for a sustainable banking system. Signatories commit themselves to measuring and disclosing ESG-related information guided by the SDGs and the Paris Agreement. A bank's initial self-assessment is to be published within 18 months of becoming a signatory, followed by annual self-assessments thereafter. Furthermore, signatories are required to fully implement the required steps on impact analysis, target setting & implementation, and accountability within four years.

2 Measurement and reporting methodologies

Development of measurement and reporting methodologies

There is broad agreement in the banking sector that banks have a role to play in contributing to the climate goals of the Paris Agreement by supporting their clients in reducing greenhouse gas (GHG) emissions. There are several methodologies to measure and report on the climate impact of the companies and projects a bank finances. Banks have different asset mixes, serve diverse roles in society and are active across a wide range of sectors, from private homes to large-scale international projects. Therefore, different climate-impact measurement and reporting methodologies could be of interest and more or less suitable for different banks.

So far no single methodology has proved perfect, or sufficient. Different methodologies could be used complementarily.

Climate-impact measurement and reporting methodologies for banks are in an incipient state of development. This diversity and the potential pitfalls are recognised by both banks and stakeholders, such as the Dutch Ministry of Finance, and are not expected to change in the near future. There is more than one road to Paris. So far no single approach has proved perfect, or sufficient: multiple methodologies are needed. In this way we can learn from each other, share best-practices and develop an array of methodologies to effectively address climate change.

Most dicussed measurement and reporting methodologies

As mentioned in the previous section a variety of measurement and reporting methodologies are in development. However, two methodologies are often discussed in the Netherlands and will be the focus of this document. These are the PCAF carbon-accounting methodology and the PACTA technology-based methodology. Over the past several years Dutch banks have put in a lot of work in developing these two methodologies, and it is still an ongoing effort:

1 Partnership for Carbon Accounting Financials (PCAF)

PCAF is a Dutch industry-led initiative to harmonise the way in which financial institutions measure and disclose GHG emissions represented by their loans and investments. Based on a set of overarching accounting principles, the direct and indirect emissions (scope 1, 2 and 3 if available and relevant)[1] of clients are attributed to a bank to arrive at the total scope 3, or 'financed emissions' of the institution. Currently, the PCAF members have developed and harmonised methodologies for nine asset classes (see table below).

2 Paris Agreement Capital Transition Assessment (PACTA) for Corporate Lending

PACTA is the technology-based methodology developed by 2° Investing Initiative (2Dii), an industry-led international initiative to enable benchmarking, including target-setting, and disclosure of the technology shift needed across certain sectors to slow global warming.[2] Detailed technology roadmaps for each sector are being developed by independent organisations like the International Energy Agency and within global frameworks such as the Poseidon Principles. These roadmaps are used as benchmarks to identify the climate impact of individual companies and a bank's corporate lending portfolios to these companies. An IT tool compares the benchmarks to the technology lending clients are using today and planning on using in the future. Currently, PACTA has identified technology roadmaps for seven sectors.

By adopting a sector-by-sector approach, banks could use various methodologies such as these two. PCAF and PACTA can be used complimentarily.

In tables below explain coverage, metrics, highlights and challenges of both PCAF and PACTA. The purpose is to summarise key aspects of the methodologies. In this way, banks can define how the methodologies could be used separately or combined complementarily, depending on their respective products and client portfolios.

[1] **Scope 1 GHG emissions** – All Direct Emissions from the activities of an organisation or that are under their control, including fuel combustion on site such as gas boilers, fleet vehicles and air-conditioning leaks. **Scope 2 GHG emissions** – Indirect Emissions from electricity purchased and used by the organisation. Emissions are created during the production of the energy and eventually used by the organisation. **Scope 3 – All other Indirect GHG Emissions** from activities of the organisation, emanating from sources that they do not own or control. This covers emissions associated with business travel, procurement, waste and water.

[2] For more information, the 'Terra Toolbox' provides an overview of methodologies and the metrics used to set targets for each sector, see a reference to the report in the Annex.

PCAF Partnership for Carbon Accounting Financials

General description

PCAF is a tool to measure and disclose a bank's scope 3 category 15 (investment) GHG emissions. The methodology is based on a set of overarching accounting principles, to measure direct and indirect emissions (scope 1, 2 and 3 if available/relevant)[1] of clients that are attributed to the financial institution.

Coverage

PCAF focuses on asset classes in the bank's portfolio. Currently covered:

1 Sovereign bonds
2 Listed equity
3 Project finance
4 Mortgages
5 Commercial real estate
6 Corporate debt
7 Corporate/SME loans
8 Indirect investments
9 Motor vehicle loans

Metrics

Carbon accounting approach that estimates the absolute and/or relative GHG emissions, i.e. 'emissions intensity' of the portfolio/loan book (GHG emissions per million outstanding/invested).

Highlights

- Suitable to measure the carbon footprint of asset classes.
- Single metrics that can be aggregated and links to emissions-based approaches within SBTi.
- An accurate measurement of the carbon footprint will help steer towards lower carbon emissions across the board and lead to solutions where most efficient. It also allows for gradual steering across sectors rather than disruptive withdrawals from a particular sector.
- Insights into individual carbon footprints stimulates technological progress towards low-carbon innovation, because this puts on the pressure to act on companies with a high-carbon footprint.

Challenges

- The main challenge is large data gaps related to the carbon footprint of individual companies, which is why the current calculations work with sector averages. Internationally accepted standards for measuring the carbon footprint at the company level still need to emerge.
- Consequently, it does not yet facilitate steering for all sectors, because the data are still mostly based on sector averages and not forward-looking.

