UK FINANCE

COP26 AND BEYOND:

The building of the regulatory framework for climate responsibility and an industry analysis of the state of play of UK net zero banking.

4 November 2021

UK Finance is the collective voice for the banking and finance industry.

Representing around 300 firms across the industry, we act to enhance competitiveness, support customers and facilitate innovation.

We work for and on behalf of our members to promote a safe, transparent and innovative banking and finance industry. We offer research, policy expertise, thought leadership and advocacy in support of our work. We provide a single voice for a diverse and competitive industry. Our operational activity enhances members' own services in situations where collective industry action adds value.

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I. FOREWORD

As Boris Johnson warned at the G20 summit in Rome just ahead of the start of COP26, time is running out for the world – and leading economies in particular – to tackle climate change. While the world waits to see what will be the outcome of COP26, all industries and sectors are examining what can be done in their area and the banking and financial services sector is no exception.

This report, published during the first week of COP26, sets out an industry policy statement in support of the UN-convened Net-Zero Banking Alliance (NZBA), all banking and finance firms embedding climate responsibility into governance and strategy, and the setting of clear definitions on ESG being determined within a globally aligned framework.

The report also provides an overview of the steps being taken to put in place a comprehensive statutory and regulatory framework that is already beginning to underpin the greening of the economy. While this has a long way to go, it is substantially advanced in comparison to the conceptual discussion that was still taking place at the time of the Paris Agreement in 2015.

Within this report we have included a climate responsibility 'resource pack'. In this we have drawn together the many governmental, regulatory and market initiatives that strike us as having relevance to understanding the expectations being placed on firms in respect of climate responsibility.

For this we have put aside any need to express an opinion, instead seeking to make available in one place 60 or so reports that have a bearing on a banking and finance firm's climate strategy. This includes a dozen announcements made in the fortnight directly preceding COP26 and two made during COP.

This report also includes an account of 21 interviews conducted over the summer as sustainability leads within firms got to grips with translating their climate activity to date into the actions needed to fulfil net zero commitments being made, as well as ever advancing regulatory expectations.

There is a real active drive within individual firms to build climate considerations into their decision-making, as this report sets out to show. This perhaps should be read in conjunction with the practitioner's guidance published a fortnight ago by the Financial Services Taskforce of the Sustainable Markets Initiative.

The report closes with case studies illustrating the breadth of climate-related activity within member firms.

Throughout the drafting of this report, we have needed to repeatedly update the reference to the number of NZBA signatories, as they have risen from the original 43 signatories from 23 countries announced on 21 April, to more than double this figure. Currently standing at 89, this includes the eight largest UK lenders and a further 30 UK Finance members.

UK Finance can be found amongst the UNEP FI recognised NZBA Supporting Institutions.

Paul Chisnall
Director, Sustainability, UK Finance

4 November 2021

"No one is escaping the trend towards green... The old way of business is becoming extinct, and supporting businesses that are working towards a sustainable future has become a board objective"

II. UK FINANCE COP26 POLICY STATEMENT

UK Finance has been a longstanding proponent of:

- Climate responsibility being brought into the mainstream of the management and supervision of banking and finance; this is evidenced by our early support for the recommendations of the G20 Financial Stability Board Task Force on Climate-related Financial Disclosures (TCFD) and steps being taken in the UK and internationally to create a statutory and regulatory framework in support of climate responsibility.
- Banking and finance firms defining their strategic purpose by reference to broader stakeholder perspectives, whether customers, employees or societal and environmental, taking these into account in their business decision-making.

Over the past 18 months we have:

- Provided assistance to the Coalition of Energy Efficient Buildings formed by the Green Finance Institute (GFI), engaged with the financial regulatory authorities and supported the Climate Financial Risk Forum (CFRF).
- Supported the Grantham Research Institute in the launch of its report 'Financing climate action with a positive social impact: How banking can support a just transition in the UK'.
- Participated in a European Banking Federation (EBF)/United Nations Environment Programme Finance Initiative (UNEP FI) dialogue on the practical application of the EU taxonomy, with their report published January 2021.
- Responded to 20 UK, EU and international consultations, engaging as appropriate with governmental and regulatory bodies.
- Published our own white paper on multi-year commitments to sustainable finance, as an early contribution to work intended by legislators, regulators, standard setters and business leaders to provide more of a common framework for environmental, social and governance (ESG) reporting.
- Held our spring 'COP26 and Beyond' roundtable and webinar series in which we involved 45 member firms in a structured dialogue combining regulatory expectations for the embedding of climate responsibility within mainstream management and supervision and the priorities for private finance as identified by Mark Carney.
- Arranged for member liaison with the COP26 Private Finance Unit and the UNEP FI on the advent of the Net-Zero Banking Alliance (NZBA) within the Glasgow Financial Alliance for Net Zero (GFANZ).

In terms of COP26, UK Finance stands behind:

- The industry-led and UN-convened Net-Zero Banking Alliance (NZBA) within the Glasgow Financial Alliance for Net Zero (GFANZ) launched on 21 April with the support of 43 banks from 23 countries. Signatories have since more than doubled and the opportunity for firms to become an NZBA signatory remains open.
- All banking and finance firms embedding climate responsibility into their governance and strategy in support of whole economy transition to net zero by 2050, premised upon just and orderly principles.
- Clear definitions on ESG reporting, extending to nature-based and social aspects of ESG, being determined within a globally aligned framework. We support in principle the remit being given to the International Sustainability Standards Board (ISSB).

UK Finance is an NZBA Supporting Institution.

III. INTRODUCTION: FROM THE TRAGEDY OF THE HORIZON TO NET ZERO AMBITION

The UK's governmental response to climate change dates back in large part to the passing of the Climate Change Act in 2008, including through the establishment of the Committee on Climate Change to provide independent advice to government on the reduction of climate emissions within the UK economy.

Arguably though, it is only through international cooperation – not least in the form of the Paris Agreement in 2015, and the adoption of a common goal to limit global warming to well below 2, preferably to 1.5° Celsius in comparison to pre-industrial levels – that we have seen a partnership begin to be forged across government, regulators, industry, academia and many others in civic society in support of climate action being taken.

This has involved turning the discussion from whether there is such a thing as man-made climate change into a broadly universal acceptance that we have a problem, and one that may prove to be existential if we do not take decisive and concerted action to reverse decades of emissions growth. Significant progress is needed over the next decade if we are to achieve net zero emissions by 2050.

Central to this was the introduction in June 2019 of a statutory target requiring the UK to bring all greenhouse gas emissions to net zero by 2050. The UK was the first major economy to pass net zero emissions legislation and earlier this year enshrined in law a new target to achieve a 78 per cent reduction in emissions by 2035 in comparison to 1990 levels.

In order to achieve this, the UK has adopted a series of overlapping decarbonisation strategies impacting different parts of the economy, with several iterations made in the months preceding COP26 in Glasgow. As far as finance is concerned, the central governmental reference point was the publication of the Green Finance Strategy in July 2019, which set out a comprehensive approach to the greening of the financial system, placing finance at the heart of the UK's clean growth strategy, 25 Year Environment Plan and Industrial Strategy.

In a regulatory context, a seminal moment was the delivery of Mark Carney's 'Tragedy of the Horizon' speech on 29 September 2015. In this he described climate change as a tragedy which imposes costs on future generations that the current one has no direct incentive to fix. This arises because the traditional horizons for the business cycle, the political cycle and for the monetary policy and financial stability remits of central banks and regulatory authorities extend out less than a decade. The nature of climate change is such that by the time it becomes a defining issue for financial stability, it may be too late to take decisive action.

It should be appreciated that Mark Carney delivered his speech both in the capacity of being the then Governor of the Bank of England, and the then Chair of the G20 Financial Stability Board. In explaining that climate risk should be seen as comprising physical risks and transition risks, he gave an early insight into a distinction between differing climate risks that shaped the supervisory regime that the UK Prudential Regulatory Authority (PRA) followed in publishing its supervisory statement 3/19 'Enhancing banks' and insurers' approaches to managing the financial risks from climate change'.

This statement in effect requires PRA-regulated firms to bring responsibility for climate risk into mainstream banking supervision – with assigned senior management responsibility. It also requires firms to distinguish between physical risk and transition risk, also dividing between credit, market and operational risk as opposed to placing in a climate risk 'silo'. This was amply illustrated as reproduced below in a Bank of England thematic report published directly before the autumn 2018 consultation preceding SS3/19. The PRA has since underlined its expectations in a 'Dear CEO' letter sent by Sam Woods on 1 July 2020. Guidance prepared by the PRA and FCA-convened, industry-resourced Climate Financial Risk Forum (CFRF), both around that time and subsequently, provides a collective industry view of the steps needed to embed climate responsibility across a firm – with the latter offering common themes but distinct approaches from the perspective of banking, insurance and asset management.

	CREDIT	MARKET	OPERATIONAL
PHYSICAL	Increasing flood risk to mortgage portfolios	Severe weather events lead to re-pricing of sovereign debt	Severe weather events impact business continuity
	Declining agricultural output increases default rates		
TRANSITIONAL	Tightening energy efficiency standards impact property exposures	Tightening climate-related policy leads to re-pricing of securities and derivatives	Changing sentiment on climate issues leads to reputational risks
	Stranded assets impair loan portfolios		
	Disruptive technology leads to auto finance losses		

Source: Fig 3.1, Transition in thinking: The impact of climate change on the UK banking sector, Bank of England, September 2018 (accessible here)

Mark Carney also foreshadows the establishment of the Task Force on Climate-related Financial Disclosures (TCFD), the international taskforce chaired by Michael Bloomberg which aims to tie together an estimated 400 initiatives around the world seeking to give definition to climate information.

The TCFD model – based upon putting figures on the exposures within a disclosure model asking about risk management, scenario analysis, governance and strategy (i.e. what climate change means in real terms for the organisation and its business model) – sits not only at the heart of the PRA's expectations, but as of this year is a 'comply or explain' requirement for premium listed companies. Government ministers announced last autumn that TCFD-type disclosure will be built into UK companies legislation. We expect that TCFD will become a statutory requirement across the G7, along with a clear mandate being given to the IFRS Foundation for the International Sustainability Standards Board.

Our support for a just transition represents the perspective we share with the Grantham Research Institute and others on the need for us to be mindful of the impact on jobs and communities when thinking about how to go about achieving net zero. The need for an orderly transition overlaps with this, and encompasses the fact that we need to encourage banking and finance to engage with companies within high emitting sectors in support of whole economy transition, rather than intentionally or unintentionally incentivising them to prematurely divest.

2019 brought the launch of the UN Race to Zero, a global campaign to rally leadership and support from businesses, cities, regions and investors for a healthy, resilient, zero carbon recovery that prevents future threats, creates decent jobs, and unlocks inclusive, sustainable growth. At the last count, 4,475 businesses, 799 cities, 35 regions and 220 investors and many others had signed up to this broad-based alliance. Members of the alliance are committed to the same goal: achieving carbon neutrality by 2050.

They have also created a powerful advocacy voice – over 600 companies have called upon the G20 to halve emissions by 2030 and to end support for coal power.

On 21 April this year – the day before President Biden's Leaders' Summit on Climate – the Glasgow Financial Alliance for Net Zero (GFANZ) was launched by Mark Carney, UN Special Envoy on Climate Action and Finance. This initially brought together over 160 firms together responsible for assets in excess of US $70 trillion. Membership has grown exponentially since. GFANZ joins leading net zero initiatives across the financial system to accelerate the transition to net zero emissions by 2050 at the latest. GFANZ member alliances are accredited by the Race to Zero campaign and must use science-based guidelines to reach net zero emissions, cover all emission scopes, including 2030 interim target setting, and commit to transparent reporting and accounting in line with UN Race to Zero criteria.

21 April also saw the launch of the Net-Zero Banking Alliance (NZBA) within GFANZ, initially formed from 43 of the world's leading banks from 23 countries, with assets of $28.5trillion. Members committed to aligning operational and attributable emissions to and from their portfolios with pathways to net zero by 2050 or sooner. The NZBA is convened by the UNEP Finance Initiative and was co-launched by the Prince of Wales' Sustainable Markets Initiative (SMI) Financial Services Taskforce (FSTF). NZBA signatories numbered 89 institutions at the last count.

With the foundations for climate responsibility having been soundly laid in recent years, due to the voluntary adoption of the TCFD recommendations, the meeting of supervisory expectations and actions taken within international industry alliances, the UK banking sector was pre-disposed to a globally set net zero commitment.

The UK's eight largest lenders and a further 30 institutions within UK Finance membership are amongst the 89 institutions signed up to NZBA globally.

In addition to the commitment statement, the UNEP FI has published guidelines for climate change target setting by banks. This has since been augmented by a practitioner's guide to net zero published by the SMI FSTF. This sets out principles that will underpin the way in which banks approach achieving net zero and includes insight into the steps that taskforce member banks have already taken and lessons learnt along the way.

The guide is for the benefit of all banks working to advance net zero commitments and enhance their climate responsibility. Further guidance is also in hand in GFANZ. These global initiatives serve to enhance coherence in the approach that institutions are taking towards tackling climate change and help overcome the fractured, piecemeal approach that previously existed.

Net-Zero Banking Alliance
Industry-led, UN-convened

NZBA commitment requires bank CEOs to agree to:

Transition the operational and attributable GHG emissions from their lending and investment portfolios to align with pathways to net zero or sooner.

Within 18 months of joining, set 2030 targets (or sooner) and a 2050 target, with intermediary targets to be set every 5 years from 2030 onwards

Banks' first 2030 targets will focus on priority sectors where the bank can have the most significant impact, i.e. the most GHG-intensive sectors within their portfolios, with further sector targets to be set within 36 months.

Annually publish absolute emissions and/or emissions intensity in line with best practice and within a year of setting targets, disclose progress against a board-level reviewed transition strategy setting out proposed actions and climate-related sectoral policies.

Take a robust approach to the role of offsets in transition plans

Summary of the components of an NZBA commitment; the commitment statement in full can be accessed here.

Ahead of the G20 Rome Summit the UNEP FI published its G20 input paper providing recommendations for credible net zero commitments from financial institutions.

