



# **Sustainable Markets Initiative**

## **Investor Expectations for Banking Transition to Net Zero Emissions**

**Asset Manager & Asset Owner Task Force**



## ABOUT THE ASSET MANAGER & ASSET OWNER TASK FORCE

The Sustainable Markets Initiative (SMI) was formed at the invitation of His Royal Highness the Prince of Wales, at the World Economic Forum (WEF) Annual Meeting 2020, with the goal of creating a coalition of parties who share his view that progress towards a sustainable future must be accelerated. The Asset Manager & Asset Owner Task Force is a sub-group of the SMI formed of a group of CEO-level executives from a number of the world's largest asset manager and asset owners. It brings together senior leaders to develop and enable solutions to help accelerate the transition to sustainable markets and support the rapid decarbonisation required across the real economy using the two most powerful levers at their disposal: capital already invested in companies and fresh capital investments directed at climate mitigation and adaptation projects.

Members of the Task Force include:

<b>AP2</b>	<b>Macquarie</b>
<b>Bank of America Merrill Lynch Asset Management</b>	<b>Morgan Stanley</b>
<b>BlackRock</b>	<b>National Employment Savings Trust</b>
<b>Brookfield Asset Management</b>	<b>New Zealand Superannuation Fund</b>
<b>CalPERS</b>	<b>Ninety One</b>
<b>CalSTRS</b>	<b>PensionDanmark</b>
<b>Capital Group</b>	<b>The People's Pension</b>
<b>CDPQ</b>	<b>PIMCO</b>
<b>Fidelity International</b>	<b>PKA</b>
<b>Gulf Capital</b>	<b>Rockefeller Capital Management</b>
<b>HSBC Asset Management</b>	<b>Schroders</b>
<b>JPMorgan Asset Management</b>	<b>TIAA/Nuveen</b>
<b>Kuwait Investment Authority</b>	<b>Vanguard</b>
<b>Legal &amp; General Investment Management</b>	<b>Washington State Investment Board</b>
	<b>Wells Fargo Asset Management</b>

This document is the product of the Stewardship & Engagement Working Group of the SMI Asset Manager and Asset Owner Task Force.

Chaired by State Street

With contributions from:

CalSTRS  
Capital Group  
Fidelity International  
Rockefeller Capital  
State Street

## I. INTRODUCTION

As long-term investors, we recognize the threat of climate change to our investments and view fulfilment of the Paris Agreement's goal to hold global average temperature rise to "well below 2°C" as an imperative. According to a report by the Boston Consulting Group, \$3-5 trillion of investments a year will be required to meet the ambitions set out in the Paris Agreement. Banks will undoubtedly play a major role in the allocation of capital to fund the climate transition, generating new investment opportunities. But at the same time, climate change will lead to significant transition and physical risks that will create material risks to the creditworthiness of the banks' borrowers and asset values. Banks need to understand and measure these risks in order to assess their operational resilience in respect to their credit exposures and impact on their capital levels. Banks need to set out a clear and credible strategy for their climate objectives and align their exposures accordingly.

Recognizing the scale and urgency of the action needed, we have developed the following investor expectations. In the spirit of partnership and collaboration, we ask banks to raise their ambition by striving for a goal of global net-zero emissions by 2050 while acknowledging that specific timelines might differ by jurisdiction, for example in emerging markets. We ask banks to make this commitment in order to manage climate-related risks and proactively position themselves for a low carbon economy.

As active stewards of capital, we regard stewardship as integral to our investment process. While each of our firms may take different approaches to stewardship, we agree on the principles laid forth herein, and we will independently incorporate them into our research and engagement efforts. We view the actions articulated herein as critical for the industry to assume a sustainable pathway, and we believe that oversight of company performance in these areas is vital to our fiduciary responsibility.

## II. EXPECTATIONS OF BANKS

1. **Strategy/Action:** Banks need to *specify their exposure to climate risks* at both the Group and business level and set out a clear roadmap tailored proportionally to their business model and revenue stream *to address those risks*. Banks' largest impact on climate change is through their investment and lending activities (Scope 3). *This includes financing high-impact sectors to support their transition to a more sustainable business model*. Strategy plans should also address the opportunities that the global transition to a low-carbon economy provides.
  - a. **Target setting** - Banks need to disclose their climate commitments covering both risks and opportunities with specific science-based targets and action plans on how these will be achieved. Banks should present a time horizon for their targets both medium- and long-term. Banks should provide an *explicit interim target* to serve as a metric to assess if their strategy is on target to meet the longer term goals and hold banks accountable to achieving their long term targets.
  - b. **Target scope** - Banks' strategy needs to have specific targets highlighting their Scope 3 risks and if a target is based on emissions intensity, then



**consideration needs to be given for certain sectors, ie thermal coal, to set emission reduction targets in absolute terms.** The Scope 3 risks should cover at a *minimum* exposure on banks' balance sheets but should also include instruments such as capital markets underwriting and guarantees. Banks should also disclose where they face data limitations and any simplifying assumptions they use to overcome these challenges in measuring and setting targets for their Scope 3 emissions.

- c. **Sector exposure - Banks should set out a clear action plan to address at a minimum exposure to sectors that are the highest GHG emitters.** The Task Force on Climate-related Financial Disclosures (TCFD) recommends that banks define carbon-related assets as energy, transportation, materials and buildings, and agriculture, food, and forest products. This recommendation is fairly narrow and should serve only as a starting base. *Banks should disclose if their plans include financing for new fossil fuel exploration and how these plans are in keeping with a 2 degree or lower scenario.*
- d. **Scenario planning - We expect banks to follow the TCFD recommendation to use scenario analysis to help inform their strategic and financial planning processes.** Our expectation is for banks to be transparent in the scenario pathway that they have chosen and align their portfolios based on their stated targets. We recommend that chosen scenarios:
  - i. Use a 2°C or lower scenario
  - ii. Be from a credible source, such as those of the IEA and IPCC
  - iii. Provide transparency on how the scenarios are applied

*We acknowledge that the current scenario pathways that are available do not all currently include a 1.5°C benchmark and, hence, banks should be prepared to evolve their scenario analysis as new methodologies are introduced. In the meanwhile, a 2°C scenario can be adapted with buffers to take into account the uncertainties around such scenarios.*

- e. **Green Finance - Banks should also specify their strategy to capture the opportunities presented in the green transition.** We see this as a massive opportunity for banks given the size of financing that is required to help economies transition to net-zero, and we expect banks to be ambitious in setting their green financing targets. Banks should aim to provide explicit targets on green financing with clear definitions of what is included. *We consider it important that banks engage and assist their clients in transitioning to a low carbon world, rather than simply divesting from high GHG emitters.*

- 2. **Disclosure:** By providing transparent disclosure on climate risks, banks can engage with all stakeholders to identify concrete actions. As part of their climate reporting, banks should provide an overview of their business model, a breakdown of their revenue generation and respective climate risks by business segment. In this way, investors can assess that proportionate consideration is being given to each business segment, representative of their relative importance. Banks need at a *minimum* to provide disclosure of the target and transition plan and alignment with the TCFD recommendations. The TCFD disclosures should be complemented with the following:



