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Science Based Targets initiative for Financial Institutions

Theory of Change and Strategy

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Overview

The governor of the Bank of England has warned that the global financial system is backing carbon-producing projects that will raise the temperature of the planet by over 4°C – severely overshooting what is required to stay well-below 2°C as agreed in the Paris Agreement. Financial institutions (FIs) play a critical role in system transformation and the lack thereof. The Science Based Targets initiative's finance sector project (SBTi Finance) is designed to clarify, improve and accelerate FIs conformance with the Paris Agreement.

To decarbonize the global economy in alignment with the Paris goals, all economic actors in the real economy are required to reduce their GHG emissions at a rate sufficient to stay within the carbon budgets established by climate science. Corporate emissions do not occur in a vacuum, but within a broader economic and regulatory system that creates a complex web of incentives and disincentives for economic actors to reduce emissions. In many ways, all actors across a given value chain (and those connected through policy and other incentives) share influence over the direct emissions of each actor and therefore share responsibility for reducing them. FIs have special influence over other actors through their investment and lending services. To drive Paris-level systemic decarbonization, it is critical to leverage shared influence and responsibility for aligning incentives as well as eliminating barriers to emissions reductions.

Project Goals

The SBTi Finance project will enable financial institutions to set targets for their investment and lending portfolios that are aligned with the reductions needed to stay in line with well-below 2°C and 1.5°C climate scenarios. The goal of the initiative is to make science-based target setting standard practice and for these targets to result in emissions reductions in the real economy.

The project intends to raise the ambition of the finance sector by defining and promoting best practice in science-based target setting and providing methods, criteria, guidance and tools to reduce the barriers to adoption and implementation (i.e. actions that lead to atmospheric reductions of GHG concentrations). Within the broad ecosystem of organizations and value chains that link financial institutions with GHG emissions in the real economy, the SBTi Finance project is focused on ex ante targets at the asset-class level.

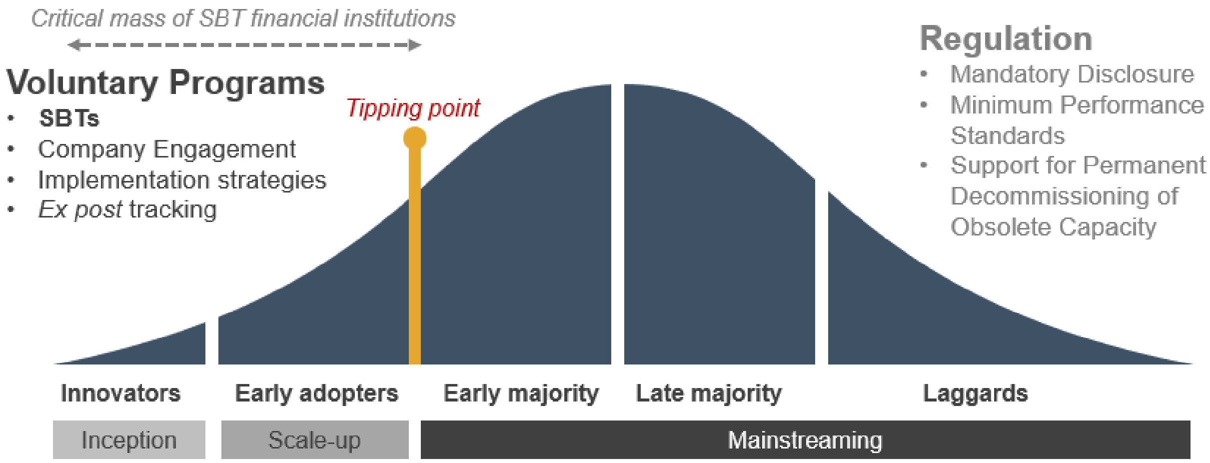
The SBTi's framework will be updated on an annual basis as our understanding of how financial institutions can achieve emissions reductions in the real economy evolves (see "Strategy" section below for more information).

Theory of Change

There is a range of theories of change that contribute to low-carbon transformation including: mandatory disclosure as a basis for broader understanding; advocacy for policy and regulations to drive investment decisions away from high-carbon activities; legal pursuit of large emitters for health and climate damages; increased R&D to support innovation; and race-to-the-top platforms to identify and recognize best practices. The validity and effectiveness of these theories varies by actor, process and system context. As a voluntary, forward-looking platform, the SBTi raises and amplifies private sector mitigation ambition through quantitative targets modelled on science-based climate scenarios.

