FINANCIAL SECTOR NET ZERO COMMITMENTS

Contributing to enhanced environmental integrity and credibility

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Coalition of Finance Ministers HP5 Transition Finance Workshop
A NEED FOR AMBITIOUS AND CREDIBLE CLIMATE ACTION
Ambitious near-term climate mitigation action needed

Projected global GHG emissions from NDCs announced prior to COP26 make it likely that warming will exceed 1.5°C and make it harder after 2030 to limit warming to below 2°C.

Source: IPCC (2022), Climate Change 2022: Mitigation of Climate Change
Finance and the Paris Agreement goals

Climate **mitigation** and **resilience** dependent on making **finance** consistent with these public policy goals (Paris Agreement Article 2.1c)

Finance-related indicators needed at national and international levels to **assess progress** in both the **financial sector** and the **real economy**

Increasing number of climate-related **metrics** and **methods** to assess finance but **lack of consistency**, data and evidence in terms of impacts
Environmental and financial integrity go hand in hand

**Environmental integrity** (contribution to climate change, real economy impacts, consistency with climate science)

**Financial integrity** (vulnerability to climate change, data and information transparency, efficient market pricing)

Source: Partly adapted from LSE Grantham Research Institute on climate change and the environment (2022), Aligning financial and monetary policies with the concept of double materiality: rationales, proposals and challenges
## Finance and net zero: who is doing what?

- Dynamic landscape of interrelated climate-related coalitions, frameworks and methodologies
- Further initiatives by data providers and standard setters
- Developments in individual jurisdictions
- Demand from and oversight by international processes: UNFCCC, G20, G7

### Table: Examples of Initiatives

<table>
<thead>
<tr>
<th>Starting year</th>
<th>Examples of initiatives</th>
<th>Coalition</th>
<th>Framework</th>
<th>Methodology</th>
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<tbody>
<tr>
<td>Prior to 2015</td>
<td>GHG Protocol</td>
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<td>Carbon Disclosure Project</td>
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<td>Institutional Investor Group on Climate Change</td>
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<td>2015</td>
<td>Task Force on Climate-Related Financial Disclosures</td>
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<td>Science Based Targets</td>
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<td>Partnership for Carbon Accounting Financials</td>
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<td>2016</td>
<td>right. based on science XDC model</td>
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<td>2017</td>
<td>Transition Pathway Initiative</td>
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<td>Climate Action 100+</td>
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<td>Network for Greening the Financial System</td>
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<td>2018</td>
<td>Carbon Risk Real Estate Monitor</td>
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<td>FTSE x Beyond Ratings’ method</td>
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<td>Paris Agreement Capital Transition Assessment</td>
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<td>2019</td>
<td>Climate Safe Lending Network</td>
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<td>Net-Zero Asset Owner Alliance (Inaugural 2025 Target Setting Protocol)</td>
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<td>IIGCC Paris Aligned Investment Initiative (Net Zero investment framework)</td>
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<td>2020</td>
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<td>CDP-WWF temperature rating</td>
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<td>S&amp;P Sustainability (formerly Trucost) Paris Alignment</td>
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<td>2021</td>
<td>Glasgow Financial Alliance for Net Zero (Financial institution net-zero transition plan framework)</td>
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<td>MSCI Implied Temperature Rise</td>
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<td>2022</td>
<td>SBTi Financial Institutions Net Zero Expert Advisory Group</td>
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Source: Noels and Jachnik (2022) Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives
Making sense of a currently confused landscape?

Key carbon emission metrics are not correlated with E pillar of ESG scores

Climate-alignment assessments of corporates differ significantly across providers

Comparison of carbon emission metrics across two providers by environmental pillar score (0-100 score)

Note: Comparison of metrics for Greenhouse gas emissions for two different providers. The data has been standardised between 0 and 100. Source: MSCI, Refinitiv, OECD calculations


Figure 4.1. Results of long-term alignment assessments for selected corporates

CONSIDERATIONS RELATING TO METRICS, DATA AND METHODOLOGIES
A combination of metrics needed to assess and incentivise financial sector progress towards net zero

- **Net Zero**

- **GHG emission metrics**
  - Metrics focusing on current GHG emissions and forward looking plans and targets to reduce GHG emissions in line with net zero commitments

- **Portfolio characteristics metrics**
  - Selected portfolio metrics that help describe operational changes in the financial institution’s assets managed to align with net zero commitments

- **Engagement metrics**
  - Metrics to measure the engagement of financial institutions with the companies in their portfolios on net zero related considerations

- **Strategy and governance metrics**
  - Metrics to understand the changes to the financial institution’s strategic priorities (i.e. decision making processes) and how these are operationalised internally (i.e. through remuneration and governance) to achieve net zero commitments
A currently limited coverage of the range of asset classes found within financial portfolios

- Not all asset classes covered by existing frameworks, methodologies and metrics

- Current data availability, metrics and assessments heavily biased towards listed companies

- Negatively impacts the policy relevance and integrity of portfolio-level assessments

Source: Noels and Jachnik (2022) Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives
Financial sector GHG metrics depend 99% on GHG data of investees and borrowers.

