Net Zero Standard for North American Banks

July 2023

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Acknowledgements

This Standard has been developed based on **IIGCC's Net Zero Banks Standard** published on June 5, 2023, and authored by Sam Cornish, Dan Gardiner, Lucia Graham-Wood, and Mahesh Roy with IIGCC investor member input (full acknowledgment **here**). It has been adapted to reflect relevant context for U.S. and Canadian banks by Blair Bateson, CFA, director at the Ceres Company Network, Sonya Hetrick, director at the Ceres Investor Network, and Jim Scott, CFA, senior advisor, financial institutions, Ceres Accelerator for Sustainable Capital Markets.

About Ceres

Ceres is a nonprofit organization working with the most influential capital market leaders to solve the world's greatest sustainability challenges. Through our powerful networks and global collaborations of investors, companies, and nonprofits, we drive action and inspire equitable market-based and policy solutions throughout the economy to build a just and sustainable future. For more information, visit **ceres.org** and follow **@CeresNews**.

Net Zero Standard for North American Banks

This Standard sets out investor expectations and best practices for U.S. and Canadian banks on the transition to net zero. It focuses primarily on a bank's financed and facilitated emissions (part of scope 3 emissions), rather than on emissions associated with their operations, since financed and facilitated emissions are much larger and reflect greater business risks and opportunities. In fact, greenhouse gas emissions associated with bank lending are **more than 700 times higher** than a financial institution's direct emissions as banks generally finance all sectors of the economy. Since corporate economic activity is dependent on the availability of financing, a portion of emissions from every sector are attributable to these banks.

This Standard complements the **Net Zero Investment Framework** (NZIF)[1] and is designed to support lenders implementing net zero commitments. The expectations are stretching—consistent with limiting climate change to a 1.5°C pathway,[2] as well as maximizing long-term shareholder and lender value and reducing systemic risk—but also achievable with determined action by all actors.[3] Failing to meet these expectations could result in severe financial and reputational consequences for banks. However, we acknowledge that each bank's ability to meet these expectations will depend on their unique business model, the legal and regulatory environments in which they operate, and their stakeholder base, among other considerations.

These expectations are also made on the basis that governments will follow through on their commitments to support a low-carbon and just transition at a pace consistent with achieving the goals of the Paris Agreement, including limiting climate change to 1.5°C (the "Paris Goals").

For some bank products and services, methodologies or frameworks do not yet exist. As such, these expectations should not be seen as prescriptive for all banks or all circumstances. Rather, the Standard provides a compass for both investors and banks navigating towards net zero, including for engagement with public policymakers and data providers to build the necessary conditions for success.

Adoption of this Standard is voluntary.

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1 The Net Zero Investment Framework, published in March 2021, provides a high-level framework that supports investors to align their investments with the goals of the Paris Agreement. Banking is considered a high impact sector in the target setting methodology for "Listed Equity and Corporate Fixed Income". Consequently, full alignment assessment is required. The Banks Standard provides industry specific guidance to operationalize this assessment.

2 As identified by the IPCC in their Special Report on Global Warming of 1.5 degrees www.ipcc.ch/site/assets/uploads/sites/2/2022/06/SPM_version_report_LR.pdf [date accessed: March 8, 2023].

3 Article 2.1(a) of The Paris Agreement states the goal of "*Holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels, recognizing that this would significantly reduce the risks and impacts of climate change;*" https://unfccc.int/sites/default/files/english_paris_agreement.pdf [date accessed: March 8, 2023].

The Standard and Assessment Framework cover ten areas:

1. **Bank commitments**
2. **Targets**
3. **Exposure and emissions disclosure**
4. **Historical emissions performance**
5. **Decarbonization strategy**
6. **Climate solutions**
7. **Policy engagement (lobbying)**
8. **Climate governance**
9. **Just transition**
10. **Annual reporting and accounting disclosures**

The largest global banks will be assessed against 72 indicators in each of these areas. This analysis will be conducted by the Transition Pathway Initiative, who will publish results in Q3 2023 - preliminary assessments will be shared with banks beforehand. The North American banks that will be covered are Bank of America, Citi, Goldman Sachs, JPMorgan Chase, Morgan Stanley, Wells Fargo, Bank of Montreal, Canadian Imperial Bank of Commerce, Royal Bank of Canada, Scotiabank, and Toronto Dominion Bank. Additional banks may be added in future years.

