

Paris Alignment for Private Financial Institutions: Commitments and Methodologies

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The Coalition
of Finance Ministers
for Climate Action

with support from



FC4S

FINANCIAL CENTRES FOR SUSTAINABILITY



THE WORLD BANK

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1. INTRODUCTION TO COMMITMENTS AND METHODOLOGIES FOR ACHIEVING PARIS ALIGNMENT



Since the signing of the Paris agreement in 2015, attention has increasingly shifted to the financial sector's role in attaining the global climate goals.

INITIATIVES

- **Financial institutions are joining a growing number of initiatives** to align their lending and investment flows with the Paris agreement or national climate goals, such as the Net-Zero Asset Owners Alliance, which aims at aligning portfolio's with net zero by 2050.
- **National initiatives have been set up to advance climate-aligned and sustainable finance.**

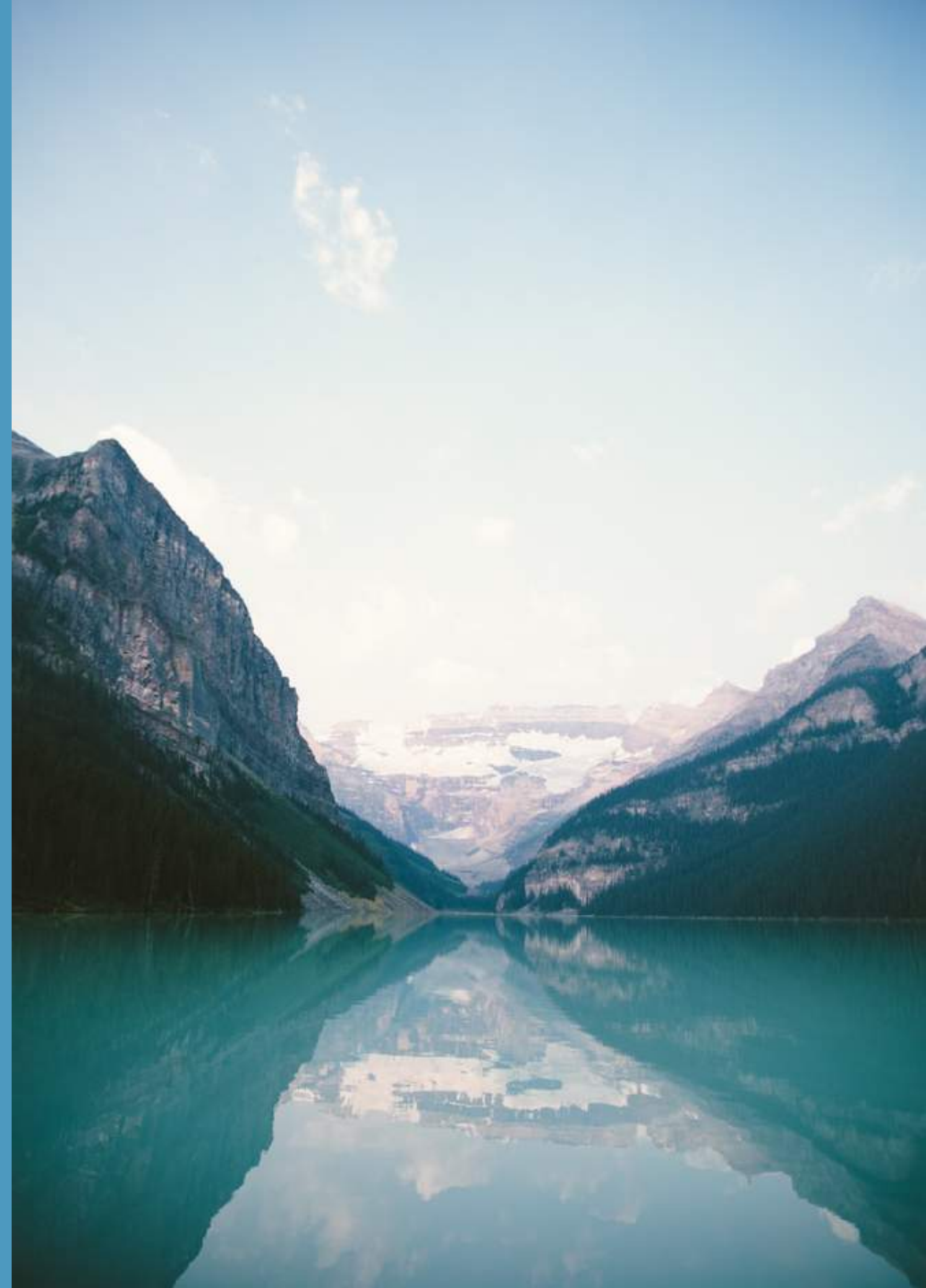
METHODS AND TOOLS

- There is currently a **wide range of methods that is being used to measure, report and define Paris alignment**, and thus for operationalizing commitments.
- **Improving comparability and further harmonization of methodologies and tools** could help raise ambition as it becomes clearer where institutions should be heading, benchmark them against each other monitor progress.
- **The recently re-established G20 Sustainable Finance Working Group (SFWG)** will carry out this exercise over 2021.

ROLE OF AUTHORITIES