This publication illustrates the extent to which climate responsibility, in many instances underpinned by a net zero commitment, is becoming embedded within governance and strategy. While we are still many years away from achieving the point where we need not refer to 'green finance' since all finance will be 'green', we are substantially advanced in comparison to when Mark Carney identified that concerted action is needed if climate change is not to become an insurmountable threat to financial stability.

This publication now divides into three:

- In the fourth section you will find what we have termed a climate responsibility 'resource pack'. This aims to draw together into a single online library many of the governmental, regulatory and market initiatives that collectively represent the architecture shaping the climate responsibility regime for banking in the UK.
- The fifth section provides an overview of early progress being made on net zero banking in the UK, the key trends and challenges.
- The sixth section sets out case studies illustrating activity in support of climate responsibility on the part of both small and large institutions.

Within the 'resource pack' we have sought to avoid offering comment or interpretation. Instead, by drawing together key reference material we hope to help colleagues within banking and finance, policy makers and opinion formers appreciate the breadth of work now being undertaken to turn 'rhetoric into action'. Through this we hope to reinforce the confidence that business leaders should have in pressing ahead with embedding climate and ESG goals across their organisations, even though the statutory and regulatory framework remains a work in progress.

Put bluntly, whether within the context of climate change, or societal expectations more generally, if we are to grasp the opportunity that the shock of Covid-19 has created, we cannot sit around and wait until the statutory and regulatory framework is fully formed. Business leaders have an opportunity to show that they want to shape the future rather than having that future shaped for them. We firmly believe that this is in keeping with the discussions taking place within boardrooms across the UK and that this is replicated not only within G7 and G20 nations, but more generally.

Our section on the 'current state of net zero banking' draws on a dialogue that UK Finance instigated earlier this year under the banner of our 'COP26 and Beyond' member dialogue and open webinar series, on the embedding of climate responsibility into mainstream management and supervision. It also draws on a series of interviews in which we encouraged interviewees to speak candidly of the progress being made within their firms and the challenges they faced, both individually and on behalf of their firms. While the analysis we offer is qualitative in nature, we believe this contributes to an understanding that banking and finance is stepping up to play its part.

Our aim in publishing this report is to provide readers with a good overview of the statutory and regulatory framework on climate responsibility that is still being put in place and the steps that are being taken within the banking and finance marketplace in support of whole economy transition to net zero.

We close with a brief word on COP26 and acknowledgements.

IV. CLIMATE RESPONSIBILITY RESOURCE PACK

The UK has been a world leader in climate policy since the Climate Change Act was passed in 2008. Since the Financial Stability Board established the Task Force on Climate-Related Financial Disclosures in 2015, there has been huge progress in developing a policy and regulatory framework for green finance. This remains a work in progress, with a wide range of important policy issues still under active discussion, both within government and industry.

This part of our online publication seeks to signpost the key policies, from the foundational to the cutting edge, as well as to provide an overview of some of the latest materials and thought leadership within and around the field of green finance.

This section is divided into six sections: UK government policies; UK regulation; international; public policy in development; key initiatives; and further guidance, commentary and advocacy. This material is brought together and can most easily be accessed via the accompanying 'resource centre' within the sustainability section of the UK Finance website.

1. UK government policies

1. Climate Change Act (2008)

The Climate Change Act (2008) was the world's first legally binding national-level climate change mitigation target. It committed the UK to reducing its greenhouse gas emissions by 80 per cent by 2050, compared to 1990 levels (in 2019 the reduction target was upgraded to 'net zero'); established a series of five-yearly national 'carbon budgets', and created the Committee on Climate Change (CCC), an independent body to advise the UK government and parliament on those carbon budgets.

2. Green Finance Strategy (2019)

The Green Finance Strategy sets out the role of the financial sector in delivering global and domestic climate and environmental objectives, including proposals for putting green finance at the heart of delivering the UK's Clean Growth Strategy, 25 Year Environment Plan and Industrial Strategy. The strategy distinguishes between the three goals of 'greening finance', 'financing green' and 'capturing the opportunity'. It also includes a commitment to establish a Green Finance Institute (see 5.2 below) to act as a bridge between the private and public sectors and sit between these three objectives.

3. Chancellor's statement on green finance: Vision and Green Financing Framework (2021)

The chancellor's vision was unveiled at his first Mansion House speech on 1 July 2021. The section on green finance included two headline announcements:

i. A set of integrated Sustainability Disclosure Requirements bringing together and streamlining climate reporting requirements to ensure consumers and investors have the information they need to make informed investment decisions and drive positive environmental impact.

ii. The creation, with the FCA, of a new sustainable investment label – a quality stamp – so consumers can clearly compare the impacts and sustainability of their investments. This is about future requirements; the recent FCA 'Dear AMF Chair' letter on authorised ESG & Sustainable Investment Funds based on current requirements

- Government departments subsequently coordinated to publish on 18 October Greening finance: A roadmap to sustainable investment. This sets out details of new economy-wide Sustainability Disclosure Requirements, and the legislative and regulatory changes that will be made to deliver them.
- The chancellor made a keynote speech during COP26 Finance Day on plans for the UK to become 'the world's first net zero financial centre', announcing that there will be new requirement for UK financial institutions and

listed companies to publish net zero transition plans. The statement was supported by a fact sheet.

4. Mandatory statutory reporting

- Following consultation earlier in the year, on 28 October BEIS laid in parliament the Companies (Strategic Report) (Climate-related Financial Disclosure) regulations 2021 and associated Explanatory Memorandum. The regulations introduce mandatory climate-related financial disclosures by publicly quoted companies, large private companies and Limited Liability Partnerships (LLPs) for accounting periods beginning on or after 6 April 2022.

5. UK Infrastructure Bank Policy Design

- The Policy Design document for the UK Infrastructure Bank set out the mandate and design of the new UK Infrastructure Bank, including the rationale for the bank and its initial areas of focus. These included: the initial £22 billion of capital available for the bank; the location of the bank's headquarters (Leeds); a local authority lending rate; next steps in the bank's development.
- The Green Financing Framework set out the government's proposals for the UK's first sovereign green bond issuance, with the aim of funding much-needed infrastructure investment and creating green jobs across the UK. This included proposals for retail green savings bonds.

6. Prime minister's Ten Point Plan for a Green Industrial Revolution (2020)

- The Ten Point Plan is billed by the government as laying the foundations for a green industrial revolution. The ten points are: (1) advancing offshore wind; (2) driving the growth of low carbon hydrogen; (3) delivering new and advanced nuclear power; (4) accelerating the shift to zero emission vehicles; (5) green public transport, cycling and walking; (6) jet zero and green ships; (7) greener buildings; (8) investing in carbon capture, usage and storage; (9) protecting our natural environment; and (10) green finance and innovation.

7. Governmental decarbonisation strategies

- The government is in the process of publishing a series of sectoral strategies tied together by the Net Zero Strategy.

  The sectoral strategies published so far are:

  i. The Transport Decarbonisation Plan, which sets out how the government will fully decarbonise all modes of domestic transport by 2050. The Plan includes banning the sale of new and polluting road vehicles by 2040, relies heavily on smart electric vehicle charging in order to tackle emissions, and outlines plans to incentivise green development to help build a 'thriving' electric supply chain.

  ii. The Hydrogen Strategy, which sets out the government's vision for low-carbon hydrogen and a roadmap to deliver 5GW of low-carbon hydrogen production capacity by 2030. Alongside the strategy, three consultations were published:

  1. Hydrogen Business Model,
  2. Designing the £240 million Net Zero Hydrogen Fund and
  3. A UK Low Carbon Hydrogen Standard.

  iii. The Heat and Buildings Strategy published aims to provide a clear direction of travel for the 2020s, set out the strategic decisions that need to be taken this decade, and demonstrate how government plans to meet its carbon targets and remain on track for net zero by 2050. It makes reference to the need to ensure private rental sector properties meet EPC rating of C by 2028 and domestic properties by 2035 'where practical, cost-effective and affordable'. The BEIS response to two interlinked consultations is expected before the year-end. UK Finance submissions on these can be found here and here.

- BEIS published the Net Zero Strategy on 19 October drawing together measures to transition to a green and sustainable future, helping businesses and consumers to move to clean power, supporting hundreds of thousands of well-paid jobs and leveraging up to £90 billion of private investment by 2030. It includes new investment in support of vehicle electrification, their supply chains and on-street residential charging points, industrial carbon capture and green hydrogen projects and monies toward further green innovation, decarbonising heat and buildings, nature-based projects and nuclear.
- The Net Zero Review published on 19 October is an analytical report that uses existing data to explore the key issues as the UK decarbonises. This is set against a backdrop of uncertainty on technologies and costs, as well as changes to the economy over the next thirty years. It considers the potential exposure of businesses and households to the transition and highlights factors to be taken into account when designing decarbonisation policy that will allocate costs over this time horizon. Overseen by HM Treasury, it acknowledges that an integral part of government policy will be the need to support households 'as necessary'.

2. UK regulation and Forum guidance

1. PRA SS 3/19

- PRA supervisory statement on 'enhancing banks' and insurers' approaches to managing the financial risks from climate change' (SS3/19), April 2019, is relevant to all UK banks, building societies, insurance and reinsurance firms and groups and PRA-designated investment firms. It built on a PRA review of the way in which firms were enhancing their approaches to managing the financial risks from climate change and after describing the two risk factors through which financial risks from climate change arise – physical and transitional risk – sets out expectations for the strategic approach firms should take.

2. 1 July 2020 Dear CEO letter

- The 1 July 'Dear CEO' letter explains that PRA regulated financial institutions should have fully embedded their approaches to managing climate-related financial risks by end-2021. This means being able to demonstrate that expectations set out in SS3/19 have been implemented and embedded throughout the organisation as fully as possible. The PRA recognises the need for proportionality reflective of a firm's exposure to climate-related financial risks and the complexity of its operations.

3. Climate Financial Risk Forum (CFRF) guidance

- The CFRF is an industry forum jointly convened by the PRA and FCA to build capacity and share best practice across industry and financial regulators on advancing the sector's response to the financial risks from climate change. Its June 2020 guide is formed around four themes - risk management, scenario analysis, disclosure and innovation - and aims to help financial firms understand the risks and opportunities arising from climate change. This was augmented by further practical guidance published on 21 October 2021. While not formally part of the regulatory regime, CFRF guidance provides an invaluable insight into the way in which firms within the UK financial sector are adapting their risk, strategy and decision-making processes to reflect climate-related financial risks.

4. Financial Reporting Council (FRC)

- In publishing its annual review of corporate reporting, on 27 October, the FRC also published its year-end bulletin of key corporate matters for companies, in which it sets out its areas of focus for the coming year. Specifically referenced are the comply or explain disclosures required on the part of premium listed companies in respect of compliance with TCFD recommendations. The FRC also expects material climate change policies, risks and uncertainties to be included in narrative reporting and appropriately considered and reflected in the financial statements.

5. **Joint statement**

   - On 28 October the FCA, PRA, Pensions Regulator and FRC combined to issue a joint statement on the publication of their climate change adaptation reports. These include a summary of the steps they have taken as the UK financial regulators to make sure that the risks from climate change and the opportunities from the transition to a net zero economy are being identified and proactively managed across the financial sector. The FCA report confirms their interest in net zero commitments being made; the PRA report indicates that they plan further updates on their approach in 2022. (See also public policy in development below.)

3. International

1. **Task Force on Climate-related Financial Disclosures (TCFD) and Network for Greening the Financial System (NGFS)**

   - The TCFD was developed by the G20's Financial Stability Board in 2015 "to develop recommendations for more effective climate-related disclosures that could promote more informed investment, credit, and insurance underwriting decisions and, in turn, enable stakeholders to understand better the concentrations of carbon-related assets in the financial sector and the financial system's exposures to climate-related risks". The TCFD's recommendations have become the basis for almost all of the world's national climate disclosure frameworks. The TCFD also publishes and annual status report on how the recommendations are being adopted, as well as extensive guidance on how the recommendations can be implemented (available through the TCFD Knowledge Hub).

   - The Network for Greening the Financial System (NGFS) is a grouping of 98 central banks and financial regulators collaborating to discuss and design policies to manage climate-related financial risk. The NGFS scenarios for climate risk have become the global benchmark which central banks and increasingly companies and financial institutions draw on.

2. **Mark Carney's Private Finance Strategy for COP26 – and associated Race to Zero Alliances**

   - Mark Carney, in his twin roles as the United Nations' special envoy for climate action and finance, and the prime minister Boris Johnson's finance adviser for the UK presidency of COP26, in November 2020 published a landmark Private Finance Strategy for COP26. The Strategy set out priorities for private finance for COP26, which were divided into four pillars: Reporting, Risk, Return, and Mobilisation. This was followed up in April by Mark Carney launching the Glasgow Financial Alliance for Net Zero (GFANZ), bringing together the financial alliances accredited by the UN's Race to Zero campaign. The banking pillar of GFANZ is the Net-Zero Banking Alliance (NZBA); its commitment text has quickly become the benchmark for a credible, recognised net zero pledge and is bolstered by guidelines for target setting.

   - GFANZ has created seven workstreams to tackle the architecture to enable firms across the wider financial sector to reach net zero. These are (1) building commitment, (2) sectoral pathways, (3) real economy transition plans, (4) financial institution transition plans, (5) portfolio alignment measurement, (6) mobilising capital to EMDCs, and (7) policy call to action. Each workstream is led by a group of GFANZ members.

   - Mark Carney's third major contribution to the financial sector's move to net zero by establishing the Task Force on the Scaling of Voluntary Carbon Markets (TSVCM). The TSVCM was created in September 2020 to discuss how to enhance and expand voluntary carbon markets, and its new governance body was unveiled in September 2021.

3. **Sustainable Markets Initiative (SMI)**
   - The SMI Financial Services Task Force published a practitioner's guide to net zero banking on 20 October. This is not a standard as such but instead includes principles that will guide the way in which banks advance their net zero commitments, also setting out steps being taken and collective lessons learnt for the benefit of all organisations that have made a net zero banking commitment.

4. **UNEP FI G20 input paper**
   - On 27 October, ahead of the G20 Rome Summit, the UNEP FI published its G20 input paper providing recommendations for credible net zero commitments from financial institutions. This sets out sets out a high-level framework for what a credible, transparent and comparable 1.5°C science-based commitment looks like and what it will mean for real economy transition.