1. BANK COMMITMENTS

Banks should establish a comprehensive commitment to net zero by 2050 or sooner that is consistent with the Paris Goals, including limiting warming to 1.5 °C. This commitment should cover all material products and services (i.e., all material on- and off-balance sheet activities)[4] and operational emissions. Where this is not yet done, banks should explain why.

Rationale: Banks play a pivotal role in directly financing and facilitating[5] the real economy; their commitment to net zero and decarbonization is essential if global climate goals are to be achieved. Investors want to understand the extent to which a bank is committed to a net zero future—and thereby enhancing long-term shareholder capital through prudent enterprise-wide risk management[6].

Additional Resources: For more information, please review Ceres' **banking work**, including reports on **transition risk** and **physical risk** for banks. For more information on mid-sized and community banks, please read Ceres' op-ed on the **2023 U.S. Bank Crisis**, and for information on Credit Unions and decarbonization, please review Ceres' and Filene Research Institute's joint report on **The Changing Climate for Credit Unions**.

4 See PCAF for definitions of on- and off-balance sheet, p.9 https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf [date accessed: March 8, 2023].
5 "Facilitated emissions differ from financed emissions in two respects: they are off-balance sheet (representing services rather than financing) and they can take the form of a flow activity (temporary association with transactions) rather than a stock activity (held on book)" PCAF, p.3 https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf [date accessed: March 8, 2023].
6 For more information, see www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf [date accessed: March 8, 2023].

2. TARGETS

Banks should establish short-, medium-, and long-term targets for reducing real economy emissions associated with their products and services that puts them on a pathway to achieve their net zero commitment. At least some of these targets should focus on the period from now to 2030.

Investors recognize that often several types of targets are needed to support a bank's net zero commitment, such as: (i) reducing financed[7] and facilitated[8] emissions (in support of real economy emissions reductions); (ii) increasing the share of financing/facilitation for companies with externally-verified 1.5 °C targets[9] and credible transition plans[10]; (iii) providing transition-linked financing and facilitation of carbon-intensive borrowers; and, where relevant, (iv) expanding capital deployment for transition-enabling activities across sectors (e.g., green building renovation and retrofit supply chain, while ensuring socially inclusive access to capital[11]).

Where addressing their financed and facilitated emissions, banks should supplement their net zero commitment with at least one of the following:

a. Set sector-specific emissions intensity targets using a physical denominator[12], aligned with a 1.5 °C pathway in each case. Intensity targets ensure that a bank is seeking to align its activities in each sector with climate objectives, independent of overall changes in the volume of activity and any shifts between sectors.
b. Set sector-specific targets for their financed emissions in terms of absolute emissions, aligned with a 1.5 °C pathway in each case. Absolute targets are more closely aligned with an overall net zero commitment, and ensure a bank is contributing positively to national and global climate goals.

Regardless of whether (a) or (b) is chosen, banks should provide investors with sufficient information to understand the impact of an intensity target on future absolute emissions, or vice versa. This "translatability" allows for banks to focus on a single objective while enabling investors to assess the bank's future trajectory on both an absolute and physical intensity basis for the purposes of investment decision-making. Alternatively, banks can go the extra mile and set both types of targets for each sector. Targets should prioritise high-emitting sectors[13].

While the long-term trajectory for absolute emissions should be to net zero, investors acknowledge the need for transition-linked products and services in 'hard-to-abate' sectors (such as diversification advisory and capital equipment optimization lending), which can lead to short term increases in absolute financed/facilitated emissions but can be important in delivering real economy decarbonization.

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7 PCAF's methodology for Financed Emissions, 2022 https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf [date accessed: March 8, 2023].

8 PCAF's Proposed Methodology for Facilitated Emissions, 2022 https://carbonaccountingfinancials.com/files/downloads/pcaf-capital-market-instruments-proposed-methodology-2022.pdf [date accessed: March 8, 2023].

9 For example, the TPI www.transitionpathwayinitiative.org/ and SBTi https://sciencebasedtargets.org/ are two providers [date accessed: March 8, 2023].

10 Key elements of transition plans include comprehensive and aligned emissions targets; credible strategies to deliver the targets (including quantified decarbonization actions and capital allocation); engagement commitments to deliver their targets (including in value chain and climate policy); contribution to climate solutions (where relevant); and comprehensive emissions and accounting disclosures. Full details in IIGCC Investor Expectations of Corporate Transition Plans: From A to Zero, www.iigcc.org/download/investor-expectations-of-corporate-transition-plans-from-a-to-zero-v2/?wpdmdl=7459&refresh=642163e4b3c3a1679909860 [date accessed: March 27, 2023]).