PACTA Paris Agreement Capital Transition Assessment

General description

PACTA is a benchmarking and disclosure tool, which also allows for target-setting. The methodology looks at the technology shift needed within certain sectors to slow global warming and then measures this against the actual technology clients are using – or plan on using in the future.

Coverage

PACTA focuses on sectors within listed equity and corporate loans/bonds in the bank's portfolio. Currently covered:

1 Fossil fuels; oil & gas, coal
2 Renewables and conventional power
3 Automotive
4 Shipping
5 Aviation
6 Steel
7 Cement

Metrics

Technology approach that applies the most relevant metric for each sector: economic activity/technology data, or CO2 intensity per unit of production (not being absolute emissions). Current and future exposure of economic activity/technology data is compared to climate scenarios such as a well-below 2°C scenario.

Highlights

- Forward-looking; steers key climate sectors towards critical shifts in technology that underpin a low-carbon future.
- Tailored to each sector's needs.
- Utilises accurate data at sector and client-level from global asset databases.
- In the absence of accurate carbon footprint information at the client level and a proper carbon price, this method is the fastest way to engage with clients on climate change abatement.
- Easy to communicate since companies currently find technology easier to grasp than a carbon footprint.

Challenges

- Does not cover all sectors, only those globally representing roughly 75% of direct emissions.
  - For some carbon-intensive sectors, meaningful metrics are still in development.
  - By not looking at the carbon footprint of all companies, some large contributors could be left out.
- Still in the piloting phase and has not yet reached the scale-up phase, therefore is not yet fully accessible.
- Could still require some manual work to link clients or physical assets financed by a bank to external databases.

The PCAF and PACTA methodologies focus on different aspects of a bank's portfolio and utilise different metrics for measurement. It is up to the individual banks to decide if and where a methodology can be more appropriately used. The working groups of these methodologies actively share knowledge and experience with each other and other stakeholders, both international and otherwise, to further develop the methodologies and evaluate how these can complement and reinforce each other where applicable.

Climate change will impact banks and the financial sector as a whole. PCAF and PACTA primarily look at the contribution of a bank's clients to climate change. These two methodologies were not developed with the aim of addressing climate-related risk. Banks have become increasingly aware of these risks and means to identify, measure and address climate risk are in development. However, like most climate metrics, such risk assessment tools and methodologies are still at an incipient stage of development. A working group that has set some first steps in this direction is the UNEP FI TCFD Working Group. Sixteen international banks (now expanded to 36) joined forces in 2017 in order to develop methodologies for measuring both transition and physical climate risks and opportunities, an effort that is coordinated by the UNEP FI. For banks to make informed decisions in the future, they have to adequately equip themselves to weigh climate-related risks.

3 Moving forward together

Joint effort is key

The percentage of banks reporting on climate change has increased over the last three years. Many banks are putting significant thought and effort into climate-impact measurement and reporting and many investors have seen this work pay off in the form of an increase in the availability and quality of disclosure.

The percentage of banks reporting on climate change has increased and is higher than the average across all companies

However, progress must be accelerated. Today's disclosures remain far behind the scale the markets need to channel investment to sustainable and resilient solutions and business models. We still need a significant amount of analytical work to equip banks with the appropriate tools and methodologies to identify, quantify and mitigate climate risks in the financial system, as well as to enable banks to contribute to mitigating climate change. Banks cannot do this on their own. Collaboration amongst banks is key, but a more effective interplay between banks, policymakers, academia and other stakeholders is also crucial.

Banks are seeking to collaborate with those stakeholders to develop together:

- Industry roadmaps based on clear sector targets (on a national level) to combat climate change;
- More robust data on energy efficiency (or even actual energy use) of real estate;
- An effective carbon price to facilitate the growth and credibility of carbon markets;
- A consistent and internationally accepted standard for accounting carbon at the company level.

As mentioned before, no single climate impact measurement and reporting methodology is perfect, or sufficient, yet. Therefore we need to combine our efforts and refine the different methodologies.

Effective interplay between banks, policymakers, academia and other stakeholders is crucial to refine measurement and reporting methodologies and tackle climate change.

How to join and start as a bank

In 2019 quite a few banks are actively involved in the different climate initiatives and manage and report on their climate impact. What if you, as a bank, also want to proactively and constructively act on climate change? What are the first steps you can take?

Below is a practical roadmap for starting climate management and reporting:

1 Take the TCFD recommendations as a starting point;
2 Establish an effective climate governance at board level within your bank;
3 Define appropriate measurement methodologies to analyse your climate impact (based on your respective product and client portfolio);
4 Develop processes to manage your climate impact, including establishing (science-based) targets and an action plan;
5 Externally report on climate impact of your lending and investments.

As mentioned in the introduction, this document is intended to be a living document and will be updated once a year or intermediately in the case of new developments that require addressing. Furthermore, the NVB is more than willing to engage in a dialogue on the subject with interested parties.

Sources used in this document:

- 2° Investing Initiative
- Commitment van de financiële sector
- EU-taxonomy
- Paris Agreement Capital Transition Assessment
- PCAF – Partnership for Carbon Accounting Financials
- Principles for Responsible Banking
- Science Based Targets initiative
- Task Force on Climate-related Financial Disclosures
- Terra progress report 2019 (includes the 'Terra Toolbox')

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