- **Ministries of Finance and Central Banks** and other **international bodies**, such as the Coalition of Finance Ministers for Climate Action, **have a role to play in fostering climate alignment initiatives and methodologies.**

2. COMMITMENTS TOWARDS PARIS ALIGNMENT



Financial institutions have increasingly been working towards Paris alignment through commitments and pledges, mostly through internationally convened networks.

- A commitment is an important first step for a financial institution's climate alignment. The **process of achieving Paris alignment** consists of different phases. Five steps are identified:
- **A bank, pension fund, asset manager or insurer preferably commits to all five phases in the Paris alignment process.** Legislative efforts by governments as well as supervisors are increasingly requiring from institutions to engage in some or all of these phases.

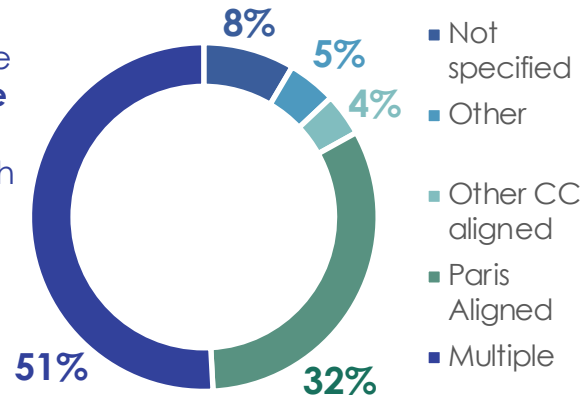


- Yet, **commitments help institutions to fill in these growing legislative demands ambitiously.**
- Thereby, **engagement from Ministries of Finance and the Coalition with such commitments could be an important complement to legislative action.**

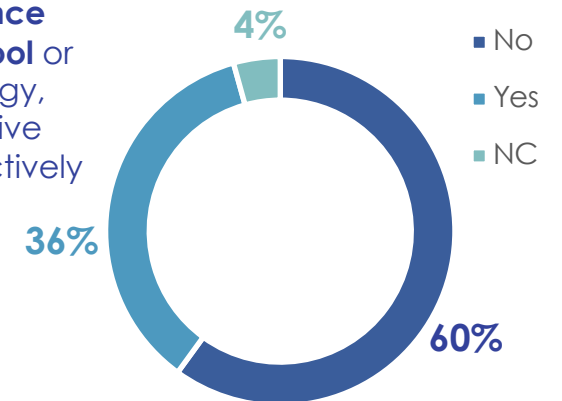
Although commitments on Paris alignment are a fundamental step towards decarbonizing balance sheets and portfolio's, operationalization remains challenging.

- Financial Centres for Sustainability (FC4S) has done an analysis of sustainable finance initiatives by “type”, based on their main identified activity.
- **The analysis shows** a strong environmental and climate change focus, and commitments' varying levels of ambition.