Scope 3 emissions are key to many real economy sectors but prone to high data and integrity challenges.
A need for a series of GHG and non-GHG metrics to ensure integrity and credibility

<table>
<thead>
<tr>
<th>Metric</th>
<th>Advantages</th>
<th>Disadvantages</th>
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<tbody>
<tr>
<td>Absolute emissions contraction</td>
<td>+ Predictable emissions reductions, less data intensive, applicable to all asset classes</td>
<td>- Could disincentivise business growth, increased GHG performance can be due to decreased output</td>
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<tr>
<td>Rate of change in absolute emissions</td>
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<tr>
<td>Sectoral decarbonisation approach</td>
<td>+Independent of entity size, business growth and price changes</td>
<td>- Data intensive, difficult to apply to companies with diverse activities, absolute emissions could increase</td>
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<tr>
<td>GHG emissions divided by physical output</td>
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<tr>
<td>Economic Intensity Contraction</td>
<td>+Independent of entity size, business growth and price changes, applicable to non-homogenous sectors and companies</td>
<td>-Volatile with macroeconomic conditions, difficult to assess the PA consistency of projections for economic denominators</td>
</tr>
<tr>
<td>GHG emissions divided by economic output</td>
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</tbody>
</table>

Further non-GHG based metrics are needed too, including to link more closely to real-economy impact.

Source: Noels and Jachnik (2022) Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives
Data, transparency and credibility lacking in relation to the reliance on offsets

Treatment of offsets by climate alignment assessment methodology providers

- Methodologies explicitly excluding the use of offsets tend to find less alignment with the Paris Agreement
- Offset data from underlying investees remain opaque

Source: Noels and Jachnik (2022) Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives
GHG target setting and assessments depend on climate scenario downscaling assumptions

Panel A: Contraction approach
Alignment when the reduction rate is the same as in the scenario.

Panel B: Convergence approach
Alignment when the performance level is the same as in the scenario at time x, here 2030.

Panel C: Fair-share approach: example for two companies with the same market share
Alignment when the carbon budget of a company is the same as or less than the carbon budget under the scenario.

In this example, company 1 and 2 have to comply to the same scenario, as they have the same market share in the same sector.

Source: Schwegler, R. et al. (2022), Portfolio Climate Alignment: Understanding unwanted disincentives when using climate alignment methodologies

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Reflections on data needs and the way forward

- Assessing a financial institution or portfolio requires coverage of and data on the range of relevant assets and asset classes
- Rise of reporting requirements in different jurisdictions and further disclosure initiatives will progressively enhance climate-related data availability
- Data disclosure and platforms need to come with clear qualifiers on methodologies, scope and coverage gaps to avoid misleading interpretations and greenwashing
- Data, buy in and participation from emerging and developing economies needed
- Range of issues require further attention to strengthen data integrity for markets and policy makers, e.g. asset class coverage gaps, scope 3 and financed emission estimation, reliance on offsets, impact of choice of climate scenario
Interested in further insights?

Check out the presentations and summary from our 22 February 2022 Workshop on Metrics for Climate Transition and Net-Zero GHGs in Finance - Supporting climate policy goals and avoiding greenwashing.
Countries and companies net-zero targets are vague

Scope
- What global temperature goal does this plan contribute to?
- What is the target date for net zero?
- Which greenhouse gases are considered?
- How are greenhouse gases aggregated?
- What is the extent of the emissions (territories, time frames or activities)?
- What are the relative contributions of reductions, removals and offsets?
- How will risks be managed around removals and offsets?

Fairness
- What principles are being applied?
- Would the global climate goal be achieved if everyone did this?
- What are the consequences for others if these principles are applied universally?
- How will your target affect others’ capacity to achieve net zero, and their pursuit of other Sustainable Development Goals?

Road map
- What milestones and policies will support achievement?
- What monitoring/review system to assess progress and revise the target?
- Will net zero be maintained, or is it a step towards net negative?

Source: Rogelj, J. et al. (2021), Net-zero emissions targets are vague: three ways to fix (nature.com)
Complementary work streams at the OECD

Responsible Business Conduct for climate action

Financial market practices for transition finance

Credible corporate plans for transition finance

Assessing the climate alignment of finance

Source: OECD (2018), Due Diligence Guidance for Responsible Business Conduct

Source: OECD (2022), Policy guidance on market practices to strengthen ESG investing and finance a climate transition

Source: OECD (2022), Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans

Source: Noels and Jachnik (2022), Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives
Elements of credible corporate transition plans

1. Setting temperature goals, net-zero, and interim targets
2. Using sectoral pathways, technology roadmaps, and taxonomies
3. Measuring performance and progress through metrics and KPIs
4. Providing clarity on use of carbon credits and offsets
5. Setting out a strategy, actions, and implementation steps, including on preventing carbon-intensive lock-in
6. Addressing adverse impacts through the Do-No-Significant-Harm (DNSH) Principle and RBC due diligence
7. Supporting a just transition
8. Integration with financial plans and internal coherence
9. Ensuring sound governance and accountability
10. Transparency and verification, labelling and certification

Source: OECD (2022) Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans