SCIENCE BASED TARGETS

DRIVING AMBITIOUS CORPORATE CLIMATE ACTION

FOUNDATIONS FOR SCIENCE-BASED NET-ZERO TARGET SETTING IN THE FINANCIAL SECTOR

Feedback Summary

February 2022

SCIENCE BASED TARGETS
DRIVING AMBITIOUS CORPORATE CLIMATE ACTION

Partner organizations

FOUNDATIONS FOR SCIENCE-BASED NET-ZERO TARGET SETTING IN THE FINANCIAL SECTOR

February 2022

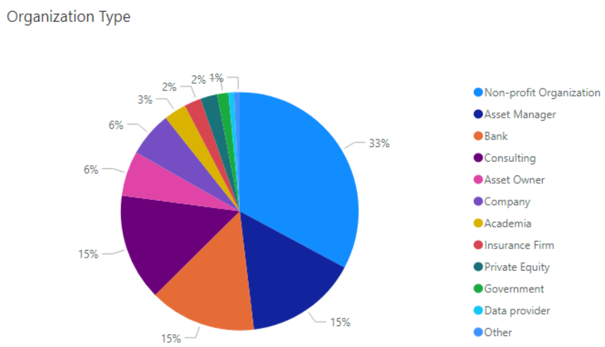
1. Introduction

In November 2021, the Science Based Targets initiative (SBTi) distributed a draft document for public comment entitled “Foundations for Science-Based Net-Zero Target Setting in the Financial Sector.” This document summarizes the feedback collected through a series of online workshops and an online survey. The workshops were held on December 7 and 13 to cover a range of time zones and included over 250 participants who were presented the draft framework and participated in break-out sessions on specific topics. The survey was completed by 131 individuals from a broad range of institutions and geographies.

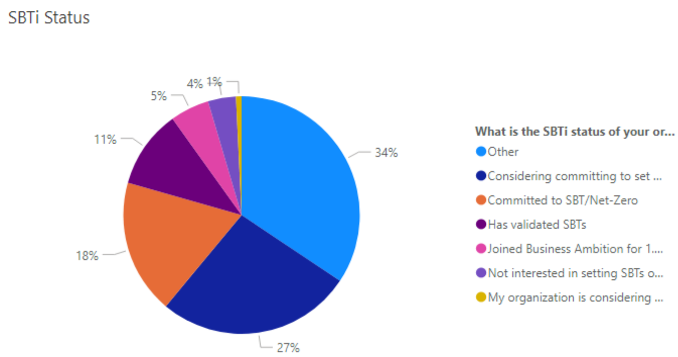
The workshops provided an opportunity for qualitative, in-depth discussion of each of the topics outlined in the survey. Workshops were scheduled to facilitate participation from Asia, Europe/Africa, and the Americas. This summary provides the quantitative results from the survey as well as qualitative feedback received through both the survey and the workshops.

2. Overview of Survey Responses

A range of different types of financial institutions, including asset owners, asset managers, banks, private equity, and insurance firms provided feedback as part of the survey. In addition, a significant portion of the feedback was offered by NGOs and consultants who work directly with financial institutions.



More than two thirds of eligible respondents are either committed to or are considering setting a near-term science-based target or science-based net-zero target and 14% have validated SBTs.