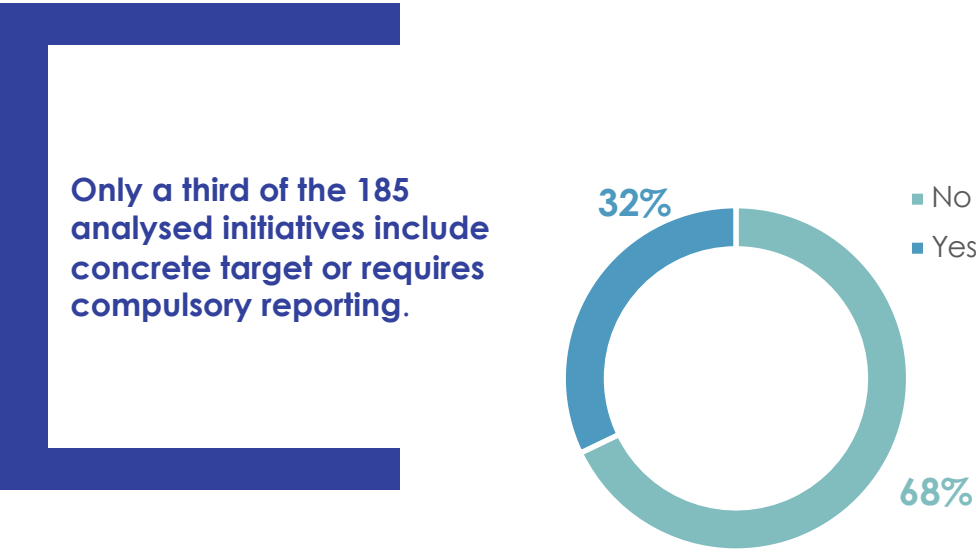
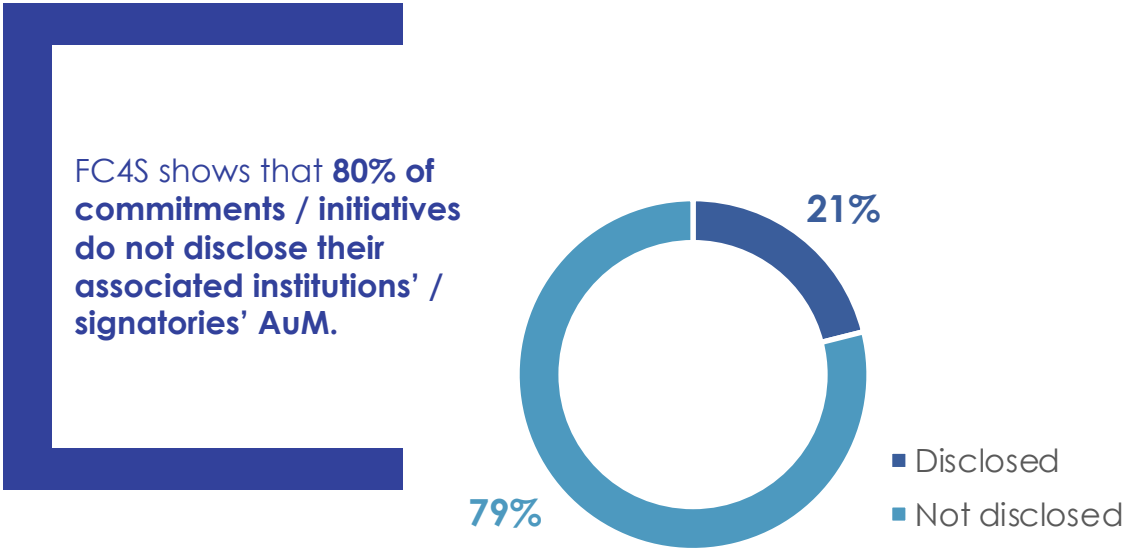
Between half and two thirds of the initiatives has **multiple environmental goals**, and about a third of them have exclusively **climate change focus**, leaving other environmental aspects with less than 10%.



About a third of the 185 analyzed sustainable finance initiatives uses a climate tool or accountability methodology, so compliance and effective impact might not be effectively controlled.