5. **United Nations Framework Convention on Climate Change (UNFCCC)**
   - The UNFCCC is a treaty, signed in the early 1990s which established the global climate negotiations. As well as being a treaty it is also the name for the UN secretariat which runs the negotiations. The UNFCCC process is now principally driven by an annual meeting known as the Conferences of the Parties (COPs). COP21 in 2015 resulted in the Paris Agreement, which has been ratified by 190 countries plus the EU. One of the most notable gaps in the current climate rulebook is Article 6 of the Paris Agreement, which is due to set the framework for global carbon trading, but has yet to be finalised.

6. **Reporting frameworks**
   - The International Financial Reporting Standard (IFRS) Foundation's remit for an International Sustainability Standards Board (ISSB) was first proposed in 2020, and quickly got the backing of the G20. It aims to be the body to lead on the development and then oversight of a set of global sustainability standards. It is expected to be formally announced at COP26.
   - The Partnership for Carbon Accounting Financials (PCAF) has emerged as the leading methodology for financial institutions to assess and disclose greenhouse gas emissions of loans and investments. It was recently recommended in the latest guidance from the TCFD.
   - The Science-Based Targets initiative (SBTi) is leading methodology for companies to accredit high-integrity, credible net zero pathways. In early 2020 SBTi issued guidance for the financial sector.
   - The World Benchmarking Alliance (WBA) was created to develop transformative benchmarks that will compare companies' performance on the UN's Sustainable Development Goals (SDGs – see next item). The WBA continues to issue new benchmarks covering key sectors (such as the financial sector), topics (e.g. gender) and systems (e.g. nature).
   - The UN's Sustainable Development Goals (SDGs) cover the period 2015-2030, and are the successors to the UN's Millennium Development Goals, which ran from 2000 to 2015. There are 17 SDGs, covering topics including poverty, education and human rights. SDG 13 is 'climate action'.

7. **Nature and biodiversity**
   - The Taskforce on Nature-related Financial Disclosures (TFND) aims to create a risk management and disclosure framework for organisations to report and act on nature-related financial risks. It is based on the concept that Nature loss presents financial risks to organisations, and is broadly modelled on the TCFD.
   - The Dasgupta Review on the Economics of Biodiversity was published by HM Treasury in February 2021, with the goal of achieving for biodiversity policy what the 2010 Stern Review did for climate change – make it a topic of serious consideration in economics.

4. Public policy in development

1. **Sustainable finance taxonomies**
   - A taxonomy for green or sustainable finance aims to define what types of financial transaction, investment, or product can be considered green or sustainable. Its primary aim is to provide the consumers of financial services and the wider public with confidence that claims of green or sustainable activities are genuine, and not greenwashing. See 1.3 above for context.
   - The EU taxonomy is the most prominent and comprehensive taxonomy in the world. It entered into force on 12 July 2020, though many of the technical details remain in development. The taxonomy sets thresholds for specific economic activities – not companies – that can be defined as green within a series of sectors. These thresholds will gradually rise over time, in line with a series of sector-specific transition pathways to net zero by 2050. (see 5.4 below on a related report.)
   - The UK's Green Taxonomy is currently being developed by the Green Taxonomy Advisory Group (GTAG). The GTAG has presented its recommendations to HM Treasury, and public consultation on the draft taxonomy is expected in early 2022. The chancellor has confirmed that the UK's taxonomy will draw from the scientific basis of the EU's taxonomy.

2. **Bank of England position on Greening the Corporate Bond Purchase Scheme**
   - The Bank of England's consultation on the greening of their corporate bond purchase scheme was especially noteworthy for setting out a template for financial institutions to transition away from carbon-intensive assets and ultimately align with a net zero transition pathway. UK Finance's response to the consultation was supportive of the approach set out, and made a number of specific recommendations.

3. **FCA proposals on new sustainability disclosures and sustainable investment labels**
   - On 3 November the FCA published Discussion Paper 21/04 on new sustainability disclosures and sustainable investment labels. Alongside the discussion paper, it also published A strategy for positive change: our ESG priorities.

5. Key initiatives

1. **Committee on Climate Change (CCC)**
   - The CCC is an independent, statutory body established under the Climate Change Act 2008. Its purpose is to advise the UK and devolved governments on emissions targets and to report to parliament on progress made in reducing greenhouse gas emissions and preparing for and adapting to the impacts of climate change.
   - In 2020 the CCC invited its Advisory Group on Finance (AGF), led by Professor Nick Robins, to prepare a report on net zero finance. The result was The Road to Net Zero Finance, which is a summary of the four meetings the AGF held, and makes recommendations in six areas: strategy, private finance, financial regulation, public finance, international frameworks and tracking progress.

2. **Green Finance Institute (GFI)**
   - The GFI established in 2019 sits at the nexus of the public and private sectors convening and leading sectoral coalitions of global experts that identify and unlock barriers to investment towards impactful, real-economy outcomes. A core workstream of the GFI is its Coalition for the Energy Efficiency of Buildings (CEEB). This published green home finance principles in September 2020 and has since published further reports on retrofit finance. In May 2021 the GFI formed a Coalition for the Decarbonisation of Road Transport spanning finance, automotive, energy and infrastructure sectors to accelerate the transition to zero emission vehicles. It has additionally contributed to the public policy debate on issues such as carbon pricing.

3. **Grantham Research Institute on Climate Change and the Environment, LSE**

   - The Grantham Research Institute has been a leading voice in favour of just transition over a number of years, often partnering with Leeds University and others in the publication of strategic reports. These include 'Investing in a just transition in the UK: how investors can integrate social impact and place-based financing into climate strategies' in February 2019; and 'Financing climate action with positive social impact: how banking can support a just transition in the UK' in July 2020. Grantham subsequently convened a broad-based UK Financing a Just Transition Alliance and this set out policy recommendations in its 'Just Zero' report published 25 October.

   - Impact Investing Institute and Grantham 'The UK's Green Gilt: Demonstrating the Contribution to Jobs and Levelling Up' report, published in July 2021, outlined a practical framework for delivering the social co-benefits dimension of the UK's green gilt, laying the foundations for further development in subsequent green gilt issuances.

4. **European Banking Federation (EBF)/UN Environment Programme Finance Initiative (UNEP FI)**

   - The EBF has been a constructive contributor to the development of EU and international policy on climate risk and sustainability and combined with the UNEP FI to launch a report in January 2021 assessing the extent to which the EU Taxonomy on Sustainable Activities could be applied to core banking products for labelling or disclosure purposes. The report is the result of a project with 26 major banks, seven banking associations and five observing organisations working together to test, pilot and assess the complexities of applying the EU Taxonomy. Follow-up work is underway and is expected to result in the publication of further practical guidance at the turn of the year.

5. **Voluntary Carbon Market Integrity Initiative (VCMI)**

   - The VCMI was established in the summer of 2021 as a multi-stakeholder platform seeking to drive credible, net zero aligned participation in voluntary carbon markets. It was created soon after the TSVCM, and is likely to make recommendations relevant to the TSVCM's core goals.

6. **International Capital Markets Association (ICMA) – Green Bond Principles**

   - ICMA is a trade body with over 600 members around the world. ICMA's Green Bond Principles, most recently updated and reissued in June 2021, have become an industry benchmark.

6. Further guidance, commentary and advocacy

1. **UK Finance White Paper on defining sustainable finance**

   - In November 2020 UK Finance published a white paper setting out a principles-based framework for the measurement and reporting of multi-year commitments to sustainable finance. The four principles are: (1) governance, (2) definitions, (3) measuring the contribution and (4) reporting and disclosure.

2. **International Regulatory Strategy Group (ISRG)**

   - The IRSG is co-sponsored by TheCityUK and the City of London Corporation and in June 2021, together with KPMG, published a report' 'accelerating the S in ESG: a roadmap for global progress on social standards'. This recognises that the 'S' of ESG – environmental, social and governance factors – can be more difficult for investors to define and quantify than the 'E' and the 'G' factors and that a lack of consistency and comparability in approaches risks impeding the drive towards more sustainable investments. At its core the report recommends a global approach to social principles and standards.

3. **Institute for Public Policy Research (IPPR) Environmental Justice Commission**

   - The IPPR Environmental Justice Commission ran a public consultation over the summer of 2021 to develop "the ideas and policies to bring about a rapid green transition that is fair and just". The key output was a digital report entitled Fairness and Opportunity.

4. **UK Sustainable Investment and Finance Association (UKSIF) vision paper**

   - In April 2021 the UKSIF published its vision paper, 'A new vision for sustainable finance'. This set out policy recommendations for the UK to consider across different sectors of the economy and policy areas in the years ahead, including on sustainable finance standards, biodiversity, net zero pathways, infrastructure investment and diversity in financial services.

5. **Association for Financial Markets in Europe (AFME) paper on ESG Disclosure Landscape**

   - AFME published a comprehensive summary of Europe's ESG disclosure landscape in April 2021. The paper, entitled 'ESG Disclosure Landscape for Banks and Capital Markets in Europe', serves as a practical guide for financial institutions to understand the scope of existing ESG disclosure requirements and offers ideas for best practices in compliance.

6. **CBI Policy Paper: Financing the transition to a sustainable future**

   - The CBI published a policy paper on 13 October outlining, ahead of COP26, sustainable finance policy recommendations to UK policymakers on how to effectively mobilise capital to achieve the UK's net zero targets and tackle other pressing environmental and social challenges. The paper sets out three guiding principles: (1) support the whole domestic economy transition with effective sectoral plans and mechanisms that can unlock critical sustainable finance flows; (2) ensure appropriate policy frameworks and unambiguous regulation to allow the financial services sector to drive the growth of sustainable finance and avoid unintended consequences hindering the transition to a net zero economy; and (3) promote international convergence in sustainability and reporting standards to scale up ESG investments beyond the UK's borders and ensure a smooth and just global transition.

7. **CBI in partnership with UK Finance – Financing green: a guide for SMEs**

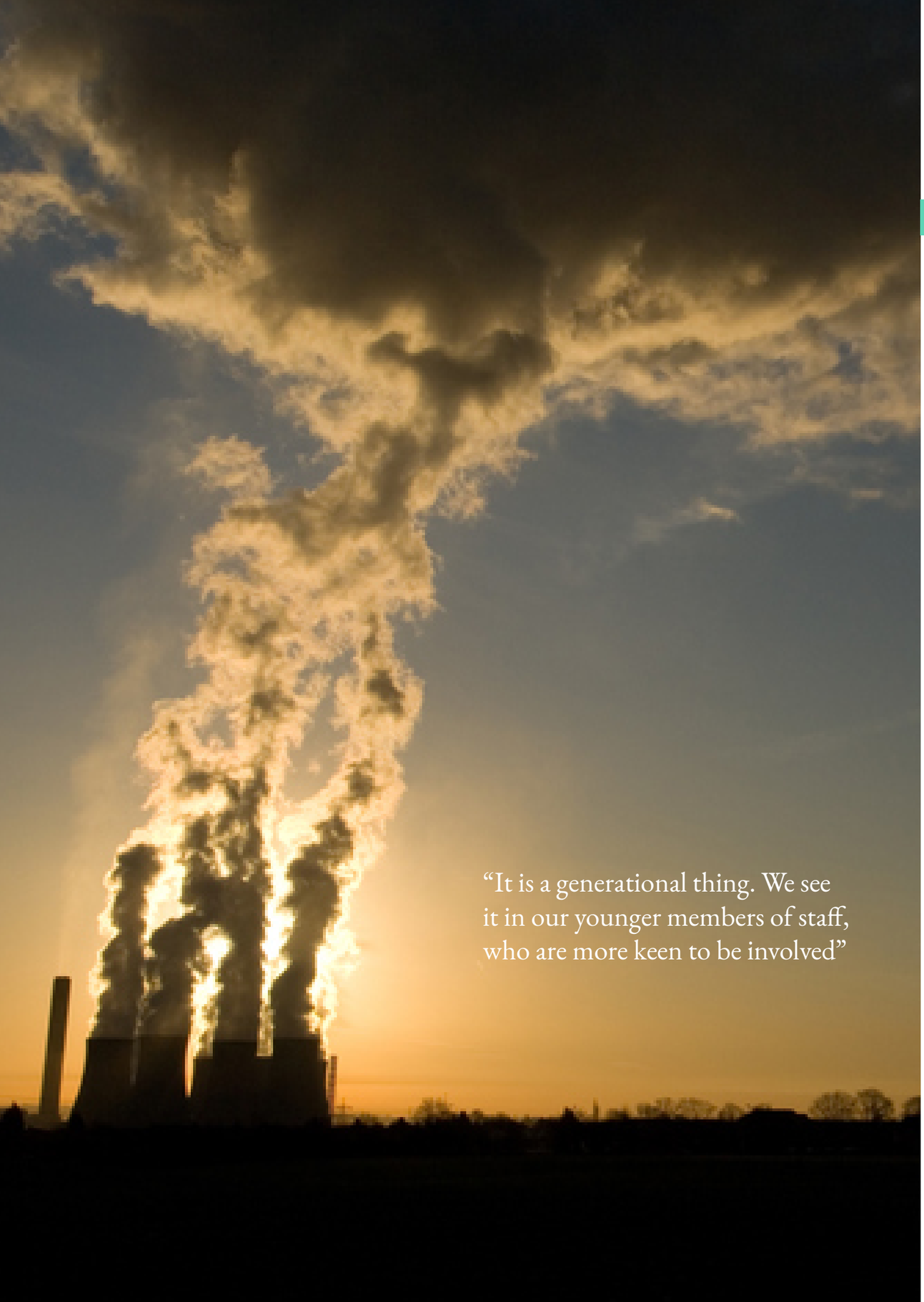
   - The CBI in partnership with UK Finance on 27 October published a guide on how SMEs can finance their climate action. The guide aims to help SMEs get started on planning to reduce carbon emissions, including whether they should consider using external finance and how to identify the right finance solution for their business.

8. **Bankers for Net Zero (B4NZ) reports on housing retrofit and SME lending**

   - B4NZ, aligned to the All Party Parliamentary Group for Fair Business Banking, was formed in 2020. In the summer of 2021 it released two highly practical reports:

     i. 'Tooling up the Green Homes Industry' sets out proposals for financing the retrofit supply chain, and notes that the UK retrofit industry must grow by a factor of ten to address the UK emissions from housing.

     ii. 'Mainstreaming Net Zero – Mobilising SMEs for Climate Action aims to show the government how the combination of action from banks and government can accelerate progress towards net zero for the UK's approximately six million small and medium-sized enterprises.