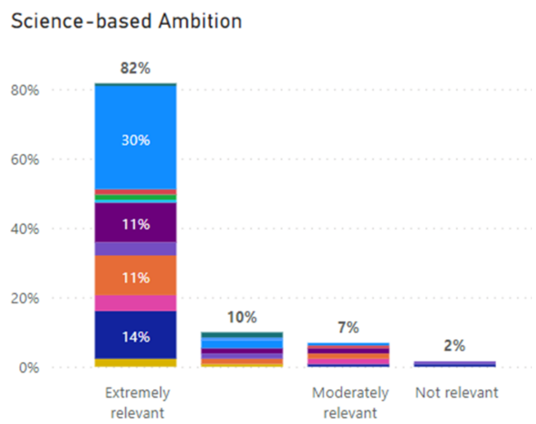


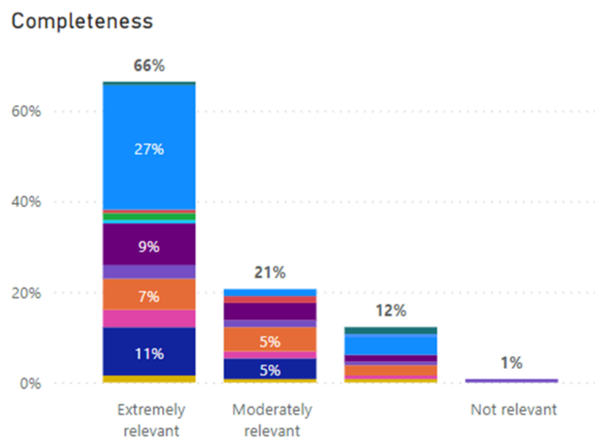
3. Principles and Definitions

This section of the survey asked if respondents agree with the five proposed principles for net-zero, and asked respondents to provide feedback on the three approaches to defining net-zero for financial institutions.

3.1 Principles

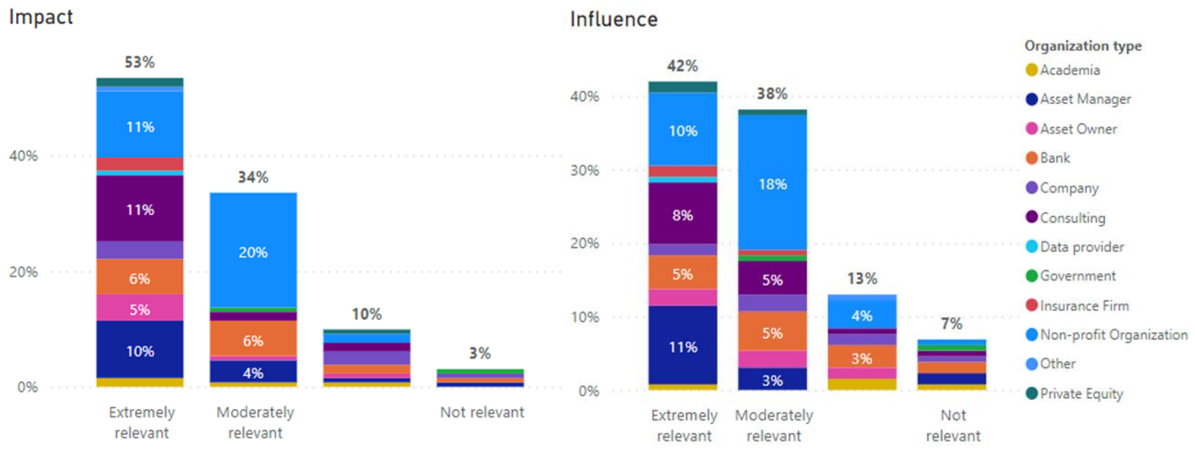
The five proposed principles include science-based ambition, completeness, impact, influence and decarbonization and green. There is wide agreement on the *Science-based Ambition* principle with ~82% finding it 'extremely relevant'. There is general agreement on the *Completeness* principle with ~66% finding it 'extremely relevant' and ~21% finding it 'moderately relevant'. Comments primarily surround the term "relevant and material" with different suggestions (e.g., that all an FI's activities/assets should be included) and questions such as regarding coverage or materiality thresholds in terms of asset class and emissions boundaries, issue of data availability, and how to define influence.





Note that the unlabeled columns represent respondents who did not select an answer

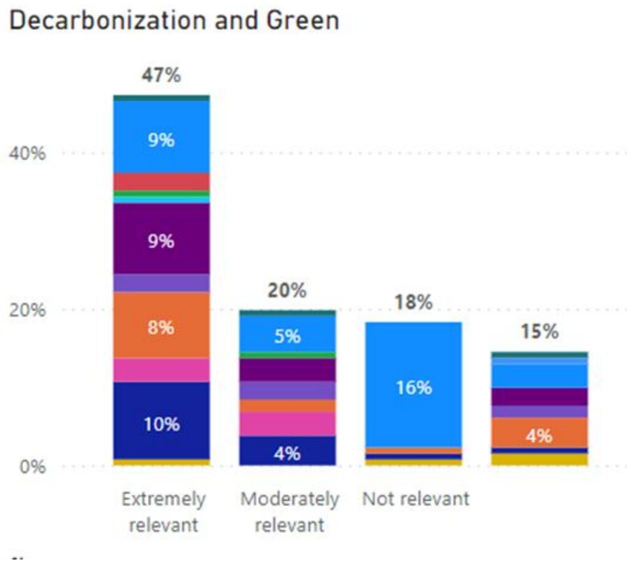
There is majority agreement on the *Impact* principle with ~53% finding it 'extremely relevant'. To a lesser degree, ~42% find the *Influence* principle 'extremely relevant'. Meanwhile, ~34% and ~38% find them 'moderately relevant', respectively, with several comments from various organization types that suggest combining these two principles given their overlap. Other comments seek further clarification on SBTi's views on divestment as a mitigation strategy in relation to the *Impact* principle, as well as how to apply the *Influence* principle to different FI types, and its inclusion of policy advocacy.



The unlabeled columns represent respondents who did not select an answer

While almost half of respondents find the *Decarbonization and Green* principle 'extremely relevant', ~20% find it 'moderately relevant' and ~18% 'not relevant', with the remaining not selecting a response. For instance, a number of FIs comment that the financing of climate solutions should be voluntary or fall under implementation strategy rather than be considered as a principle.

Several respondents also suggest *Accountability* and *Transparency* as additional principles to be considered to inform net-zero target setting in the financial sector, with a few also proposing *Just Transition* as a principle and a need for *sectoral approaches*.

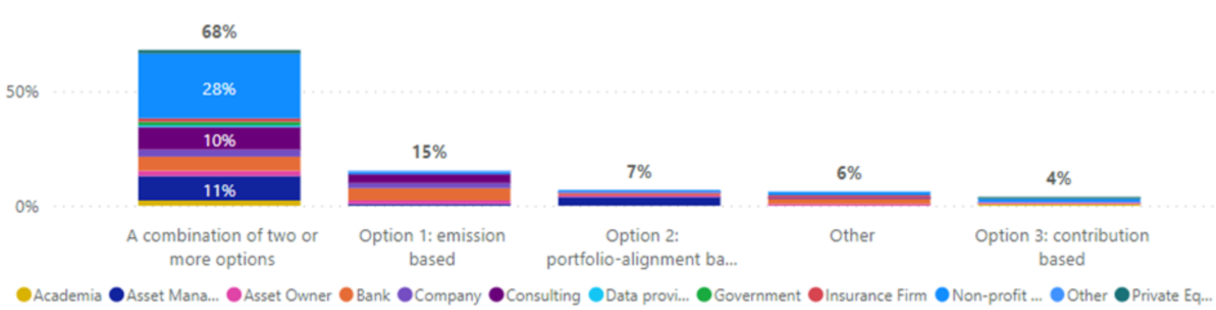


The unlabeled column represents respondents who did not select an answer

3.2 Definitions

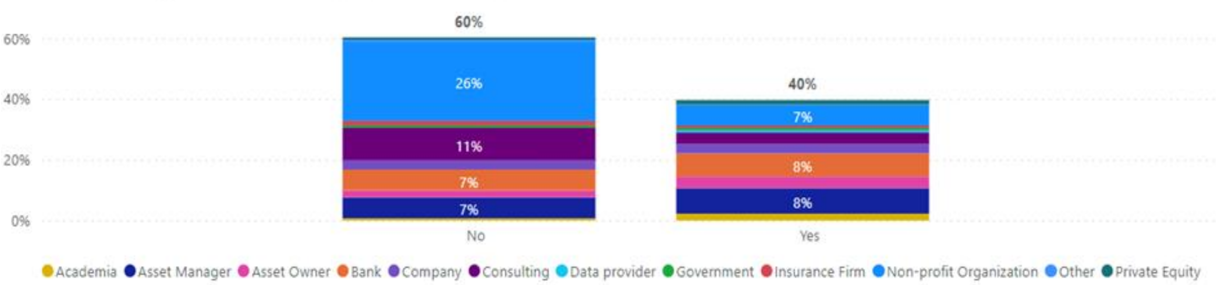
A majority of 68% agree with a combination of two or more options to define net-zero. Additionally, ~15%, half of which were banks and consulting firms, view 'Option 1: emission based' as the most relevant; ~7%, half of which were asset managers, choose 'Option 2: portfolio-alignment based'; and ~4% select 'Option 3: contribution based'.