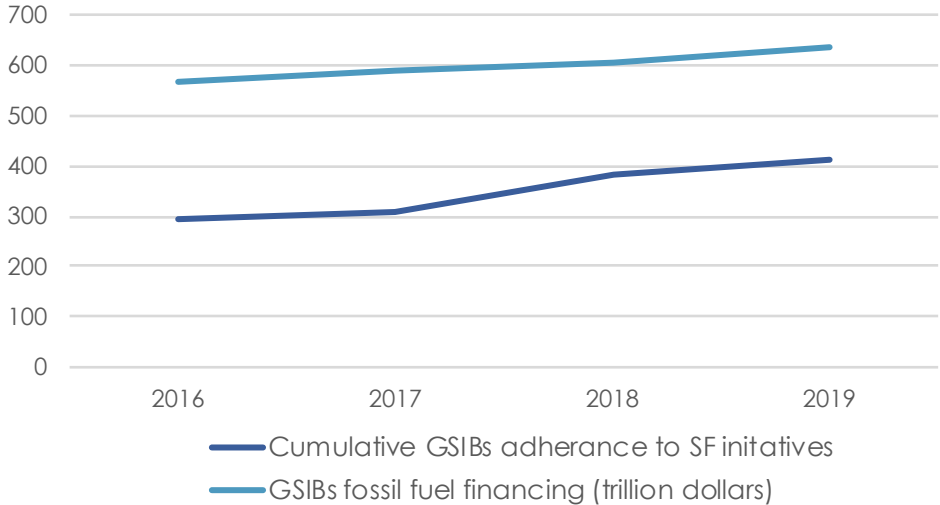
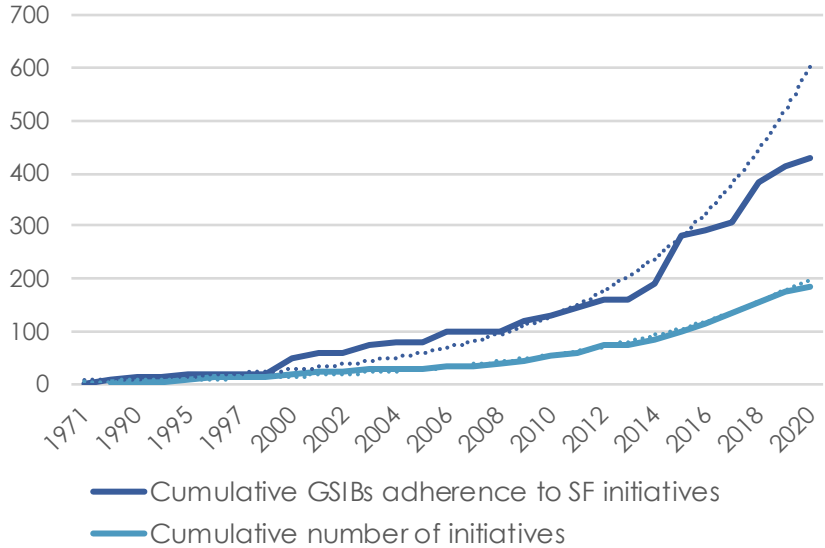


Transparency both at the members and the commitments level is necessary to grow public accountability and generate confidence in these initiatives.



It is essential that commitments pose a real ambition to financial institutions to avoid greenwashing and inaccurate estimations of financial institutions' committed capital.

- FC4S analysis reveals that **Globally Systemic Important Banks (GSIBs)** have increased their participation in sustainable finance initiatives at a remarkable rate, but their fossil fuel finance (when considered as a group) has increased, surpassing the U\$S 600 trillion.



It has also been shown that the alignment of portfolios is no guarantee for real world impact.

- **Reliable and comparable climate data is still a challenge.** Financial institutions depend on reporting by other firms, which is not always complete, fully developed or available.
- **Aligning a portfolio could mean selling off emissions to another institution,** which would not actually take emissions out of the system. It is essential to recognize that **activities that result in “relative” rather than “absolute” emissions reductions may be counterproductive to achieving long-term emission reduction goals.**
- This case proves that **alignment is hugely dependent on the developments in the real economy.**

CASE 1

FIRST RAND USING PCAF

- **FirstRand** - a South African Bank with about \$90 billion in assets – is using the **PCAF methodology** for 3 asset classes: motor vehicle finance; commercial real estate and mortgages.
- Challenges experienced thus far have mainly related to **the availability of granular information on the portfolio.**
- The transition to a low carbon economy poses serious challenges to South Africa, where over 90% of electricity is generated from fossil-fuel activities and the coal industry is a significant employer. **Transitioning to a low carbon economy therefore needs to be measured with due consideration to a “just” transition.**

Ministries of Finance can play an important role in setting up national collective climate commitments, helping improve accountability and data comparability.

CASE 2

NETHERLANDS FINANCIAL SECTOR COMMITMENT

- In July 2019 the Dutch government **presented its national climate and energy plan** (NCEP) which aims to reduce GHG emissions by 2030 to 49% of the level recorded in 1990.
- The commitment was **signed by over 50 institutions** (combined over €3 trillion in assets).
- The institutions agreed to **mandatory measuring and reporting of emissions** from 2021 onwards. As of 2022, institutions will publish action plans that outline how they will contribute to a decrease in CO2 emissions.
- Financial institutions will also **exchange knowledge and best practices** on methodologies and actions to align portfolio's.

CASE 3





FRENCH COMMITMENT TO REDUCE COAL-FIRED INVESTMENTS

- The Paris financial centre has committed in July 2019 to **publish individual coal exit strategies**.
- These commitments mean that **by 2030 French financial institutions will no longer finance coal** in the EU and OECD countries, and from 2040 onwards in the rest of the world.
- The Paris financial centre should **promote the dissemination and open source standardization** of these methodologies.
- To ensure the credibility of these commitments, **controls have been put** in place by supervisors and by the financial sector itself.

3. TOOLS AND METHODOLOGIES FOR ACHIEVING PARIS ALIGNMENT



Moving from committing to measuring is the first challenging step for a financial institution. Different methodologies apply to the different phases of Paris alignment:

	MEASUREMENT	TARGET-SETTING	STEERING	TRACKING PROGRESS	REPORTING
EXAMPLE TOOL	 PCAF Partnership for Carbon Accounting Financials	 SCIENCE BASED TARGETS	 PACTA Paris Agreement Capital Transition Assessment	 Transition Pathway Initiative	 POSEIDON PRINCIPLES
SECTORS	Cross-sectoral	Cross-sectoral	Power, fossil fuels, automobile, cement, steel, shipping and aviation	Cross-sectoral	Shipping
ASSET CLASSES	Listed equity and bonds, business loans, CRE, mortgages, motor vehicle loans, project finance	Real estate, mortgages, electricity generation project finance, corporate debt and equity	Public equity, corporate bonds, corporate lending	Equities (to be expanded to fixed income)	Lenders, lessors, and financial guarantors with shipping portfolios
METRICS/DATA	GHG emissions	GHG emissions	Technology exposure based on asset-level data or GHG intensity	Carbon intensity	Annual Efficiency Ratio based on fuel consumption

These tools and methodologies contribute to the operationalization of high-level commitments and the alignment of financial institutions' portfolios.

CASE 4

SWITZERLAND'S CLIMATE ALIGNMENT ASSESSMENT 2020

- The **Swiss federal government monitors periodically the impact of financial institutions' voluntary climate action.**
- In 2020 all Swiss financial market actors **were invited to test their portfolios for their compatibility with the global temperature goal**, on a voluntary basis, anonymously and free of charge.
- The results showed that there **still is a long way to go to achieve full alignment** of the financial sector with the Paris goals, but positive developments are in sight.
- The country-wide test allows for comparison between peers and the different financial sectors, including the products offering and demand side. It **triggers knowledge exchange on effective action and facilitates the sharing of best practices.**

- There is no “perfect” or “fully comprehensive” methodology (and it is questionable whether there will be).
- **As each of the existing methods provides a starting point to assess how an institution should be heading towards Paris, they could be used alongside each other**, as they have distinct objectives, characteristics, and cover different sectors or asset classes.
- While a combination of methods could be useful, working towards further harmonization remains necessary to increase data **comparability** and **accountability**.

In developing the Paris alignment process, there are a number of issues which need to be taken into consideration:

1

Making results more comparable and accountable is essential. Currently the figures that different institutions portray are not easily compared, since data sources and methodologies differ.

2

There is evidence internationally² that **reliable and comparable climate data is a real challenge**, as the First Rand case confirms.