11 See for instance, www.lse.ac.uk/granthaminstitute/publication/financing-a-just-transition-to-net-zero-emissions-in-the-uk-housing-sector/ [date accessed: March 8, 2023].

12 This is the sector relevant unit of production - refer to TPI's carbon performance methodology, p.6 www.transitionpathwayinitiative.org/publications/100.pdf?type=Publication [date accessed: May 22, 2023].

13 The high-emitting sectors that will be covered by TPI in the Assessment Framework currently include: Oil and Gas, Power, Coal Mining, Airlines, Shipping, Auto Manufacturing, Steel, Aluminium, Diversified Mining, Paper, Cement, Food, and Real Estate.

These targets should eventually cover all of a bank's material business activities, including public and private-sector lending, project financing, over-the-counter (OTC) derivatives (between banks and their borrowers), acquisition financing, asset-backed financing, investment banking advisory and underwriting services, asset management, and custody and trust services[14,15]. Although methodologies for assessing emissions in some of these areas do not yet exist, banks are nonetheless encouraged to pursue long-term efforts to cover these activities with targets. Banks should additionally establish targets to reduce their operational emissions in line with a 1.5 °C pathway.

Rationale: Bank targets establish levels of climate ambition and plot a decarbonization trajectory that can be assessed for alignment against 1.5 °C climate objectives. Short- and medium-term targets are moreover needed to operationalize long-term goals. Investors want to measure the decarbonization ambitions of their bank holdings in order to understand transition risk in their portfolios and help them to align their own financed emissions with net zero.

Investors encourage banks to set targets that incentivize real economy decarbonization. This includes incentivizing aligned, or transition-linked, activities in high-emitting sectors (recognizing that taking on these clients/projects may cause a bank's absolute financed/facilitated emissions to rise, in the short-term). Carbon credits (offsets) should not be used as a substitute for mitigation, and client-purchased credits should not be counted as progress toward banks' short- and medium-term targets for financed and facilitated emissions. (Please note that offsets are still a very nascent market and unique in that integrity needs to be assessed by both buyers and suppliers for permanence, additionality, verifiability, and enforceability for endurance)[16].

Acknowledging that banks provide different products and services to customers and operate under various business models, investors place the greatest emphasis on those that are most material in their impact on real economy emissions—and are associated with the greatest climate-related risks. With regards to bank's asset management and custody and trust services, investors highlight the role of stewardship activities, which include but are not limited to corporate and policy engagements, to drive targeted portfolio decarbonization as a means for real economy emissions reductions[17].

Additional Resources: For more information on bank target setting, please review Ceres' **banking resources**, including a recent **assessment of bank oil and gas targets**, as well as Ceres' reports on **transition risk** and **physical risk** for banks. For more information on how derivatives should be included as part of a bank's financed emissions calculations, please review Ceres' report on **Derivatives & Bank Climate Risk**.

3. EXPOSURE AND EMISSIONS DISCLOSURE

Banks should disclose both the financed and facilitated emissions associated with all material business activities. We recommend that banks disclose financed and facilitated emissions separately. Banks should also disclose total exposure to high-emitting sectors across business activities in terms

14 As identified in the NZBA Supporting Notes for Guidelines for Climate Target Setting, p.18 www.unepfi.org/wordpress/wp-content/uploads/2022/08/Supporting-Notes-for-Guidelines-for-Climate-Target-Setting.pdf [date accessed: January 24, 2023].

15 See www.netzeroassetmanagers.org/ [date accessed: March 8, 2023].

16 Investments in nature-based solutions that protect and restore ecosystems and sequester carbon are necessary, but these should be done in addition to deep emission reductions to meet global net zero goals (Integrity Matters: Net Zero Commitments by Businesses, Financial Institutions, Cities, and Regions: Report from the United Nations' High-Level Expert Group on the Net Zero Emissions Commitments of Non-State Entities, www.un.org/sites/un2.un.org/files/high-level_expert_group_n7b.pdf [date accessed: May 22, 2023]). To determine the role carbon credits may play in a client's carbon strategy and ensure that they are not counted toward bank's targets, banks can look to a company's CDP reports (Section C 11.2), whether their emissions reporting is done in accordance with the GHG Protocol Standards, and whether they have set a verified Science Based Target that prohibits the use of carbon credits to meet near term goals. If a company does not separately report credits and offsets as required by GHG Protocol, does not have a verified target that limits or prohibits the use of carbon credits, or does not disclose the role that carbon credits and offsets play in their climate strategy, banks should assume that the client is using carbon credits and plan engagements accordingly.