The SBTi presents three options to define net-zero. Which one do you most agree with?



Meanwhile, ~60%, which included a large block of non-profit organizations, believe that different types of definitions should not apply to different types of FIs, citing that greater standardization is needed to ensure "consistency, transparency and comparability," "to bring clarity to financial market participants and their clients," and would otherwise "create additional complexity to a complex issue." In addition, "it is different asset classes that require different approaches, rather than different types of financial institutions." On the other hand, ~40% believe that different types of definitions should apply to different types of FIs to support multiple approaches depending upon business model, roles, services, mandates, asset classes, available transition levers, etc., to lead to wider adoption.

Should different types of definitions apply to different types of financial institutions?



From the ~68% who most agree with 'a combination of two or more options' to define net-zero, various comments were made about how and why the proposed approaches should be combined. For example, one respondent states that each proposed definition "incentivises different behaviors in financial institutions" and "as such, a balance of options is needed to track progress and manage such trade-offs." Option 1, which is based on financed emissions, is seen by several as a "headline target" for monitoring progress towards an end goal quantified by GHG emissions, with portfolio alignment and portfolio contribution acting as approaches to reach that emissions-based goal. Portfolio alignment makes sure that assets in carbon-intensive industries follow science-based decarbonization trajectories helping to ensure real-economy impact. Meanwhile, over 20 respondents suggest that portfolio contribution could be used as an additional optional target to provide transparency. Several respondents also share that alignment is viewed as a process more closely associated with Option 3, rather than a state of portfolio construction of all net-zero SBTi-validated corporates, which one respondent describes as "an unrealistic goal."

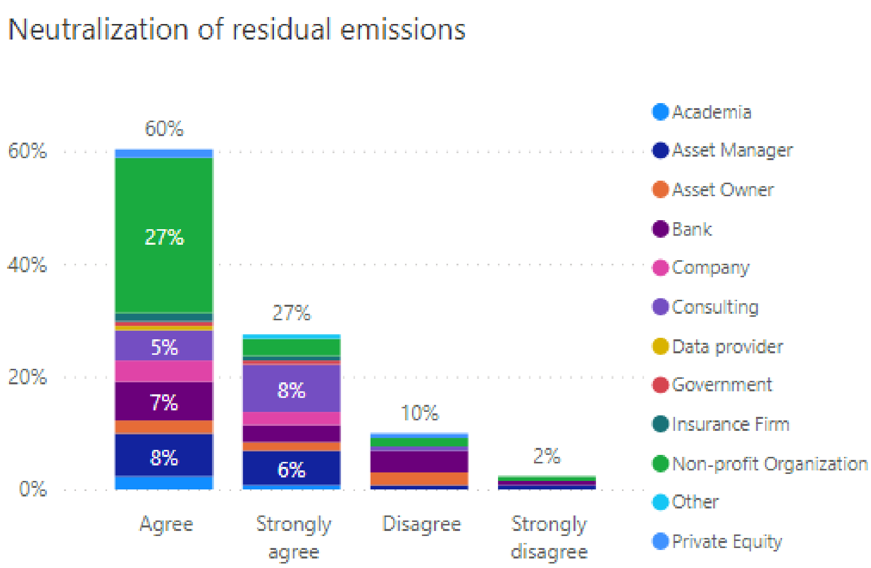
Feedback in the survey and discussions during the workshop raised questions surrounding the differentiation between achieving a state of net-zero and the 'approach' or 'way to monitor progress' towards that state. In one respondent's words: "although there can be common definitions in the end-state of net-zero (i.e., net-zero financed emissions), the process of getting there is going to vary between FIs." For example, to reach a state of net-zero financed emissions, another respondent suggests that financed emissions could be a way to monitor progress while FIs execute reaching the target by engaging and helping their portfolio companies set targets, and by increasing investments in climate solutions. In light of these comments, it is proposed that definitions incorporate a differentiation between achieving a state of net-zero and the transition stages, with the latter allowing for different approaches for different types of FIs.

4. Role of Carbon Credits

A major aspect of net-zero is defining the role of carbon credits and removals on the transition to net-zero, and the role they play in the final net-zero claims by financial institutions.

4.1 SBTi's approach to the use of carbon credits for net-zero claims

Almost 90% of respondents agree or strongly agree with carbon credits not being used by FIs to claim net-zero. While the majority of respondents do not support carbon credits for claiming net-zero, there was broad support from several FIs that carbon credits can be a useful voluntary addition to support decarbonization in the wider economy.

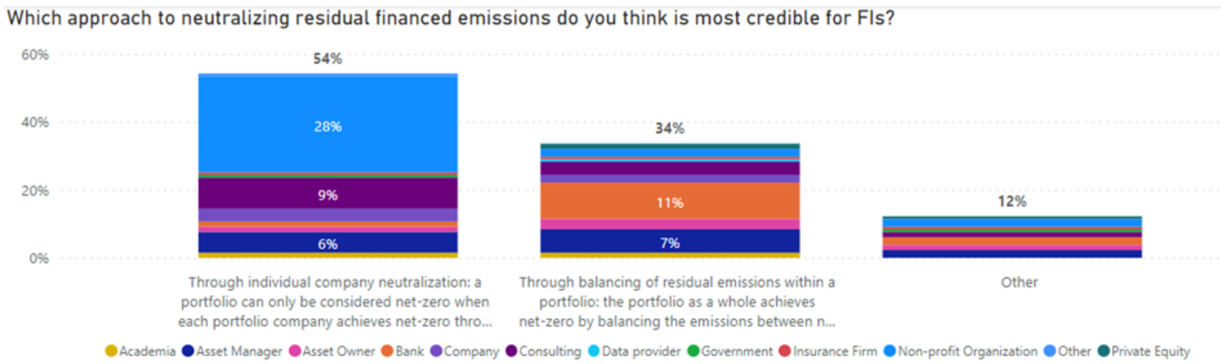


There was also concern that waiting to reach a state of net-zero "reduces the urgency for FIs to deploy finances into this area to support the economy-wide transition." 15 respondents highlighted the need for investment in carbon removal technologies, and that targets should capture and incentivize this need for early stage investment to reach wider societal net-zero goals.

Feedback also highlighted the need to differentiate the purchase of credits, from the direct investment in new carbon removal. While there was strong support against recognizing carbon credits, many highlighted the net-zero approach should not discourage legitimate investment in carbon removal if "it cannot be used to offset other emissions."

4.2 How to neutralize residual financed emissions?

Just over half of respondents support an individual company neutralization approach, with NGOs clearly favoring this stricter approach to accounting for net-zero. Meanwhile, among asset owners, asset managers and banks, a majority support a wider balancing of residual emissions at the portfolio level (i.e., positive residual emissions could be balanced by negative emissions).



Those in favor of supporting individual company neutralization highlighted the following issues:

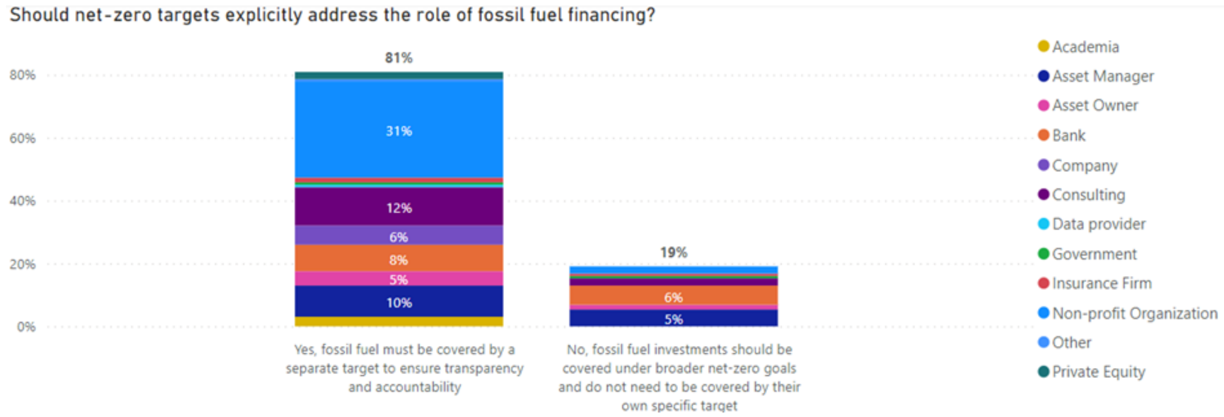
- Simpler accounting: individual portfolio company neutralization avoids creative accounting, avoids definitions of net-positive / negative, and ensures a better reflection of real-world impact. Two asset managers raised concerns that portfolio balancing approaches can open up gaming opportunities with financial instruments such as short positions and derivatives.
- Responsibility: The burden of addressing residual emissions should be primarily carried by the companies – not their investors or lenders. A third of respondents, specifically NGOs, highlighted that portfolio level neutralization could move the burden of reducing GHG emissions away from the emitters.