The SBTi builds on attributional accounting (specifically the GHG Protocol Corporate and Value Chain Accounting and Reporting Standards) to make the shared, cross value-chain responsibility between actors explicit. By requiring economic actors to set targets not only for their direct emissions, but for all emissions across their value chain over which they have influence (i.e. scope 2 and 3), the **SBTi seeks to align all relevant economic actors across a value chain behind a common goal and therefore create incentives and eliminate barriers for broader Paris-aligned systemic transformation.**

To make science-based target setting standard practice, the SBTi is generating a critical mass of companies and financial institutions with science-based targets (SBTs), developing mechanisms to institutionalize the adoption of SBTs, and developing methods, criteria, guidance and tools to reduce barriers to adoption. The SBTi achieves impacts broader than the sum of its parts through company and financial institution peer influence, defining best-practice for GHG mitigation targets within key sectors, and demonstrating to policymakers the level of ambition that can be achieved and requesting supporting policies. The figure below illustrates the tipping point aspect of SBTi's theory of change; regulation is mentioned in the figure as a complementary action to address laggard, high-emitting companies.



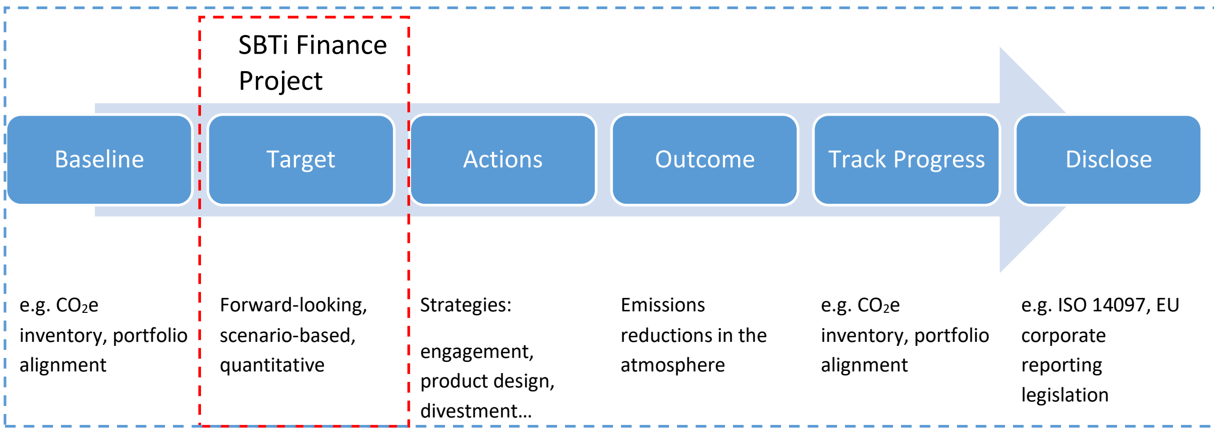
Context

Financial institutions differ from other economic sectors: they provide finance and other services to the companies that are responsible for reducing GHG emissions, rather than having direct control over GHG emission reductions. The indirect but central role of finance is recognized in the Paris Agreement, which contains a separate Article 2.1(c) – in addition to mitigation and adaptation targets – on "making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development."

As articulated by Article 2.1(c), financial institutions require an approach within SBTi that is tailored to their role and recognizes that climate target-setting is one of numerous activities needed for systemic transformation. Activities that connect financial flows with GHG emission reductions in the real economy include emissions measurement and disclosure, physical and transition risk assessment, target setting, tracking of mitigation actions, and performance and disclosure. The SBTi Finance project contributes to the wider portfolio transition framework through its transparent and robust target-setting platform. Figure 1 illustrates components of this process.[1]

Portfolio Transition Framework

Figure 1: Science-based targets and the portfolio transition framework



The SBTi Finance project is intended to serve as a link between the objective of emissions reductions in the real economy and FIs' activities to achieve this objective. SBT-Finance targets inform the extent of mitigation actions needed to meaningfully drive emissions reductions and shift investment behavior.