- a. **Management discussion & analysis** – Banks should provide annual disclosure of actions/strategies taken during the year to meet Scope 3 portfolio targets, sectorial exposures, and sustainable finance objectives. Banks should consider proving this disclosure in their main financial reports based on the guidelines and direction of their local jurisdictions.
  - b. **Sector exposure** - Banks should explicitly disclose their exposure to carbon-intensive industries. As highlighted in the strategy section, the starting point should be the TCFD recommendation of covering energy, transportation, materials and buildings, and agriculture, food, and forest products, but banks should aspire to broaden this list.
  - c. **Financial implications** - All relevant risks associated with climate change should also be assessed and, if determined to be materially meaningful, then should disclose impact on company performance and prospects. The financial accounts must be prepared to account for climate risks and associated discussion provided about the impact of these considerations following the regulatory framework of local jurisdictions.
  - d. **Taxonomy** - Banks should work to provide disclosure according to a taxonomy on green investment and explain how such classification is being applied to their products. Ratios of 'green' and 'non-green' finance may be useful in demonstrating alignment to the Paris Goals, with an emphasis on quantifying how clients are assisted in their transition.
3. **Governance:** We expect banks to make a commitment to an ambitious decarbonization plant that ideally gets to net-zero emissions by 2050 and has an overarching supervision by the Board. It is critical for this commitment to be supported by management leadership and implemented through company culture. Robust governance in the banks' decarbonization roadmap should include:
- a. **Risk ownership** - Board need to prioritize implementing their climate strategy and ensure that specific attribution of this responsibility is done throughout the organization. Accordingly, banks should provide clarity around the risk management process of assessing climate risks. Risks that are identified need to be reported in a robust way across the Group. Banks should have in place the necessary escalation processes for climate-related risks that are identified.
  - b. **Climate competence** - Boards should have the requisite skill sets and knowledge to oversee the bank's climate strategy and identify within whom they reside. Banks need to be well-informed where the climate risks would show up across their activities and boards are expected to stay climate competent through ongoing learning and updates from climate-related teams.
  - c. **Incentivization** - Board and senior management compensation should be aligned with the commitment set in regards to decarbonization. Compensation should be linked to the company's specific sustainability metric and targets as outlined in its disclosure. KPIs need to be specific and tied to interim targets. The targets should be stretching, aligned with strategic priorities, and focused on the most material aspects of the banks' climate strategy.
  - d. **Culture** - Assessing climate risks and opportunities need to be embedded in the culture of the organization from the top down. Educational and training



programs should facilitate culture development on the key climate topics and be integrated into performance assessments for those staff where it is relevant to their role.

### III. RELATIONSHIP TO OTHER REPORTING INITIATIVES

Banks should engage with other banks and working groups with the aim to establish disclosure according to a global taxonomy, akin to US GAAP, IFRS frameworks used for financial disclosures.

We understand that banks currently face a number of disclosure frameworks and guidelines. As investors our aim is for the expectations set above to be able to use existing frameworks. As stakeholders we have an interest in aligning ourselves with the work already undertaken by such groups as IIGCC and CA100+.

### IV. CONCLUSION

The banking sector is facing multiple transitional, liability and physical climate related risks across all its activities, and therefore it is vital that these are properly managed. At the same time, it is uniquely positioned to be a catalyst for ensuring a rapid and orderly transition across the economy to reach the Paris Goals.

We are all long-term investors acting in the interests of the beneficial owners whose capital we manage. Despite our various viewpoints and investment approaches, we believe the expectations for banks that we set out above are important to the sustainability of the industry. We believe that our own efforts to reference these expectations in our investments and our engagements - along with efforts of other asset owners and asset managers to do the same - will have the effect of accelerating the transition to a Net-Zero future by 2050. These asks are meant to serve as an example of best practice - they are not intended to be overly prescriptive, and are certainly not exhaustive. Rather, they are designed to accelerate actions that - if taken - will lead to faster decarbonization of a critical industry.



## REFERENCES

- Final Report Recommendations of the Task Force on Climate-related Financial Disclosures  
[FINAL-2017-TCFD-Report-11052018.pdf \(bbhub.io\)](#)
- Science Based Targets Guidance  
[Financial-Sector-Science-Based-Targets-Guidance-Pilot-Version.pdf](#)
- PCAF Global GHG Standard  
[The Global GHG Accounting and Reporting Standard for the Financial Industry \(carbonaccountingfinancials.com\)](#)
- NGFS Technical Documentation  
[Overview of Environmental Risk Analysis by Financial Institutions | Banque de France \(ngfs.net\)](#)
- UNEP Guidelines for Climate Target Setting for Banks  
[UNEP-FI-Guidelines-for-Climate-Change-Target-Setting.pdf](#)