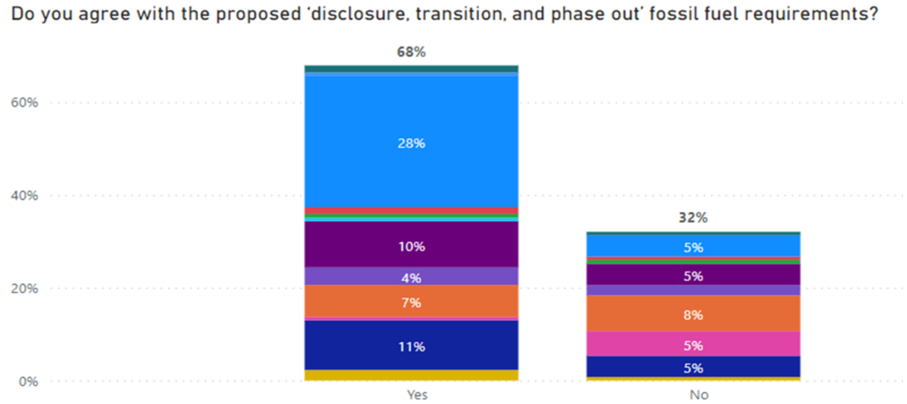
Supporters of the other viewpoint, balancing net-positive and net-negative portfolio emissions, stressed the following key points:

- It is not practical or achievable to have each debtor or investee reach net-zero, especially for FIs with large and diverse portfolios. Three banks highlighted the need for a balancing approach, as it enables FIs to better support the "unique needs of [their] diverse client bases through the transition."
- Portfolio balancing reflects what will happen in the wider economy where net-positive and net-negative sources will have to balance each other. Several banks and asset owners noted the need for "flexibility" for meeting other risk and return metrics, with most other portfolio KPIs being typically weighted average. This will help ensure that meeting net-zero targets will not be in direct conflict with meeting the primary business responsibility.
- FIs can leverage negative emissions assets to be able to continue to finance a few net-positive assets as long as the latter have a clear net-zero plan in place.
- Others highlighted that the balancing approach should only count when the positive part of the portfolio follows a credible 1.5°C sector-level trajectory.

5. Fossil-Fuel Financing

Based on the central role of fossil fuels in causing climate change, three questions for net-zero financial institution targets are whether fossil investments should be explicitly addressed, whether a 'disclosure, transition, and phase-out' approach is appropriate, and how such an approach could be improved. While ~81% of survey respondents agreed that net-zero targets should explicitly address the role of fossil-fuel financing, the consensus dropped to ~68% regarding the proposed 'disclosure, transition, and phase-out' approach. Respondents shared a range of views on how the SBTi Net Zero for Financial Institutions approach to fossil fuels could be improved, which are summarized below.





While non-profit organizations accounted for the largest portion of the 'yes' vote, other categories of respondents also replied that the SBTi should explicitly address the role of fossil-fuel financing in its net-zero targets.

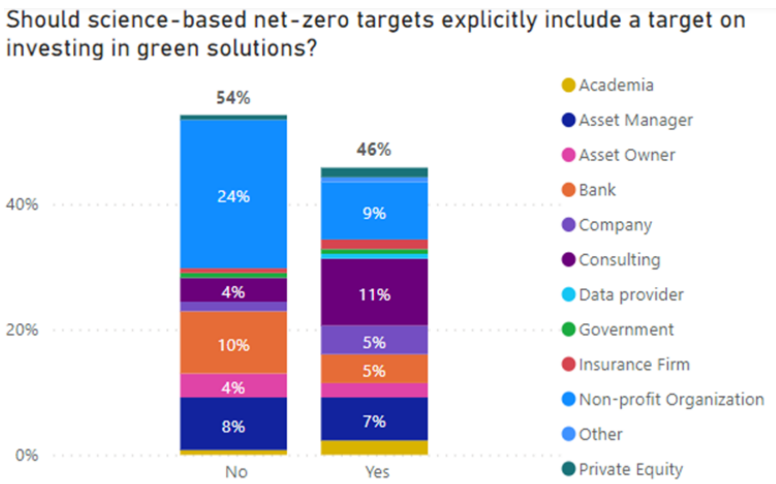
Six top issues related to the fossil fuel requirements include coverage, phase-out clarification, equity implications, transition definition per fuel, qualitative versus quantitative methods, and scientific basis. While some financial institutions and stakeholders expressed preference for broad coverage of all activities related to fossil fuel exploration, production, sale, and use, others advocated for more narrowly focused criteria on financing of fossil fuel production and unabated fossil fuel power plants.

Several respondents confused the proposed phase-out provision with a total divestment approach to all coal, oil and gas companies. The disclose, transition, phase-out approach is intended to advance 1.5°C engagement and only advocates the phase-out of financing for fossil fuel companies unable or unwilling to transition. The equity and distributive implications of energy transition are beyond the scope of SBTi, but many studies indicate that not taking action has a more detrimental impact on vulnerable populations and global inequality than fossil fuel phase-out.

The last three issues of transition pathway per fuel, methods, and scientific basis are all linked to the lack of a single 1.5°C scenario for global stabilization. While the IEA NZE2050, IPCC, and UN Emissions Gap Report all consistently indicate a transition away from fossil fuels, the differences among scenarios create challenges for target-setting method development. As the SBTi works on finalizing a detailed oil and gas sector target-setting method, the disclose, transition, and phase-out approach is intended to guide financial institutions' net-zero target formulations. These and other questions will be conclusively resolved in the SBTi Net-Zero Finance Standard development process.

6. Metrics and Methods

A range of metric and target-setting methods are currently being employed by FIs to define net-zero investment strategies. The Foundations paper presents an overview of these approaches and proposes two questions: whether climate solutions financing should be explicitly addressed with a separate target, and what is the most credible metric for tracking the financing of climate solutions.



The survey respondents were almost split evenly, with ~54% in favor of a separate target, primarily driven by respondents from NGOs and banks. Those against specific climate solution targets highlighted that they could be seen as optional approaches that FIs can take to support wider net-zero targets.

A few key issues that emerged on this topic during the survey and workshops include:

- Concern that there remains little scientific consensus on how to define climate solutions and how to determine an ambitious rate of financing.
- Decarbonization and climate solutions are interlinked, as climate solutions will be required to achieve sector-based decarbonization targets. Ultimately, different types of FIs will have different abilities to provide financing, and therefore should not be mandated to meet specific financing thresholds.
- Due to the complexity, climate solution financing could be limited to specific disclosures on renewable energy and emissions removals. Metrics such as total MWh financed or CO_2 removed can be used to simplify the target setting approaches.

When seeking feedback on credible metrics to track financing of climate solutions, established taxonomies using green/brown ratios were favored by half of respondents. A range of other metrics were also proposed by respondents including sector-based ones (e.g., % of power sector in renewables, % of automotive in electric vehicles, etc.).

7. Other Feedback

In addition to questions on specific topics, the survey was also used to solicit wider feedback on the concept of net-zero and what the Foundations paper should specifically address. The following provides a synthesis of key themes that emerged from respondents in the survey and during both workshops:

- **The role of different types of FI:** a number of respondents suggested that the paper offer more nuance on the different types of FIs and their role in the transition, i.e., explain in more detail how the roles of banks, investors, insurers, etc. have different abilities to help the economy achieve net-zero. Some smaller FIs proposed that there be an equivalent to the corporate SME criteria also for FIs. It was also requested that the role of the insurance sector should be outlined in more detail, specifically the leverage insurance companies have via both investments and underwriting.
- **The role of different asset classes:** the paper should acknowledge the scope of net-zero and how that relates to the types of asset classes it should encompass, and the role of on vs. off balance sheet activities.
- **The types of investment strategies:** particularly the role of active vs. passive investment. The paper could consider how alternative investment strategies, such as short selling, can be integrated into net-zero concepts.
- **The role of the wider financial system:** particularly data service providers and stock exchanges could be addressed in the paper, as they can have an important role in influencing FIs and providing necessary services to set and achieve net-zero goals.
- **Just transition:** the concept of just transition and the role of finance was highlighted by many as not being featured sufficiently in the paper.
- **Collaboration with other standard-setters (e.g., GFANZ):** many respondents asked for further explanations to better highlight how the paper will be used by other actors in this space, specifically GFANZ and the associated net-zero alliances. There were also suggestions that the SBTi provide additional engagement opportunities in the standard development process.

8. Next Steps and Opportunities for Participation

To support the halving of GHG emissions by 2030 and continued exponential growth of SBTs, the SBTi Finance team has developed a strategy for 2022 in the run up to 2025. As covered in this summary, primary deliverables include development of a net-zero standard with related publications:

- Publication of the revised SBTi Net-Zero Foundations for Financial Institutions paper and a draft **SBTi Net-Zero Standard for Financial Institutions**. The SBTi Financial Net-Zero Standard follows the Corporate Net-Zero Standard and is similarly expected to provide a link between high-level commitments, long-term science-based net-zero targets and financial institution near-term target setting.

- **SBTi Finance meta criteria** for assessing alternate methods and resources. The meta criteria will link with our net-zero work and an announcement will be made when they are published.

In addition to the Net-Zero Standard and meta criteria, key 2022 deliverables include:

- **Updated and expanded SBTi Finance framework**. This will include updated Criteria for financial institution SBTs and additional target validation capacity. A related goal for 2022 is that we reach 300 financial institution commitments to set SBTs with 150 financial institution SBTs submitted and validated by SBTi.
- Integration with ongoing **SBTi sector method developments**. Starting with the Forest, Land and Agriculture (FLAG) consultation and Buildings sector work, SBTi Finance will update its resources to leverage new developments.
- **PCAF Integration and Guidance**. In collaboration with PCAF, SBTi is developing guidance for financial institutions on using financed emissions assessments to set SBTs. This includes recommendations on how the PCAF accounting standard can be used as a screening tool to identify areas of most material emissions and guidance for FIs on the most appropriate SBTi target-setting method (SDA, Portfolio Coverage, or Temperature Rating) based on PCAF assessment results.
- Aligning **TCFD reporting** with climate science and SBTs. SBTi is developing guidance for companies on how to develop a TCFD report that demonstrates a company's alignment with climate science. The guidance clarifies how SBTs and net-zero target setting are tangible ways for companies to demonstrate that they are successfully assessing and managing their climate risk and transitioning their business to thrive in a zero-carbon economy. The guidance also clarifies how portfolio level SBTs, set by financial institutions, can be used within a TCFD report to demonstrate how they are managing climate risk exposure and driving emissions reductions in the real economy.
- **Securities underwriting** target-setting methods and target validation criteria. This work explores both the potential adoption of existing target-setting methods and/or development of new target-setting methods. The method and criteria development will include pilot testing by financial institutions and stakeholder review.
- **SBTi Monitoring, Reporting, and Verification (MRV) Framework and Protocol**. As SBTi launches its MRV Framework in Q4 2022, the SBTi Finance team will provide a standardized and robust mechanism to track target-setting entities' progress against their SBTs.

Beyond these deliverables, SBTi Finance is exploring additional method development for new asset classes. By 2025, we aim to establish SBTs as harmonized best practice for financial institutions' near- and long-term target setting.

Stakeholders are invited to participate in the Net-Zero Financial Standard development process and other SBTi Finance projects. The best way to learn about SBTi Finance work and opportunities is through our stakeholder email list, which can be joined at the SBTi Finance website.