V. STATE AND TRENDS IN UK NET ZERO BANKING

1. Summary

- Net zero banking is a relatively new concept, and the UK is leading the world in this emerging field.
- The banking and finance sector recognises the necessity of the transition to a net zero world in order to achieve the goals of the Paris Agreement and address the climate emergency.
- From conducting 21 highly candid interviews with firms at the forefront of the transition to net zero banking, we have gained a rich understanding of the key issues, which are presented here for the first time.
- There are many good reasons for the financial sector to commit to net zero, and a significant proportion of the sector has already done so through the Net-Zero Banking Alliance. Achieving a net zero financial sector is highly challenging, and many firms are tackling the challenge head on.
- We trust that this publication contributes to the net zero agenda by demystifying the steps being taken by the financial sector towards net zero, and highlighting the principal remaining challenges.

Key messages

- Climate action, and especially climate disclosures, has rapidly become mainstream within the banking and finance sector. This is particularly true among the largest firms. (section V.2.1)
- UK Finance members have collectively made sustainable financing commitments totalling over US $9 trillion before 2030. (section V.3.4)
- Among the challenges for banks in making the transition to net zero emissions is that doing so requires a fundamental rewiring of some deeply held assumptions about the sector's role, regarding a precisely quantified understanding of risk and being led by clients' stated needs. (section V.4.1.1)
- Firms reported that there were risks to both transitioning towards net zero banking too fast, and too slow – the pace had to be just right in order to avoid climate breakdown (if too slow) and an unnecessarily disorderly transition (if too fast). (section V.4.1.3)
- While the sector is highly supportive of carbon pricing, views differ on the detail of what this should entail. Member firms noted in particular the uncertainty around carbon trading within the UN's climate negotiations and the fast pace of change in the voluntary carbon markets. (section V.4.5)
- Lessons learned by our expert practitioners included the importance of leadership from the top while ensuring the whole organisation is brought on board; the importance of training, and a considered approach to its sequencing; and a wide range of reflections on data. (section V.4.6)

2. Introduction

This analysis provides an overview of the current state of net zero banking in the UK, the key trends and challenges, and prospects for further progress. Our goal is to contextualise and demystify the transition to net zero banking in the UK by providing the perspective of banks and bankers. We hope that this will contribute to an informed debate of the role of banking in the transition to net zero – something the sector overwhelmingly supports.

The analysis is about banks and building societies operating in the UK and providing retail, wholesale, investment and related financial services, which we will refer to henceforth as 'firms', and collectively as 'the financial sector'. We exclude from these definitions the wider constellation of entities in the financial services industry, such as hedge funds, private equity, venture capital, asset management, insurance and payments.

We have taken as our guide two central pillars in the field: Mark Carney's Private Finance Strategy for COP26, and the Net-Zero Banking Alliance (NZBA):

- Mark Carney's Private Finance Strategy for COP26 is sets out a route to ensuring that "every professional financial decision takes climate change into account". As well as providing this publication with a series of industry deliverables, against which we have mapped industry progress (Figures 1 and 2), the strategy also provides the overarching framework through which we have structured part of this publication (Industry Analysis).
- The NZBA is the world's leading alliance for net zero banking. Launched on 21 April with the support of 43 banks from 23 countries, signatories in the run-up to COP26 had reached 89 firms from 37 countries, with collective assets of US $66 trillion. This amounts to 42 per cent of global banking assets.

The genesis of our state and trends analysis of UK net zero banking was the UK Finance COP26 and Beyond work stream, which began in March 2021. Under this work stream over 40 member firms met for a series of monthly roundtables to discuss steps being taken towards the net zero transition, as well as topics including climate risk and stress testing. UK Finance also hosted a series of public webinars on these topics (accessible here). The regular interactions facilitated by this workstream resulted in a community of practice, which enabled both a quantitative survey of measures being taken as described in section 2 below, and a series of open and frank conversations with key individuals working on the net zero transition in member firms, described in section 3 below.

2.1. What is net zero banking?

The concept of a net zero financial institution is relatively new. Though debate remains, this has broadly come to mean that the total greenhouse gas emissions of a firm – across its own operations, services it purchases, and investments it makes; known as scope 1, 2 and 3 emissions – are either zero or are matched by an equivalent or greater number of credible carbon offsets. In the financial sector over 99 per cent of emissions are scope 3, also known as 'financed emissions'.

Introduction to carbon accounting in the financial sector

Carbon accounting, as set out in the industry standard Greenhouse Gas Protocol, divides a firm's emissions into three groups: scope 1, scope 2 and scope 3:

- Scope 1 emissions are direct GHG emissions, meaning those stemming from sources owned or controlled by the firm, such as their facilities (like offices they own) or vehicles.
- Scope 2 emissions are indirect GHG emissions from consumption of purchased electricity, heat or steam (used in offices or premises they own).
- Scope 3 emissions are all other indirect emissions, including their supply chains (such as the emissions of their IT contractors driving to the firm's offices) and their investments (meaning the proportion of all clients' investments which can be attributed to the firm).

Scope 3 emissions are complex to calculate, but are estimated to be roughly 700 times the financial sector's scope 1 and scope 2 emissions (CDP 2021).

While various conceptual and methodological issues remain outstanding – on the role of offsets, offset standards, on how to accurately measure and attribute financed emissions to various financial service providers – no firm today is net zero. Most net zero targets are for 2050. This is the date commonly agreed to be aligned with the goals of the Paris Agreement.

The NZBA is the principal grouping of firms pledging to achieve net zero emissions by 2050 or sooner. NZBA signatories also commit to publish net zero aligned 2030 targets using credible sectoral decarbonisation pathways. The Net Zero Breakthroughs paper, published by the UK government in January 2021 in order to set expectations for the private sector 'Race to Zero (which the NZBA is nested within), set a target of 20 per cent of globally systemically important firms (G-SIBs) being signed up to net zero by COP26. Of the 30 G-SIBs, 24 (80 per cent) are currently NZBA members.

2.2. UK leadership

Alongside the UK's policy and political leadership on net zero, the UK financial sector has shown international leadership in the drive to net zero. When the NZBA launched, with 43 members, the UK had more firms in the Alliance than any other country. The UK's eight largest lenders and a further 30 UK Finance members are amongst the 89 signatories to NZBA.

The UK's financial sector is also playing a leading role in the whole-economy transition. It is by far the biggest driver cited by the rest of the economy in pushing them to act more sustainably, with 92 per cent of business leaders saying that firms have been significant in influencing their business to act do so; the next most important driver was governments with 87 per cent (Addleshaw Goddard, 2021).

UK Finance is firmly in support of the transition to a net zero economy, and hence a net zero financial system, by 2050 or sooner (see UK Finance Policy Statement).

2.3. Private finance and the Paris Agreement

The Paris Agreement included a commitment from developed countries to provide US $100 billion of climate finance per year to developing countries by 2020. Private finance can count towards this total provided if it can be shown to have been mobilised by public funding from a developed country. A recent authoritative account of the amount of climate funding mobilised in 2019 was $79.6 billion, of which $14 billion was private finance (OECD 2021).

2.4. Industry progress against Mark Carney's deliverables

Figure 1: Deliverables from Mark Carney's Private Finance Strategy for COP26

	Reporting	Risk Management	Returns	Mobilisation
Goal	• Improve the quality and quantity of climate-related financial disclosures. • Promote alignment of disclosure globally around TCFD framework. • Establish pathways to mandatory disclosure.	• Assess the resilience of companies and financial sector to climate risks. • Ensure financial sector develops tools and products to manage climate-related financial risks.	• Ensure financial institutions have the frameworks to: • Assess the credibility of net zero transition plans. • Measure alignment of their portfolios with the transition to net zero. • Make their own commitments to net zero.	• Increase private financial flows to emerging and developing economies to finance the transition to net zero by: • Developing pipeline of investable projects. • Aligning development bank funding with climate goals. • Encouraging new market structures and products.
Deliverables	Publish stocktake of compliance with TCFD recommendation, best practice examples, and refined TCFD recommendations around scenario analysis. **Action: TCFD**	Conduct climate stress tests of banks and insurers and issue guidance to financial firms on climate risk management. **Action: central banks; supervisors**	Review approaches and establish best practice/standards for financial institutions to assess the credibility of companies' transition plans to net zero. **Action: banks; asset managers; asset owners; academic and NGO communities**	Develop a pipeline of investable projects by connecting available capital to projects that meet pre-defined investment principles, such as the CFLI's investment readiness guidelines. **Action: private sector investor coalitions; countries**
	Issue guidance for financial firms and corporates on climate-related reporting and implementing the TCFD recommendations. **Action: central banks; regulators; governments**	Issue guidance for financial firms and corporates on climate-related reporting and implementing the TCFD recommendations. **Action: central banks; regulators; governments**	Issue guidance for financial firms and corporates on climate-related reporting and implementing the TCFD recommendations. **Action: central banks; regulators; governments**	Issue guidance for financial firms and corporates on climate-related reporting and implementing the TCFD recommendations. **Action: central banks; regulators; governments**
	Develop TCFD-compliant listing guidance. **Action: stock exchanges and standard setters**	Promote scenario analysis in the real economy through development of sector-specific scenarios and guidance. **Action: companies**	Develop consumer-friendly metrics that reflect investment alignment with net zero. **Action: conduct regulators; investors**	Development banks to align investment with climate goals and report alignment of their own lending portfolio; facilitate access to markets, de-risk investment and provide technical assistance. **Action: MDBs; NDBs; RDBs; DFIs; countries**
	Publish pathways to making climate-related financial reporting, based on TCFD recommendations, mandatory. **Action: countries**	Capture climate risks in central bank mandates, including in monetary policy, financial stability and market operations where applicable. Central banks in turn to disclose in line with TCFD, including on alignment of their investment portfolios. **Action: finance ministries; central banks**	Commit to align portfolios and lending with net zero, disclose accordingly, and publish credible transition plans. **Action: banks; asset managers; asset owners**	Encourage the development of the infrastructure for scaling up high-quality voluntary carbon markets. **Action: financial market infrastructure providers; banks; companies**
	Establish pathways to globally consistent mandatory reporting. **Action: international standard setters**	Establish centre(s) of excellence for central banks and supervisors to share knowledge and build capacity around climate risk measurement and practices. **Action: NGFS; central banks; supervisors**	Incorporate data that helps measure transition-readiness of firms and portfolio alignment of investors into list of recommended disclosures. **Action: TCFD; standard setters; countries**	
	Climate-related risks and assumptions to be considered during assurance of company reports and accounts. **Action: auditors**	Integrate climate risks into IMF FSAPs and Article IV reviews. **Action: IMF**		
	Commit to voluntary TCFD disclosures. **Action: companies**	International standards to review approach to climate risk measurement and management. **Action: FSB, BCBS, IAIS**		
		Develop the insurance products needed to de-risk the transition and improve physical risk modelling to increase coverage. **Action: insurance sector**		

Figure 2: Industry progress against selected deliverables from Mark Carney's Private Finance Strategy for COP26

	Reporting	Risk Management	Returns	Mobilisation
Progress against Mark Carney's Asks				
	Commit to voluntary TCFD disclosures All systemic banks in UK Finance membership have formally supported TCFD; the vast majority have already published TCFD reports with the rest to publish their first by end 2022.	**Embed use of scenario analysis in the financial sector using the NGFS reference scenarios** This is happening, including beyond the systemic firms, following the PRA's July 2020 'Dear CEO' letter.	**Review approaches and establish best practice/standards for financial institutions to assess the credibility of companies' transition plans to net zero** This work is well underway, with larger firms having established significant relevant expertise across the board in order to profile an integrated sustainability screen as part of wider due diligence. Smaller firms are also developing their capabilities in this regard.	**Encourage the development of the infrastructure for scaling up high-quality voluntary carbon markets** Many members are active participants in both the voluntary carbon markets and in the TSVCM.
		Promote scenario analysis in the real economy through development of sector-specific scenarios and guidance This work is being led by the larger firms; smaller firms are starting to explore sector-specific guidance where appropriate.	**Commit to align portfolios and lending with net zero, disclose accordingly and publish credible transition plans** A majority of the member firms involved in our COP26 tracker exercise have joined the Net Zero Banking Alliance, and the UK Finance Board in May endorsed the NZBA in principle.	Also, over **$9 trillion in sustainable finance** committed to be facilitated by end 2030.
Next Steps				
	Create and apply common approaches to GHG accounting - work expected to be led by the IFRS Foundation's new International Sustainability Standards Board (ISSB).	Cooperate towards common data protocols and shared data. New policies such as the EU's Single Access Point (ESAP), or the New open-source climate initiative (OS-Climate).	Leading firms to publish 2030 targets based upon sectoral decarbonisation pathways.	

3. Industry analysis

This section analyses the publicly available information of a group of 39 UK Finance members, from across the banking and finance sector, and covering both members and non-members of the NZBA. Firms participating in our COP26 and Beyond work programme collectively represent over 90 per cent of UK banking assets, and all are embedding climate responsibility into governance and strategy, as required by TCFD and included in PRA supervisory expectations.

This analysis draws on the four pillars of Mark Carney's Private Finance Strategy for COP26: reporting, risk, returns and mobilisation.

3.1. Pillar 1: Reporting

Our analysis related to two aspects of climate-related reporting:

- Climate-related financial risk disclosures (in line with TCFD recommendations)
- Emissions accounting methodologies

Since its launch in 2017, the TCFD has set the over-arching standard for global carbon-related financial risk reporting. The TCFD sets out recommended disclosures in 11 areas, which fall within four groups: governance, strategy, risk management, and metrics and targets. As such it invites firms to report broadly on what they are doing in response to climate change.

Of the 39 member firms we analysed, 28 (72 per cent), including all 26 larger firms, were officially TCFD 'supporters'. In addition, 24 firms (62 per cent) had either published TCFD reports, or in three cases, planned to do so for the first time in 2022.

By far the most popular emissions accounting methodology among the member firms analysed was the Partnership for Carbon Accounting Financials (PCAF). PCAF was mentioned by 14 of the firms analysed (36 per cent), including 13 of the 26 larger firms (50 per cent). This is in line with the wider move towards PCAF becoming the industry standard, recently affirmed by a TCFD report which proposed PCAF carbon accounting as part of its foundational reporting principles for all organizations.

The other noteworthy methodology was the Paris Agreement Capital Transition Assessment (PACTA), which was mentioned by nine of the larger firms (35 per cent; 23 per cent of total). We heard from some members that PACTA is particularly useful for firms with significant exposure to the oil and gas sectors.

3.2. Pillar 2: Risk

All large firms have either embedded climate risk into their mainstream risk management processes, or are in the process of doing so. Among larger UK firms the chief risk officer has been the most popular choice to be the designed the senior person responsible for climate risk, though most larger firms have also recruited new head of climate risk roles.

Within the terms of NZBA commitment statements, signatories are beginning the process of drawing up science-based transition paths for carbon-intensive sectors. This is in addition to changes made – or being made – to firm-wide lending policies. These focus on specific activities and practices no longer considered appropriate and can be geographically determined as even within the developed world there are nations that are more dependent upon e.g. coal electricity generation than others and phasing this out will take time.

3.3. Pillar 3: Returns

The Returns pillar of Mark Carney's framework includes firms' headline emission reduction targets, which is the focus of our analysis here.

Among the 26 larger firms in our survey, 21 were NZBA signatories. Of the 13 smaller firms, 2 were signed up to the NZBA. More have since signed up. As noted above, this entails net zero scope 3 targets.

The number of firms committing to reductions in scope 1 and 2 emissions was slightly higher, at 27 out of the 39 firms: 22 out of the 26 larger firms, and 5 out of the 13 smaller firms.

3.4. Pillar 4: Mobilisation

Mark Carney's Private Finance Strategy divides this pillar into two parts: sustainable finance commitments, and carbon markets. Our quantitative analysis focusses on sustainable finance – which is also covered qualitatively in section 3.5 – whereas carbon markets are addressed in section 3.6.

Sustainable finance commitments had been made by 24 out of the 26 larger firms we analysed, totalling US $9.345 trillion by 2030. Firms' commitments ranged from just over $1 billion to over $2 trillion. These commitments include a range of funding types, including facilitated finance.

4. Industry perspectives

In August and September 2021, UK Finance conducted 21 interviews with members from across the banking and finance sector, to understand their and the wider industry's perspectives on key issues relating to net zero.

This section aims to set out the key messages we heard in as balanced and neutral way as possible, in order to give a clear and accurate a picture of thinking within the sector. We have not sought to interpret or comment on what we heard.

Before summarising the key messages we heard, it's worth noting the deep heterogeneity among the firms we spoke to. Some were NZBA members, others were not. Some were large international institutions, others were mid-tier and smaller domestic firms. Some were active across all sectors and all types of banking (retail, investment, capital markets, etc.) while others focused almost exclusively on providing retail services to a single sector (e.g. residential mortgages). Some were based in the UK, others in the rest of Europe, or the rest of the world. This means that while there are some important commonalities between firms' perspectives, each comes to the issue from their own distinct angle.

4.1. Challenges of a net zero commitment

Having set out industry views on the benefits, and in most cases necessity of the sector's transition to net zero, this section on challenges seeks to highlight the barriers so that solutions to these challenges are discussed and developed as a priority. In turn this will hopefully contribute to the sector's transition to net zero.

4.1.1. Uncertainty

The most common challenge to signing up to a net zero commitment (such as the NZBA), cited by both members and non-members alike, was the uncertainty surrounding the commitment itself, including what it meant for the business and how it would be achieved. This uncertainty had multiple dimensions:

- Factors outside of banks' control: given that a net zero financial system requires a net zero real economy, and this would depend to a significant degree on government policies (see 4.1.2), many banks felt that a net zero commitment involved taking a 'leap of faith' that other stakeholders would make the shift possible. For smaller banks this uncertainty was even more acute as they often felt that their leverage over customers and also suppliers was likely to be extremely limited.
- Need for new technologies: in many cases achieving net zero relies upon technologies which remain under development. For example, the production of low or zero carbon steel is becoming available but not as yet on a widely available, scalable basis. If these technologies are not developed and deployed at sufficient scale in time, net zero goals in certain sectors may be impossible to meet.
- Long time horizons: because most net zero commitments were for 2050, this meant projecting almost three decades into the future – a period during which there would be myriad unpredictable technological, social and political developments which would be unimaginable today.

- Competitiveness concerns: some firms feared that by pushing their clients in some industries and markets towards net zero they would be at a competitive disadvantage compared to rival firms who did not. It is worth noting that this concern was less present among larger banks conducting all or most of their business in Europe (including the UK).

- Challenge of near-term targets: the NZBA commitment requires signatories to scope 3 decarbonisation goals for 2030, in line with credible 2050 net zero trajectories. In many sectors this means very steep reductions in the next eight to nine years, which is seen as a particular concern (especially given concerns around government policy – see next section).

- Uncertain cost-benefit calculations: many members felt that the benefit of making a net zero commitment was clear from an ethical and reputational perspective, but this was difficult to quantify in business terms. Meanwhile the costs of making a net zero commitment included the considerable costs of investing in and growing the necessary teams and functions within banks.

Committing to net zero in the face of these significant uncertainties ran counter to the core tenet of banking, which is to adopt a prudent position based on a highly quantified assessment of risk. In short, banks in general only make commitments they know they can meet. They are not given to taking leaps of faith.

Another core tenet of banking which net zero commitments was seen to rub up against was the core imperative to 'serve the client'. The financial services industry is at its core a service industry, and in embarking on ambitious net zero journeys, banks would have to start seeking to work with their clients to actively encourage them to decarbonise their activities. In some cases banks would have to – and already have, in the case of some coal companies – end longstanding, productive, profitable and entirely legal relationships. One member firm noted the irony of banks being asked to stop conducting business which remained perfectly legal – often at the behest of governments who were choosing to keep those activities open.

4.1.2. Government policy and the real economy

Among the most cited challenges was the absence of policies seen as necessary to accelerate the transition in key industries and sectors. Key policies the banking and finance sector would like to see from the government, ideally with international coordination, include scaled-up carbon pricing and expanded requirements for companies to provide timely and reliable emissions data (see 4.1.3 below).

One of the greatest concerns expressed was in the residential mortgage sector, where interviewees felt the government's policies on home energy efficiency retrofit were insufficient to drive the necessary improvements quickly enough to meet the government's targets. Confidence had been dented by the troubled roll-out and then cancellation of the Green Homes Grant in 2020. There was a strong sense that the upcoming Heat and Buildings Strategy was a significant opportunity for the government to provide clarity in this important area.

There was a sense that government – and wider stakeholders – have a tendency to over-estimate the potential role of the financial sector in the net zero transition. Interviewees noted that there was a mutual interdependence between the financial sector, government policy, and the real economy, and that the financial sector would not be able to drive the transition without active support from government and active demand from key actors in the real economy. We also heard that much financial activity occurs outside the regulated financial sector. For example, much private sector investment is self-financed by companies, or by venture capitalists, private equity, hedge funds and sovereign wealth funds – all of which are outside of the core banking and finance industry. Finally, some interviewees expressed concern that by playing into exaggerated expectations of the sector's role in the transition, banks could be setting themselves up to outsized blame should targets not be met for reasons outside of their control.

Some NZBA members cited among their reasons for joining that doing so brought them together with other banks sharing their objectives, and that this would strengthen their hand in urging the government to develop stronger climate policies. Meanwhile one non-NZBA member cited among their reasons for not joining that they felt this gave them greater leverage in urging the government to develop stronger climate policies.

As with further government policy, demand in the real economy was seen as an essential pre-requisite for a successful transition. While many banks were starting to advise and encourage their clients to align their approaches with the net zero transition, this had to be done gently. There was the potential for carbon intensive companies to shop around between banks based on their approach to the transition. One interviewee noted that in some geographies when their firm's client managers raised climate change with client companies they were told pointedly that the companies' other banks were not raising such issues.

Calls from some stakeholders to fully divest from carbon-intensive sectors, or immediately end relationships with carbon-intensive clients, were seen as sub-optimal. Many banks were actively ending their financing for specific activities, such as oil and gas exploration in the Arctic, and for specific sectors, such as thermal coal sector – the coal used to generate electricity, as opposed to coking coal, used to produce steel and for which there is currently no cost-effective alternative. Some banks had already de-banked carbon-intensive clients for being unable or unwilling to transition towards net zero. This, however, was seen as a last resort rather than the default as firms were instead encouraging clients and sectors to transition towards net zero. It was considered that calls to immediately divest from much larger sectors such as oil and gas, cement, and steel were not feasible because there was currently not enough low-carbon business with which to replace that scale of financing.

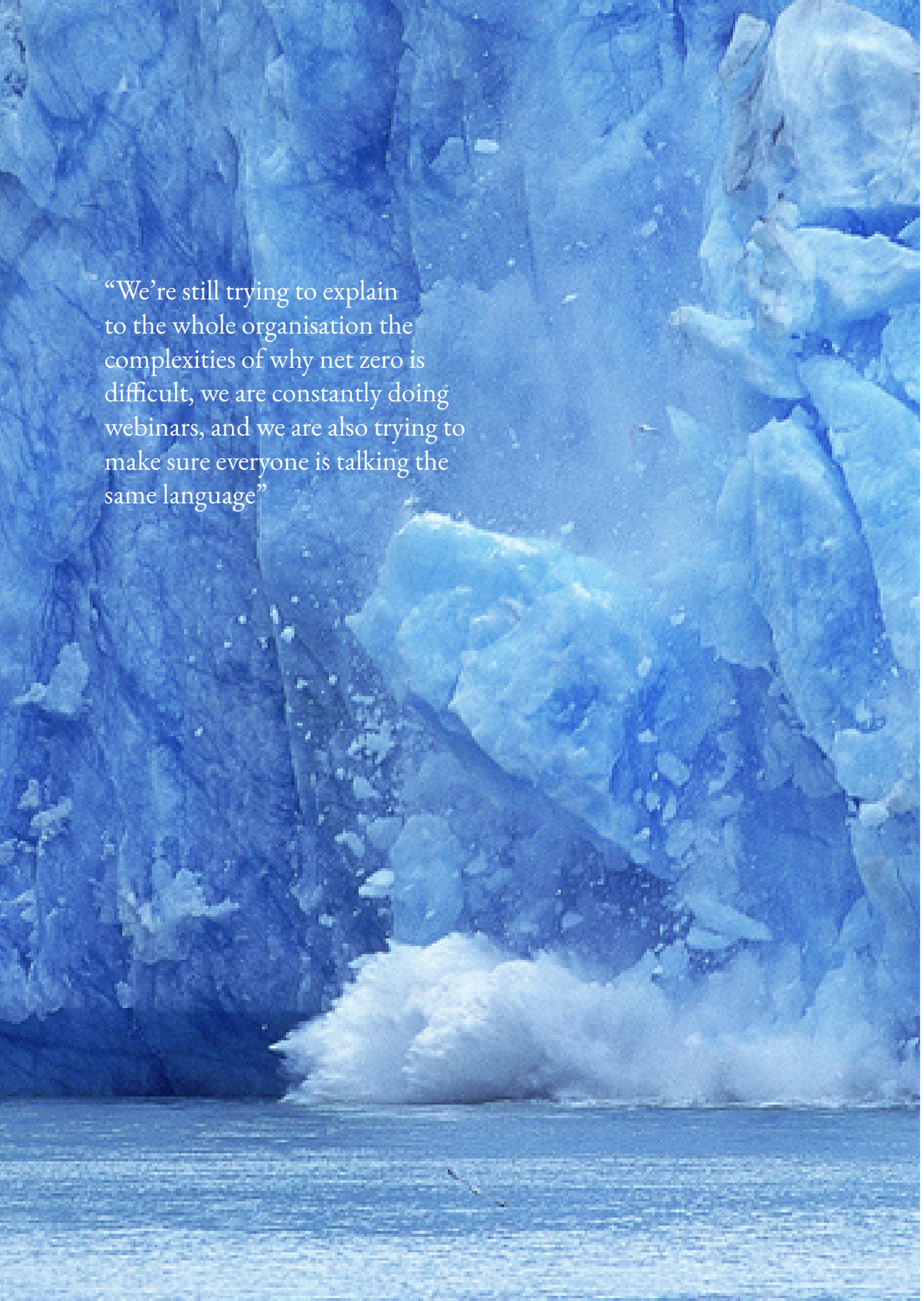
4.1.3. Data

Probably the most common challenge raised – not just in our interviews but in almost every member discussion on this topic in recent years – was data, and specifically a lack of reliable, timely and comprehensive emissions data from client companies. For a firm to calculate its scope 3 emissions this data is required from each of their customers.

The lack of a globally recognised cross-sector carbon accounting methodology has resulted in an ever-growing patchwork of different methodologies and standards by region and sector. This proliferation is driven in part by the recent boom in companies offering climate-related data to the financial sector. There are currently around 40 such data platforms requiring banks to work with multiple providers depending on which sectors they are most exposed to and the type of data they seek.

Members highlighted concern about a lack of consistency in estimations made of firms' emissions (both across years and between different data providers). Often their data sets have significant gaps in them, or they are often not transparent in their methodologies (including which proxies they use when source data is unavailable). The regulatory authorities are currently exploring whether to regulate ESG data providers, something many of our members welcomed.

Even specialist data companies are in the learning phase, and are often in a race with the firms who they sell services to – a race which in some cases the firms are winning. One member working in a smaller domestic firm described commissioning a data provider to produce bespoke data sets relating to physical risk for the property sector. However, once this data set was produced and assessed it was considered less useful than the data set produced in-house using the firm's own method.



"We're still trying to explain to the whole organisation the complexities of why net zero is difficult, we are constantly doing webinars, and we are also trying to make sure everyone is talking the same language"

The fragmented data patchwork can also be overly burdensome on firms' clients. We heard one anecdote of a British dairy farmer who had been asked to apply to different carbon calculators to supply milk to two different buyers. This reflects a wider set of challenges relating to climate data within the SME sector, which is extremely heterogeneous and consists of a large number of very small entities. Many mid-tier firms, which have relatively high exposures to the SME sector, therefore struggle to estimate their scope 3 emissions with any degree of accuracy. However, this is not a barrier to action. One firm told us that their approach to the sector was to start by exploring the decarbonisation of what much of the SME sector has in common: a physical premises, as well as their sources of electricity and heating.

Firms with a focus on unsecured consumer credit – i.e. credit cards – face additional challenges in seeking to calculate their scope 3 emissions, in that the methodologies for these calculations are not agreed. This partly stems from privacy concerns, as well as technical challenges. Due in part to these challenges some banks are not currently seeking to include emissions relating to unsecured credit in their scope 3 calculations, and instead focusing on emissions relating to their supply chains (e.g. IT services). Other banks are trying to estimate these emissions associated with unsecured credit. For example, if a customer uses a credit card to spend £1000 with an airline, the firm will assume they have bought air travel, though there is no way of knowing if they have bought a long-haul flight in economy, two short-haul flights in business class, or short-haul tickets in economy for the whole family.

Despite the challenges for banks in accessing the right data, many noted that despite data problems the UK has been a global leader in this area. For example, the ongoing expansion of TCFD-style reporting requirements across the UK economy was seen as a great boon for firms seeking to calculate their scope 3 emissions. Another great resource is the Energy Performance Certificate (EPC) regime, which gives UK's properties an energy efficiency rating which can be freely accessed by postcode. Members described several deficiencies with the EPC regime, such as the 50 per cent of properties not covered, and the fact it measures energy efficiency rather than climate impact. However, we also heard that the current system is far ahead of what is available in other advanced economies – for example Switzerland has no EPC equivalent, and Hong Kong has no postcodes).

We also heard from one large firm that data issues can sometimes be overstated and that after 20 years of emissions accounting methods being developed in key sectors and increasingly widely adopted, data is no longer a significant barrier.

One final headline challenge that we heard of was to the pacing of the transition within firms. We heard from both smaller, regional firms as well as global firms that while there was clearly a risk in moving towards too slowly, for the reasons set out in section V.4.1, there were also sizeable risks in going too fast. These risks fall into two categories and would apply to a range of public-facing actions firms may take, including the creation of new green financial products, or the setting of new green targets.

The first major risk is that hastily changing policies and shifting investments to align with net zero risked causing undue disruption to specific sectors and potentially to the wider economy at large. This in turn would jeopardise the government and the industry's goal of facilitating a just transition, one which avoids disproportionate cost falling on either more vulnerable parts of society (such as people on low incomes), or in specific parts of the country. As well as being unjust, such disproportionate impacts could erode public support and political for the transition. The risks of the net zero transition between seen as 'unfair' on specific groups have been all too evidence in the recent backlash against specific climate policies in France, which prompted the *gilets jaunes* movement.

Introduction to climate risk scenarios

There are broadly two sets of climate-related scenarios worth noting. The first is what are known as 'outside-in' scenarios, which refer to the extent to which a combination of climate change (i.e. 'physical risks') and likely policy responses to climate change ('transition' risks) could affect the financial sector. An example of a physical risk would be increased flooding impacting on property valuations and hence increasing the risk to a firm's mortgage portfolio. An example of a transition risk would be a government deciding to suddenly apply or increase a carbon tax, which would impact a wide range of businesses and in some cases cause sudden drops in some business's valuations, in turn increasing the risk to a firm's corporate loan book.

The principal body defining the key scenarios for outside-in assessments is the Network for Greening the Financial System (NGFS), a grouping of central banks and regulators (98 at the time of writing). The three headline NGFS scenarios are:

- **'Orderly transition'** – carbon prices start to increase within a year and result in relatively low physical and transition risk
- **'Disorderly transition'** – carbon prices remain low and then jump suddenly in 2030, resulting in low physical but high transition risk
- **'Hothouse world'** – carbon prices remain low, resulting in high physical risk but low transition risk

The second set of climate scenarios are known as 'inside-in' and refer to the extent to which the financial sector and broader economy impact the climate. This means that these scenarios focus on projected emissions from different regions and sectors of the economy over the coming decades. There are a range of such climate scenarios in use, including those from the International Energy Agency.

The second major risk is that moving too fast towards net zero, without appropriate planning, creates considerable risk of error. This in turn could cause problems for customers or result in accusations of greenwashing. For example, if a firm launches a new green product which has not been properly risk assessed, or market-tested, then risks arise that the product may have to be removed or the terms suddenly changed. If a new green product were to be launched on which front-line staff have been insufficiently trained, then risks arise that customers may misunderstand the offer, or even inadvertently be mis-sold a product. In both cases customers could easily be confused or frustrated, denting their confidence in the transition and potentially prompting them to take their custom elsewhere.

Another risk with rushing products to market, or setting new targets, without full due process is that this could open the firm up to charges of greenwashing if it were later found that the product was somehow unable to deliver on its stated goal. We heard multiple times of the significant concern within firms of all sizes about accusations of greenwashing, which they took extremely seriously and scrupulously sought to avoid.

4.2. Scenario analysis

The emergence and expansion of ('outside-in' – see boxed text) climate-related scenario analysis was among the most notable outcomes of the TCFD. Climate-related scenario analysis has rapidly become a key component of risk management in the banking and finance sector. Building on this work, a number of central banks, including the Bank of England, in 2021 conducted their first ever climate-related tests of the banking system.

The Bank of England's test, known as the Climate Biennial Exploratory Scenario (CBES) exercise, applied to seven of the UK's largest firms and was underway at the time of our interviews in August and September 2021. We spoke with a number of participating firms in preparing this report. In most cases they had been conducting such exercises in-house since at least 2020, and had been applying climate-related scenario analysis since the publication of the PRA's climate-related 2019 Supervisory Statement (SS3/19) and July 2020 'Dear CEO' letter. They had all invested significantly in recent years to create and grow climate risk teams, as well as investing in climate risk awareness more broadly across their workforces. They noted the PRA's requirement that each firm appoint a Senior Management Function (SMF) responsible for climate risk. In most cases firms had given their chief risk officers this responsibility and asked them to create governance mechanisms to support them in the role and embed the function more broadly within their organisations. Scenario analysis was at the core of this approach.

However, this focus on climate risk was not just confined to the seven CBES firms. SS3/19 had invited all regulated firms to consider conducting climate-related scenario analysis. Many had chosen to prioritise this work, despite in some cases small risk teams. Our interviews made clear that the distinction between smaller and larger firms on scenario analysis was not whether it was taking place, but how mature it was. Larger firms – including large firms outside of the CBES exercise – have well-embedded teams, governance and processes to assess and manage climate risk and scenario analysis. They have long recognised that climate risk requirements are only going to increase, and invested upfront to build capacity and expertise.

Recent reports have noted the high demand for climate risk professionals as more and more teams are formed and grown, while the pipeline of experts has not grown accordingly, resulting in salary inflation. Smaller firms are largely in the process of embedding these considerations in their operations, though all have started on the journey. Another distinction in relation to scenario analysis is that larger firms are more likely to be turning their attention to the key 'inside-out scenarios', whereas for smaller firms this is largely not yet a focus. This raises a wider point that firms told us, which is that the nature of the scenario analysis will depend on the portfolio. One such example we heard of was that scenario analysis for firms mostly active in unsecured consumer lending is mostly about transition risk, particularly focused on potential rises in unemployment, which then takes on a region and place-based angle.

4.3. Transition pathways

One of the core requirements of NZBA signatories is that they publish net zero aligned 2030 targets using credible sectoral decarbonisation pathways. This formalises a trend seen in global firms in recent years to start calling out particular activities which they will cease funding. Many large European and North American firms have committed to cease support for thermal coal mining, or oil and gas exploration in the Arctic, or 'mountain-top removal' mining. However, these are generally very specific activities, which make up a small proportion of a firm's balance sheet.

In requiring members to set sector-wide targets against transition pathways, the NZBA is asking firms to go much further than they have before. This requires a lot of complex analysis to understand emissions and emissions pathways for clients in those sectors (as per the data challenge mentioned above), as well as challenging mathematical modelling to produce accurate projections. As with the burgeoning field of climate risk mentioned above, there is also a need to rapidly build and train sizeable teams of experts able to produce plans based upon agreed sectoral transition pathways. However, despite these significant challenges associated with the requirement to produce sectoral plans, every single NZBA firm we spoke to was confident of meeting the 18 month deadline.

Target setting against sectoral pathways represents the macro level of the transition, i.e. what firms are planning to do in the aggregate. At the micro level the transition entails a series of in-depth conversations between the firms (in particular their client relationship managers) and their major corporate clients. These conversations require relationship managers to undergo extensive training to understand the intricacies of transition pathways within their clients' sectors, including the potential for those clients to invest in energy efficiency or lower-carbon technological alternatives. However, there is a limit to the extent of the advice and support that firms are able to give to clients: as one interview told us, "we're bankers, we're not consultants", emphasising the need to focus on the core function of assessing credit risk and lending as appropriate.

In facilitating these conversations between clients and experts elsewhere in their firms, relationship managers often had to ask clients to complete lengthy climate-related questionnaires, which were not always welcome. One interviewee at a large firm explained to us the importance of firms conducting desk research to seek to answer as much of their own questionnaire as possible, to minimise the burden on the client.

We also asked firms how they assess the credibility of their clients' transition plans when those clients request funding. We heard that some of the largest firms have clear guidelines and rules in place, while some of the smaller large firms are still developing processes and are therefore currently more ad hoc in their approach. One interviewee at a large firm told us that a review of a corporate client's recent capital expenditure was a very helpful way of comparing rhetoric to reality – as we were told, "capex doesn't lie". Other methods include buying access to third party data companies' indices to look at their ratings of a particular corporate's track record (though noting the challenges with such data, as set out above), or asking whether the company has an independently verified climate target (e.g. under the SBTi).

While all of the above refers to large firms, with the expectation that transition pathways will be made public by the end of 2022 – and indeed some already are public – there will soon be a raft of free materials for all firms, regardless of their size, to draw on. Another benefit of these pathways being published is that they will prompt constructive debates around the merits or downsides of particular approaches and pathways, and potentially result in a 'soft convergence' towards optimal approaches across the banking and finance industry.

4.4. Sustainable finance

As set out above, member firms have collectively committed to facilitating over US $9 trillion in sustainable finance by 2030. However only a fraction of this can be officially be counted as 'climate finance' as per the definitions emerging under the Paris Agreement. There are two main reasons for this discrepancy. The first is that most of the sustainable finance committed is not reliant on public climate finance, and hence cannot be counted as 'mobilised' by public funds. The second is that sustainable finance is broader than climate finance, encompassing environmental goals (such as biodiversity) as well as social objectives, including the UN's SDGs.

Member firms told us that a majority of their sustainable financing would focus on climate change, and in particular the transition towards clean energy and industrial processes, a critical priority in this decade if the goals of the Paris Agreement are to be met. Another key distinction is that while some of the US $9 trillion takes the form of loans and other investments, a significant amount would be 'facilitated finance'. One example of this would be if a firm helped a corporate client to issue a green bond – the funding generated by that bond would be counted as the firm's facilitated finance, even though those funds are not coming from its balance sheet.

The nature of these sustainable funding goals also means that in most cases it is not possible to specify in advance, and in some cases, ever, which geographies the sustainable finance flows to. This is because the most likely recipients of this funding are multinational companies. For example, if a loan is made to a large auto manufacturer to boost their energy efficiency software in their factories this would result in reduced emissions across a number of countries and jurisdictions. Despite these challenges some large firms are in the process of establishing regional targets and scorecards, which they expect to make public in the coming year or two.

Finally, it is worth noting that many firms have in recent years exceeded their sustainable financing targets, and increased them as a result. This suggests that the market for sustainable investments continues to grow faster than projected.

4.5. Carbon pricing and carbon markets

The industry is broadly very supportive of carbon pricing measures, such as a carbon tax. Such measures would ensure all companies would internalise the social costs of the emissions they were responsible for, and hence incentivise them to reduce those emissions. In general, this would be ideal for the financial sector because once these costs were priced in then the need for more complex and challenging market shaping and incentives would be reduced.

There was broad consensus among the firms that we spoke with that voluntary carbon markets (VCMs) could have an important role to play in the net zero transition, and that their use must not be a substitute for in-house emissions reductions within firms (scope 1 and 2 emissions) or their clients (i.e. firms' scope 3 emissions). If used at all, this should only be to cover any residual emissions in hard-to-abate areas after in-house mitigation had been achieved. However, beyond that broad agreement we encountered a range of views.

Smaller firms were cautious about VCMs. They saw the use of VCMs as a reputational risk which could lead to charges of greenwashing, though in most cases had not fully wrestled with the question of their use and chose to first focus on reducing their own scope 1 and 2 emissions as much as possible. They were aware that there was a significant industry push to improve and expand VCMs but given their limited resources had not engaged with the debates and hence were yet to establish firm positions on the use of VCMs.

The largest firms were generally more positive about carbon markets in general, and offsetting in particular. In many cases they were very familiar with the theory and practice of offsetting; actively engaged with the key industry grouping on the topic (the Task Force on Scaling Voluntary Carbon Markets, or TSVCM – see section IV.3.2); and had participated in these markets for many years (as a buyer and/or as a market facilitator).

On the whole these firms were positive about the role of offsets in the transition, and confident that the well-documented deficiencies in these markets – including fragmented markets, variable quality and imperfect price signals – could swiftly be resolved through the TSVCM.

Despite this positive view of VCMs, larger firms nonetheless had some open questions about their use. These included:

- Whether to seek credits with 'co-benefits' beyond pure climate outcomes, such as promoting and preserving biodiversity, or social goals.
- Whether to seek offsets from specific jurisdictions, such as those in which a given firm has a presence, or whether to instead target specific types of offsetting activity which aligns with the firm's ethos.
- Whether offsets can or should be included in calculations of a firm's scope 3 emissions – this issue presented significant practical challenges, in terms of the current carbon accounting methodologies, as well as raising political and ethical questions.

Carbon pricing, carbon trading and voluntary carbon markets

Economists have long argued that climate change can be solved simply by putting a price on carbon. In the economic jargon, greenhouse gas emissions are an 'externality', meaning a cost of economic activity which is not borne by the economic actor but by society at large. Therefore, ensuring that those emissions are adequately priced should correct the incentives and hence result in the necessary decarbonisation.