3

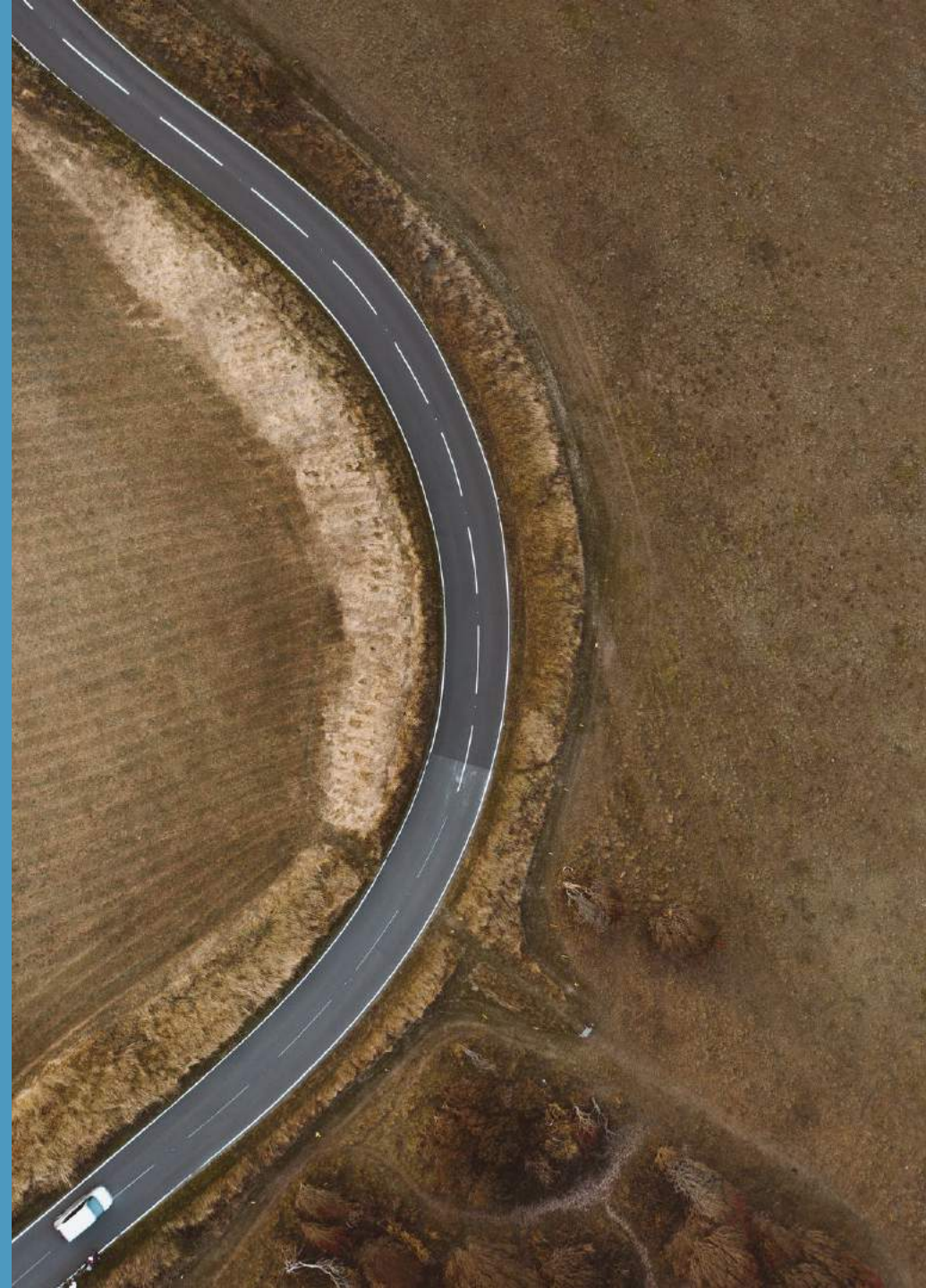
The **alignment of portfolios is no guarantee for real world impact**. An important feature will be how they support a whole-economy transition that promotes engagement over divestment.

4

An effective Paris alignment approach **has a broad coverage and considers different sectors (different transition pathways or technology roadmap) and asset classes**

² Data quality and availability have been mentioned by more than two thirds of FC4S financial centres as a key challenge to mainstreaming sustainable finance in 2020. Other bodies highlighting this challenge are the [IIF](#) (2020) , the G20 ([2017,2018](#)), WRI ([2019](#)), among others.

4. CONCLUSIONS AND RECOMMENDATIONS



There is still a need to improve commitments' design, enhance current tools and metrics, and harmonize commitments and methodologies.

Ministries of Finance are particularly well placed to foster alignment within their respective financial sectors.

- They are recommended **to raise awareness and educate the relevant actors** in their financial sector on the different alignment tools and methods.
- They are encouraged to take an active role in **facilitating system-wide sustainability and climate initiatives and commitments within their jurisdiction.**
- They could bring **different industry associations together, set-up knowledge-sharing and monitoring mechanisms,** and above all public-private dialogues feed well into the policy-making cycle.
- They could also **take advantage from the work that the G20 Sustainable Finance Working Group,** which will look how sustainability disclosure and reporting – including ESG data analysis - could be improved over time.

The Coalition could play a role in fostering Paris alignment in the financial sector within its member states.

- **By supporting TCFD's work on forward-looking metrics** to secure the benefits that alignment metrics can bring.
- **Facilitating the exchange of knowledge between members** setting up financial system-wide commitments or collective commitments, as well as assessing Paris alignment in the financial sector.
- **Working on expanding best practice-sharing** on climate alignment initiatives, methodologies and metrics, initiating follow-up work to explore how different methodologies can be further harmonized or what common principles could be established.
- **Engaging with the COP26 team,** to ensure the work is aligned.

Thank you!



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