As of February 2020, more than 50 financial institutions have publicly committed to setting targets through the SBTi. Once the framework is introduced in the summer of 2020, the goal is to have 100 financial institutions with approved SBTs by the end of 2021. A critical mass of financial institutions with SBTs is expected to provide a strong foundation for making the practice mainstream and integrating SBTs into various national policy and regulatory approaches.

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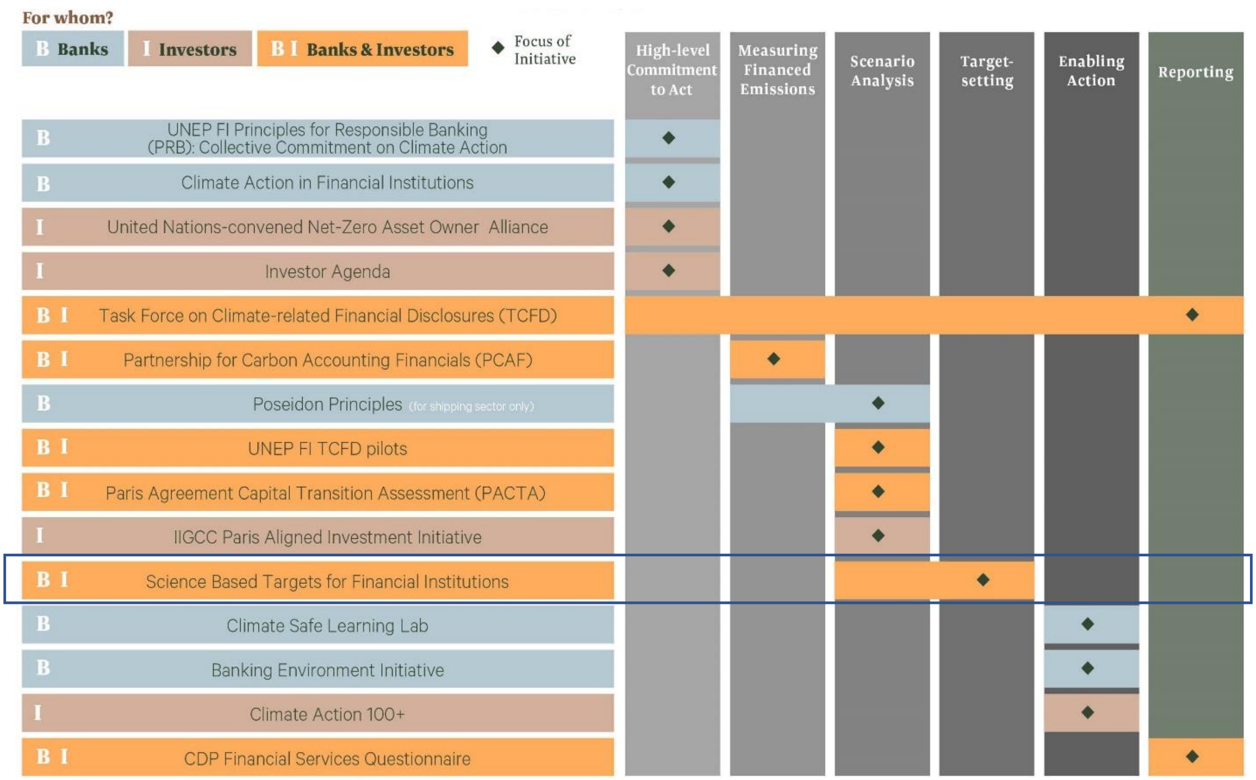
[1] The first step for many financial institutions in climate alignment is measurement and disclosure of scope 1, 2, and 3 emissions. Three examples of related disclosure platforms are CDP (particularly the forthcoming financial services questionnaire), the Partnership for Carbon Accounting Financials (PCAF), and the Assessing Low Carbon Transition (ACT) initiative. Assessment of portfolio exposure to physical and transition risk is a next step that's exemplified by Task Force on Climate-related Financial Disclosures (TCFD) reporting, the Transitions Pathway Initiative (TPI), Right Based on Science, and the OS-Climate platform. A progressive next step after quantifying emissions and risk is to set targets for future emissions reductions—the SBTi has developed methods and criteria for company targets that are being elaborated for investors and banks in collaboration with the UNEP-FI's Asset Owners Alliance (AOA) and Principles for Responsible Banking (PRB). Activities to reduce emissions and achieve targets are numerous, including investor engagement (CA100+, the Investor Agenda) tracking via the Investor Energy-Climate Action Toolkit (InvECAT), fuel switching to renewable energy (RE100), energy efficiency improvements (EP100), new accounting frameworks (ISO 14097), fossil fuel divestment and shareholder advocacy campaigns (As You Sow), and the European Commission's taxonomy of sustainable activities.