Carbon pricing broadly comes in three different forms:

- Carbon tax, where this is a fixed charge for every tonne of greenhouse gas emitted, paid by entity responsible. A carbon tax creates a fixed price for emissions but allows for an unspecified level of overall emissions.
- Cap and trade, also known as an 'emissions trading systems', or ETSs – this limits the total amount of offsets that can be emitted within a jurisdiction, issuing (usually by auction) that number of allowances, each worth one tonne, then allowing those allowances to be traded. Cap and trade fixes the total emissions but creates a variable price.
- Voluntary Carbon Markets – in contrast to ETSs which are also known as 'compliance markets'. VCMs trade in carbon credits, or offsets, each worth one tonne of CO2, as with an ETS. They are increasingly popular among large corporates, for example airlines which offer passengers the ability to offset the emissions associated with buying a flight.

The 1997 Kyoto Protocol created the first global carbon market, known as the Clean Development Mechanism (CDM). The CDM allowed countries to trade credits, much as companies trace credits in VCMs today. The CDM was seen by environmental campaigners as deeply flawed and contributing to overall emissions increases because of methodological shortcomings.

Article 6 of the Paris Agreement created provisions for new forms of global carbon markets to replace the CDM. However, these provisions have yet to be finalised so those markets have not been realised. Finalising these provisions is one of the priorities at COP26.

4.6. Lessons learned

Interviewees were asked to share the top lessons learned in their and their firms' journeys towards net zero. The most common response we received was that the journey is more complicated and takes longer than expected, so if a firm has not yet started on the journey, it should begin immediately.

Beyond that the responses can be grouped as follows:

Leadership

- Firms should be proactive in leaning into this transition. One interviewee told us that "no one is escaping the trend towards green... The old way of business [i.e. supporting carbon-intensive sectors] is becoming extinct, and supporting businesses that are working towards a sustainable future has become a board objective". This clear-eyed vision of the changing tide was instrumental in helping this interviewee's large firm stake out a position of leadership within the market.
- Multiple interviewees told us of the importance of getting senior leadership, in particular the board and CEO, signed up to a clear and decisive climate position at the earliest opportunity. This should be underpinned by ensuring that members of the senior leadership have climate metrics and goals reflected in their objectives. We were also told of the importance of ensuring climate metrics are reflected in colleagues' objectives at all levels of seniority. Clear, quantified and ambitious targets were also seen to be highly useful mobilising tools at the organisational level – they were described to us by one interviewee as "a great catalyst for rapid action".
- There was however a note of caution that when seeking senior support for climate action, it was important to be ready to use it quickly. One interviewee explained how their firm's top leadership team undertook training on climate change, quickly became highly motivated, and within weeks had issued its first green product.

A holistic approach

- We heard repeatedly that tackling climate change within a financial institution is a deeply holistic task which does not lend itself to a traditional 'command-and-control' approach. What is required is a shift in mindset which requires staff buy-in at all levels and in almost all functions.
- This mindset shift is made easier by the fact that most staff within firms are very keen on taking action on climate change. It is a very popular area to work on, especially for younger members of staff. There is a sense of the agenda being both meaningful and increasingly high profile, and staff want to be a part of that. So, with many colleagues the key is not to motivate them but to harness their pre-existing motivation to ensure everyone is clear on their role and pulling in the same direction.
- Many interviewees reported the importance of joining up different teams working on key aspects of climate policy. In the UK this work is often driven by the risk team, in response to the PRA's SS3/19. However, increasingly overall climate policy is being led by the strategy team, or the CEO's office, or in larger firms by a chief sustainability officer. The sooner these teams are all brought together to create a common vision, the better.
- One interviewee noted that some teams in their firm embraced the climate agenda more eagerly than others, and if they could go back in time, they would have more assertively sought to mobilise those more reluctant teams. The interviewee reported that they should have "created more turbulence" by calling out those teams' lack of intent.

Expertise

- Training colleagues across the firm, as early as possible, was seen by several interviewees as essential – especially as it often takes much longer than anticipated, and in some cases will remain an ongoing effort.
- This training must have the right focus. One interviewee expressed regret that their firm didn't start on more business-oriented climate training earlier, and instead started with a general overview of E, S and G. It would have been more useful to start sooner on the more practical, customer engagement side of the transition. As this interviewee said, "It's not about getting lost in the climate science; it's more about the core principles and how they apply in people's day to day roles".

- In larger firms the training challenge is harder to crack and will take longer, and so needs a sustained commitment. One large firm had trained over 20,000 staff on climate change, but the task was an ongoing challenge. We were told "We're still trying to explain to the whole organisation the complexities of why net zero is difficult, we are constantly doing webinars, and we are also trying to make sure everyone is talking the same language".
- One interviewee in a smaller firm recommended bringing in external experts to rapidly build up the right levels of knowledge for key staff, and at the same time get a sense of the industry benchmarking. This had been an effective way to quickly embed climate knowledge despite starting from a low base.
- One interviewee at a larger firm commented that there were many extremely good methodologies available to help firms consider the transition and advised firms not to tweak or reinterpret them. We were told that "transparency is what really matters - apply the standards when you can and make your life easy".

Data

- An essential first step according to numerous interviewees is for each firm, even the smallest, to conduct an assessment of their scope 1 and 2 emissions. Without knowing what a firm's emissions are, they will be unable to address them. As one interviewee told us: "You have to be able to get your own house in order".
- We heard repeatedly of the severe challenges in getting the right data from client companies needed to estimate a firm's scope 3 emissions. Interviewees told us of the importance of engaging with a client base as early as possible, to both educate them on the need for and definitions of reliable emissions data, and to prepare them to produce and supply it. As well as enabling a firm to calculate its scope 3 emissions more accurately, this data also allows firms to understand the decarbonisation challenges they face and propose financing solutions.
- We heard from one large firm that a key lesson had been the need to integrate data requirements across different business units. A central data coordination function was created following a realisation that different teams within the firm were independently spending time seeking, and in some cases paying for, the same data sets.

Perspective

- We heard from multiple interviewees that the task – decarbonising the financial system, and in turn the global economy – can seem overwhelming and it was essential to keep a sense of perspective and optimism.
- Building on this point, we were told that staff working on this agenda must not "let the perfect be the enemy of the good", as not every client will want to undertake what might be the ideal transition to net zero as quickly as they could. In many cases some progress is better than no progress.
- One interviewee told us that people working on this agenda should keep a diary, because "in hindsight it can look like not much progress has been made, when really it has".
- Many stakeholders have been and remain critical of the financial sector for not doing more sooner in response to climate change. One interviewee at a NZBA member told us that it can be disheartening to put out a big net zero commitment and then be criticised by stakeholders. While in reflecting on this point the interviewee noted that "this is also the role of stakeholders, and it is important to keep listening to them". Another interviewee cautioned that too much pressure on the sector to act could incentivise greenwashing.

4.7. Outlook

Although we didn't ask interviewees to share their outlooks for the future, many offered thoughts on this unprompted. The key messages we heard were:

- The sector has come an incredibly long way in a short space of time and will in the coming years continue to make rapid progress while also consolidating the progress already made. For example, the rapid emergence of a plethora of rival standards, methodologies and data systems has created a chaotic landscape for firms and stakeholders to navigate. In some areas this chaos is giving way to order, such as with the emergence of clear industry preferences for specific methodologies such as PCAF (for carbon accounting) and SBTi (for decarbonisation target setting). The creation of the International Sustainability Standards Board (ISSB) under the International Financial Reporting Standards (IFRS) Foundation is seen as another welcome step in this direction.

- The publication of sectoral pathways, largely prompted by the establishment of the NZBA, will prompt a new wave of industry and stakeholder debate about those sectors' trajectories and hopefully result in a convergence of views – alongside accelerating action.
- One interviewee noted that the coming years may see regulatory and/or legislated requirements for companies, including financial firms, to reduce emissions for environmental reasons – rather than simply to reduce financial risk. The focus purely on risk was seen by this interviewee as too narrow.
- VCMs will continue to grow rapidly, their methodologies will improve, and they will channel ever growing finance towards developing countries.
- It was drawn to our attention that the Asian Development Bank has explored the possibility of carbon-intensive assets being bought and wound down ahead of their natural decommissioning date (link).

VI. CASE STUDIES

Deutsche – A trio of inaugural sovereign green bonds

HSBC – Financial Services Taskforce

JPMorgan Chase – CFRF Industry Practitioner Scenario Analysis

Lloyds Bank – Dogger Bank wind farm

Nationwide – Suite of green products as part of £1 billion green fund

Paragon – Green bond issuance

Standard Chartered – Technaf solar plant, Bangladesh

Triodos – Maximising environmental and social value

West Brom Building Society – A proportional response

Deutsche – A trio of inaugural sovereign green bonds

Deutsche Bank arranged inaugural green bonds for three sovereigns in September, demonstrating the strength of the bank's Sovereign, Supranational and Agency (SSA) Debt and ESG Advisory platforms. This included the bank pricing the largest-ever green bond to date, a £10 billion inaugural green gilt for the United Kingdom's Debt Management Office (DMO). Anchored by its core domestic investor base, the transaction garnered a high quality orderbook in excess of £100 billion, the largest green bond issuance on record.

Earlier in the month, Deutsche Bank arranged a €5 billion inaugural green bond for the Kingdom of Spain. The issue was met with strong enthusiasm from investors, with demand reaching over €60 billion within hours of books opening. It benefited from solid support from green investors, who received more than two thirds of the allocation.

The Republic of Serbia successfully placed a green seven-year €1 billion euro benchmark, with Deutsche Bank acting as joint bookrunner. The green tranche was placed alongside a 15-year conventional €750 million offering, making it the Republic's first-ever dual-tranche transaction. Deutsche Bank has led all 12 of Serbia's bond issuances and took the additional role of green structuring agent on this transaction.

The market has seen the equivalent of US $970 billion of issuance from SSAs this year, slightly up on last year's bumper year with US $940 billion, fuelled by governments' needs to fund Covid rescue plans. Deutsche Bank is currently third in the SSA debt origination league table, up from seventh this time last year. This uplift in activity is beginning to be reflected across the spectrum of clients, including corporates and financial institutions.

HSBC – Financial Services Taskforce

Industry collaboration will be critical to accelerate climate action and lower global emissions. Recognising this, HSBC's Group Chief Executive, Noel Quinn, chairs the Financial Services Taskforce ('FSTF'), part of HRH The Prince of Wales' Sustainable Markets Initiative. The FSTF brings together some of the world's largest banks to amplify and accelerate action on climate-related initiatives.

Banks face many challenges in aligning their portfolios with pathways to net zero. Due to the diverse nature of their business, different teams in different geographies will have to solve unique problems and support a variety of client needs. Each bank's journey will be dependent on the sectors it finances, as these sectors will reduce emissions at different speeds and to varying degrees, given technology constraints.

To help address this, the FSTF has published a Practitioner's Guide to support banks across the world in developing and implementing net zero strategies. The guide brings to life the approaches and actions banks are taking to operationalise their net zero strategy. It assembles FSTF members' experience and the recommendations made in the guide provide suggestions for approaches that banks can take over time as methodology, data and climate science continue to evolve. It is the result of discussions between the banks in the FSTF and builds upon the Net-Zero Banking Alliance (NZBA) Commitment Statement, an initiative co-launched by the FSTF.

Another area of focus of the FSTF is to amplify the work of the 'FAST-Infra' initiative (Finance to Accelerate the Sustainable Transition). This scheme is designed to help to close the trillion-dollar sustainable infrastructure investment gap1. It aims to do this by transforming sustainable infrastructure into a mainstream, liquid asset class in order to direct investment towards sustainable, resilient projects. FAST-Infra was conceived by Climate Policy Initiative (CPI), HSBC, the International Finance Corporation (IFC), OECD and the Global Infrastructure Facility under the auspices of President Macron's One Planet Lab. FAST-Infra, and HSBC's leadership in this initiative, will be featured as part of the COP26 Finance Day activities.

Both the Practitioner's Guide and FAST Infra initiative are tangible examples of how industry action can help achieve our common goal of transitioning to a low-carbon future.

1 OECD 'Green Infrastructure in the Decade for Delivery' https://www.oecd.org/environment/cc/policy-highlights-green-infrastructure-in-the-decade-for-delivery-assessing-institutional-investment.pdf

JPMorgan Chase – CFRF Industry Practitioner Scenario Analysis

JPMorgan Chase recognizes that business has an important role to play in addressing climate change, and advancing solutions that help support sustainability. The firm is applying its capital, data, expertise and other resources to help address climate change; promote long-term, innovative solutions for a more sustainable future; and help its clients navigate the transition toward a low-carbon world.

Managing climate-related risks is a critical component of advancing sustainable solutions for business and communities. As part of its efforts, JPMorgan Chase joined the PRA and FCA co-Chaired Climate Financial Risk Forum (CFRF) at inception in 2019 and has chaired the Scenario Analysis workstream for the banking sector over the previous year. The firm's work over these two years has focused on sharing perspectives amongst the members and co-developing publications about emerging good practices on climate scenario analysis. The Forum is a unique setting which allows for participants to debate strengths and limitations of external climate reference scenarios – such as those developed by the Network for Greening the Financial System (NGFS) and International Energy Agency (IEA) – and discuss how to overcome challenges in integrating climate scenarios into risk models.

JPMorgan Chase is also committed to addressing climate change and advancing climate action through several avenues, including its Paris-aligned financing commitment that includes carbon reduction targets for the Oil & Gas, Electric Power and Auto Manufacturing sectors, and a target to finance and facilitate $2.5 trillion in sustainable development over ten years – including $1 trillion for green initiatives.

Lloyds Bank – Dogger Bank wind farm

The world's largest offshore wind farm, currently under construction in the North Sea, is set to boost the UK's progress towards net zero carbon emissions with the support of a new £5.5bn funding package. SSE Renewables, which is working alongside Norwegian energy firm Equinor to develop the new Dogger Bank Wind Farm, has secured the funding to support the installation of wind turbines across the first two phases of construction, with the 18TWh farm expected to begin generating power from 2023. 190 turbines are planned for this phase of the project, which will see Dogger Bank A and B constructed more than 130km off the coast of Yorkshire. Once complete, Dogger Bank is expected to provide renewable energy for up to six million British homes.

Each of the first two phases will be supported by Lloyds Bank as Mandated Lead Arranger (MLA) and Lloyds Bank Corporate Markets as the Hedge Execution Bank and hedge provider. The final group of lenders comprises 29 banks and three Export Credit Agencies (ECAs); Bpifrance Assurance Export – the French ECA, EKN – the Swedish ECA, and GIEK – the Norwegian ECA.

Lloyds Bank also provided a Clean Growth Financing Initiative (CGFI) and Helping Britain Prosper (HBP) eligible initial debt commitment of £1.0bn across commercial (£500m) and ECA covered (£500m) tranches (final allocation of £510m). This is one of the largest commitments in the bank group and the Lloyd's largest ever commitment in the offshore wind sector.

The deal furthers the longstanding relationship between SSE and Lloyds Bank. The Bank is currently supporting the development of Seagreen, a joint venture between SSE and Total which will provide low carbon energy to more than a million homes. Once complete, Seagreen will overtake SSE's Beatrice development – also backed by Lloyds Bank with a £300m commitment (£198m final allocation) – as Scotland's largest offshore wind farm.

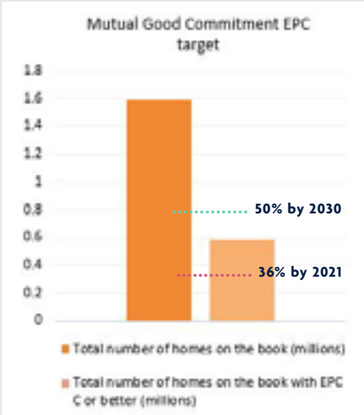
The investment will play a part in helping Lloyds Bank and the UK accelerate the decarbonisation of the UK economy and contribute to offshore technology that will be able to power up to six million British homes.

Nationwide – Suite of green products as part of £1 billion green fund

In 2020, Nationwide launched its £1bn green fund, supporting its ambition to lead the greening of UK homes. Since then, Nationwide has launched three mortgage products aimed at doing just that: a green additional borrowing mortgage, a green reward mortgage, and a green further advance for the buy to let customers of its subsidiary, The Mortgage Works. These products are designed to support greener home choices, through cashback awards or lower-than-standard-mortgage interest rates, helping its members and customers make energy efficient home improvements and purchasing more energy efficient homes. In November 2020, Nationwide launched its Mutual Good Commitments - a bold set of initiatives closely aligned to its strategy and which support its ambition to re-build society, nationwide, following the pandemic. These included the ambition that, by 2030, at least 50 per cent of homes in its mortgage portfolio will have an Energy Performance Certificate (EPC) rating of C or better. Nationwide's green products aim to support the achieving of this commitment.

Nationwide is also aiming to be an exemplar for sustainable housebuilding with their not-for-profit housing development, Oakfield. Oakfield is a unique, off-gas development, with all 239 homes designed to be EPC A rated – heated and powered by air source heat pumps and solar panels. Nationwide has worked closely with the local community in the design and planning of the homes, which includes initiatives that encourage wildlife and biodiversity too. It hopes other companies use the development as a blueprint for building good quality, sustainable homes.

In May 2021, Nationwide published its enhanced climate-related financial disclosures, aligned to the recommendations of the Taskforce on Climate-related Financial Disclosures. To track progress against their EPC target, and to calculate the carbon emissions for their mortgages (scope 3), Nationwide developed an innovative model to interpolate publicly available EPC data and to provide EPC ratings for the roughly half of the mortgage portfolio that does not have a valid EPC. The model uses a combination of artificial intelligence and machine learning techniques to match similar property features in order to best estimate EPC's. Nationwide's absolute emissions for its mortgage portfolio were calculated at 6.25MtCO2e/y. Nationwide then used the Partnership for Carbon Accounting Financials' Global Standard to calculate its financed emissions, weighted by the ratio of loan amount to property value, at 2.75MtCO2e/y.



In June 2021, Nationwide signed up to the Net-Zero Banking Alliance and Glasgow Financial Alliance for Net Zero, committing to being net zero by 2050 at the latest. Part of this commitment requires the setting of intermediate science-based targets for scope 1, 2 and 3 emissions. Nationwide intend to leverage their EPC interpolation model to support them in setting these targets and to inform the development of their net zero transition plan.

Paragon – Green bond issuance

Paragon Banking Group PLC is a FTSE 250 specialist bank whose lending products include mortgages for landlords and loans for business customers. Lending is funded by deposits from savings customers, together with wholesale funding. In March 2021, Paragon issued a new wholesale Tier 2 bond, establishing a Green Bond Framework to support the issuance.

Many financial institutions issue bonds, so called Alternative Tier 1 and Tier 2 instruments, that provide both a source of funding from the cash received from investors and a capital resource that is used to support lending on the balance sheet. Investors are typically fund managers that are seeking an appropriate return from an organisation with a robust credit profile and, more recently, strong sustainability credentials.

Paragon's Green Bond Framework provides clear and transparent criteria to identify investments which support the transition to a low carbon economy and create long-term value for stakeholders. The proceeds of any Green Bond issued by Paragon under the Framework are exclusively allocated to an eligible loan portfolio of new and existing green loans. The eligibility criteria used to define the eligible green loan portfolio are strictly based on the ICMA Green Bond Principles and on the good market practice of Green Residential Real Estate, where new or existing residential buildings belonging to the top 15per cent low carbon buildings in the region, include buildings certified, or to be certified, with an Energy Performance Certificate ('EPC') label A or B in England and Wales.

Establishing a green bond framework does incur both initial and ongoing cost, with external reporting requirements aligned to enhanced internal control and product development expectations. The Board concluded that the principles of the framework were aligned to its support of the UK's ambition to reduce greenhouse gas emissions to net zero by 2050. Identifying the financial risks from climate change as a Principal Risk for the Group and establishing a governance framework that includes the green bond have been important milestones in embedding sustainability, which is core to its strategy.

The Green Bond, which is overseen by Paragon's Sustainability Committee, has been a catalyst for the identification of both challenges and opportunities that present themselves in the climate space as Paragon seeks to help reduce the impact of its lending on the environment. The Green Bond demonstrates Paragon's continued commitment to mobilise capital towards activities that enable a just, fair and inclusive transition to net zero.

Standard Chartered – Technaf solar plant, Bangladesh

Standard Chartered helped finance the building of the Technaf Solar Plant in Bangladesh – the largest of its kind in the country at the time of financing. The plant, which is being built on the shores of the Naf river in Teknaf, will supply power to the national grid.

At peak production the plant supply will cover up to 80 per cent of the present electricity demand of the entire Teknaf region. Over a 20-year span the plant is forecast to achieve carbon emission savings of approximately 400,000 tons.

Around 136,500 are expected to benefit directly from energy from the solar plant, with around 170 people employed during the construction of the plant. Some 70 people are currently employed now the plant is operational.

A total of 87,000 solar panels were used to construct the plant, which has five sub stations. The plant has a power generation capacity of 28 MW, dwarfing the highest capacity of a solar power plant prior at the time, which was 3MW.

According to ESI Africa, the demand for electricity in Bangladesh is projected to reach 34,000MW by 2030 and the nation is planning to diversify its energy mix, which is currently heavily based on natural gas, by increasing the share of renewable energy.

The financing for the plant, which stood at USD 25 million, was provided in project finance by Standard Chartered and with Bangladesh-based One Bank. As part of the financing arrangement, Private Infrastructure Development Group (PIDG) company GuarantCo, provided an unconditional credit guarantee for over 50 per cent of the project debt. PIDG is an infrastructure development and finance organisation which operates in emerging markets.

Triodos – Maximising environmental and social value

Triodos Bank has been a trailblazer in the banking sector when it comes to addressing climate change. Long before most financial institutions even started to consider the way they lend and invest was linked to the serious impacts of climate change, Triodos - initially founded in the Netherlands in 1980 - choose to focus its entire business model around serving people and planet.

Triodos has become a leader in sustainable banking, only financing projects and initiatives that demonstrate positive social, environmental and cultural impact. This broad view is represented by the UN's Sustainable Development Goals, which Triodos has used in its integrated reporting since 2016, mapping what it does in support of each of the global goals.

The bank has worked hard to actively identify the sustainable sectors where it can stimulate innovation and drive forward positive change, for example financing some of the first wind power developments across Europe in the 1980s. However for Triodos - which has offered retail banking in the UK since 1995 - the transition to net zero must be a just one, that considers societal impact and leads to an inclusive transition.

When measuring the impact of its finance, Triodos understands that metrics and targets do not tell the whole story. Therefore each loan or investment is individually assessed, and the bank aims to find qualitative evidence of impact first of all and then back this up with quantitative metrics where appropriate to do so.

Triodos has developed an 'Impact Prism' that uses thirty-five questions to identify the broader impact and purpose of each loan or investment, ranging from questions on social justice to those focused on climate and wider sustainability. The main goal is to use the results to discuss opportunities to increase the impact of customers and projects that the bank finances.

Triodos has a mission to 'help create a society that protects and promotes quality of life for all'. Understanding that climate change is fundamentally a social issue as well as an environmental one, Triodos uses climate targets to demonstrate to stakeholders what their contribution is to a safe increase in global temperature and urges the rest of financial sector to plot a similar path, in particular when it comes to divesting its fossil assets. Carefully considered science-based targets will help to deliver this mission, clearly including both environmental and social objectives.

West Brom Building Society – A proportional response

Climate change will affect every firm on the planet, whether a local building society or a globally systemic bank. As a mid-size mortgage lender with a simple, purpose-led business model, West Bromwich Building Society is less exposed to climate change risk than a larger bank. Climate change risk, however, is far-reaching in breadth and magnitude and can manifest through existing risk channels. Increasing frequency, severity or volatility of extreme weather events can impact property assets, with loans backed by these properties potentially incurring additional losses through heightened flooding and subsidence risk. The Board therefore took a decision to act in the face of this risk and quantify the potential impact of climate change, in line with PRA expectations as outlined in Supervisory Statement 3/19.

As the Society did not have access to the relevant knowledge and resource in-house, a third party, 4most, was selected to produce a Climate Stress Model. The Model was designed to calculate the additional expected losses that the Society could incur due to flooding and subsidence in the future under High, Medium, and Low emission scenarios as modelled by the Met Office. The High, most severe scenario aligned with the Representative Concentration Pathway (RCP) 8.5 scenario, which assumes a "business as usual" worst case scenario for atmospheric CO2 concentration in the 21st century. The Model translates flood and subsidence risk into additional expected losses over the base expected loss by applying adjustments to the value of the property to reflect the short and long-term costs incurred due to flood and subsidence risk and by assessing the impact of these events on the likelihood of a default occurring.

The outputs of the Model, which were presented to the Board and included within our ICAAP document, showed very modest losses on the Society's residential mortgage portfolio under even RCP 8.5. This has provided the Society with limited comfort that current underwriting standards are robust. This does not mean that our work is over. As more guidance is released by the Bank of England and industry stakeholders to meet customer's demands, the Society will continue to adhere to regulatory expectations and identified best practice in a proportional manner.

In additional to physical risk we are also ensuring transition risk, which can manifest through increased energy efficiency standards for Buy-To-Let properties in particular, is identified through capture of EPC Ratings. We recognise climate change as a risk to our business model, the wider financial system, and the world. All firms, where small or globally systemic, have a part to play to combat climate change. We will therefore endeavour to identify all emerging risks and take prompt mitigating actions.

VII. ENDNOTE

About this publication

This publication was prepared over the last couple of months with COP 26 in mind and aims to combine an account of the embedding of climate responsibility into governance and strategy in recent years with insights into the foundations being laid in support of net zero commitments being made by an increasing number of banking and finance firms. We plan to interlink with the sustainability pages of the UK Finance website (www.ukfinance.org.uk/sustainability) in order to maintain the resource pack included in the first half of the publication and to relate further climate-related and broader ESG developments.

About our member contributors

UK Finance formed a cross-cutting Sustainability Committee reporting directly into its main board early last year in reflection of the strategic priority being given to climate responsibility and other aspects of ESG reporting within banking and finance. Representation is at a senior level, including in some cases global head of sustainability, and membership is reflective of the breadth of UK Finance, with UK and overseas firms, large and small, within the committee's 24 members.

In March this year we augmented our member engagement on climate change within a structured dialogue that we labelled 'COP26 & Beyond'. This enabled us to double the number of firms that we could include directly in our industry discussion on embedding climate responsibility and the setting of net zero targets. 39 firms also contributed to an industry benchmarking exercise in which we mapped progress being made within individual firms whether by reference to management reporting under TCFD recommendations, PRA supervisory expectations or the four pillars of Mark Carney's COP26 priorities for private finance. Of these, 21 firms – some signed up to NZBA, some driven more by pre-existing management and supervisory expectations – participated in bilateral interviews that shaped considerably the banking and finance insights provided in the latter part of this publication.

About our authors

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Paul Chisnall has responsibility for climate risk, green finance and sustainability at UK Finance. He brings to this a perspective based upon experience in company law, corporate governance, strategic and financial reporting.

Ben Rattenbury joined UK Finance in 2020 to assist with deepening our member engagement on climate responsibility having previously worked for BEIS, DFID and DECC. He has since left to join a technology company working on natural capital accounting.

Data gathering and interviews contributing to the understanding set out in this report were assisted by summer interns William Hudson and Maya Middleton-Welch.

"It is a generational thing. We see it in our younger members of staff, who are more keen to be involved"

"We're bankers, we're not consultants"

"Capex doesn't lie"

"No one is escaping the trend towards green... The old way of business is becoming extinct, and supporting businesses that are working towards a sustainable future has become a board objective"

"A great catalyst for rapid action"

"Created more turbulence"

"It's not about getting lost in the climate science; it's more about the core principles and how they apply in people's day to day roles"

"We're still trying to explain to the whole organisation the complexities of why net zero is difficult, we are constantly doing webinars, and we are also trying to make sure everyone is talking the same language"

"Transparency is what really matters - apply the standards when you can and make your life easy"

"You have to be able to get your own house in order"

"Don't let the perfect be the enemy of the good"

"In hindsight it can look like not much progress has been made, when really it has"

"This is also the role of stakeholders, and it is important to keep listening to them"