Just as the SBTi Finance project is focused on the target-setting component in the broader portfolio transition framework, it is also one of numerous collaborative climate initiatives. Figure 2 illustrates the coverage and relationships among the project and related initiatives. The SBTi is developing the framework in an open and deliberative way that seeks to harmonize with complementary initiatives.

Figure 2: Science-based targets are part of a broader ecosystem



Source: PCAF (https://carbonaccountingfinancials.com/files/downloads/Overview-Initiatives-Shaping-Climate-Action-Journey-for-FIs.pdf)

Strategy

The SBTi Finance project is a sector and asset class-based element in an economy-wide comprehensive transition framework. The framework will drive emissions reductions in the real economy by harnessing financial institutions' shared influence and responsibility for real economy emissions as part of a movement towards systemic alignment with the Paris goals. In order to achieve this, the SBTi aims to provide a framework for financial institutions to set targets at the asset-class level that are aligned with climate scenarios, and that enable an ex-post evaluation of financial institutions' contribution to real-economy emissions reductions in relation to the Paris Agreement's mitigation goal. The SBTi Finance framework includes a set of methods and tools that can be used to set targets, criteria that the SBTi will use to assess targets submitted to the initiative, and implementation guidance to support financial institutions in their target development.

The SBTi's framework will be updated on an annual basis as our understanding of how financial institutions can achieve emissions reductions in the real economy evolves. Because it is not yet clear which specific actions from financial institutions leverage real economy emission reductions most effectively—and which metrics are best for tracking their climate actions—the SBTi's framework will include annual disclosure requirements and/or recommendations. This information will build our understanding of the most effective actions financial institutions can take to achieve their targets, helping us refine our framework over time. If and when evidence of the effectiveness of different actions becomes available, additional requirements may be added related to specific actions to be undertaken to achieve targets.

To clarify the role of science-based targets within the complementary system of climate-finance initiatives and players, the table below lists key components that are covered and outside of the project.

Figure 3: Components included and excluded from the SBTi framework for financial institutions

Included	Outside of Current Scope
Scope 1 and 2 science-based target methods, tools, criteria, and guidance	Impact assessment (pending data and evidence availability)
Scope 3 target methods, tools, criteria, and guidance	Additionality (quantification or attribution without sufficient evidence)
Disclosure of target implementation strategy	Ex-post tracking
Flexibility on actions to achieve targets	Implementation requirements ('how')
Engagement strategies (via Portfolio Coverage)	Leakage remediation
	Evaluation of strategies' cost effectiveness

The SBTi Finance project is focused on scope 1, 2 and 3 targets and disclosure of implementation and engagement strategies. As with companies, the SBTi maintains flexibility on actions required to achieve targets with the understanding that companies and financial institutions have unique information on their mitigation options. The SBTi recognizes the validity of the components currently out of scope and intends to elaborate on these and other issues in its criteria and guidance for financial institutions' targets. The target-setting framework is being developed by the partners of the SBTi, as well as external partners, through an inclusive, multi-stakeholder process to ensure practicality and validity for financial institutions. All draft and final products from the project are freely distributed on the SBTi website for perusal and application by other stakeholders.

In summary, the SBTi Finance project:

- Is one element in an economy-wide comprehensive portfolio transition framework;
- Focuses on quantitative scope 1, 2, and 3 emissions reduction targets modelled on science-based climate scenarios as the basis for SBTi approval;
- Provides expectations for FI disclosure of the actions it plans to implement and achieve its target;
- Links to interdependent tools and initiatives for mutual exchange and to eliminate redundancies;
- Contributes to harmonization of approaches for SBT target-setting and reporting of emissions reductions in the real economy.

Learn more at https://sciencebasedtargets.org/financial-institutions/.