17 See for instance, www.iigcc.org/resource/iigcc-net-zero-stewardship-toolkit/ [date accessed: March 8, 2023].

of an appropriate financial metric (e.g., loan exposure). Disclosures should ideally be broken down by business activity and sector (e.g., in a matrix format[18]).

Additionally, banks should disclose financed and facilitated emissions on both an absolute and a sector-specific, emissions intensity basis (with a physical unit as a denominator). Banks should disclose the methods used to attribute emissions, and clearly state activities or sectors that are not covered. Where widely recognized, third-party methodologies exist[19], banks should use these to calculate emissions disclosures (as opposed to using proprietary methods). Banks' emissions disclosures should be of a high quality, well supported by underlying reported asset-level emissions data, and preferably independently audited[20]. Where possible, banks should separately report the contribution of client-purchased carbon credits (i.e., offsets), while encouraging borrowers not to include these credits in their calculation of emissions.

While the above is feasible now for large corporate clients, there will be challenges in capturing the necessary data at the level of mid-market corporate clients and small to medium enterprises (SMEs). In these cases, banks should estimate or help clients measure their emissions (using tools like the **SME Climate Hub** or the upcoming Ceres Roadmap360) to support a comprehensive understanding of the emissions associated with the bank's activities.

In certain facilitation activities (such as advisory services) where methodologies are not currently widely in use[21], it may be difficult to disclose emissions; banks are nonetheless encouraged to pursue efforts to do so and to support methodological development.

Banks should also disclose operational emissions, including those from owned but unleased real estate assets[22,23].

Rationale: Banks typically have a broad range of business activities providing different services. Investors seek clarity on the emissions a bank is financing and facilitating across these activities in order to understand (a) the extent of the bank's transition risk, and (b) the bank's role in enabling greenhouse gas emissions, leading to further physical risk due to climate change. Further, emissions disclosures ensure a firm footing for measurement of progress against targets (historical emissions performance).

Best practice is for banks to use widely recognized standards and frameworks for emissions disclosures, where available (such as GHG Protocol and the Partnership for Carbon Accounting Financials), because this enables standardized comparison. Understanding that carbon credits are not a substitute for decarbonization, investors also seek to understand the full contribution of offsetting measures to a banks' emissions disclosures (including credits purchased by the bank and by its clients).

Additional Resources: For more information on bank exposure and emissions disclosure, and the appropriate use of carbon credits for offsetting, please review Ceres' report on **Evaluating the Use of Carbon Credits**.

18 Sectoral targets for mortgage/real estate related lending and capital markets activities (covered bonds, mortgage/real estate securities) should ideally draw on the science-based and investor supported CRREM curves for different types of buildings (Carbon Risk in Real Estate Monitor www.crrem.org) [date accessed: March 8, 2023].

19 E.g., Methodology for Financed Emissions, 2022 https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf [date accessed: March 8, 2023].

20 See PCAF Global GHG Standard for tiers of disclosure quality, p.72 https://carbonaccountingfinancials.com/files/downloads/PCAF-Global-GHG-Standard.pdf [date accessed: March 8, 2023].

21 See p.18 www.unepfi.org/wordpress/wp-content/uploads/2022/08/Supporting-Notes-for-Guidelines-for-Climate-Target-Setting.pdf [date accessed: March 8, 2023].

22 Where banks have operational control of real estate assets, these assets contribute to operational emissions. https://carbonaccountingfinancials.com/files/consultation-2022/202205-public-consultation-real-estate.pdf [date accessed: March 8, 2023].

23 As per https://sciencebasedtargets.org/resources/files/Financial-Sector-Science-Based-Targets-Guidance.pdf [date accessed: April 11, 2023].

4. HISTORICAL EMISSIONS PERFORMANCE

Banks should report annual progress towards all their stated emissions targets. This performance should be expressed using the same metric as the target, thereby enabling investors to directly track both annual and performance-to-date against these targets. Where possible, the major contributors to progress should be quantitatively disclosed and the contribution of loan portfolio divestment and/or M&A (both at the bank and asset level) should be clearly set out.

Rationale: Investors want to see if banks are decarbonizing and if progress is aligned with the trajectory implied by their targets. This provides valuable information as to the credibility of both the decarbonization strategy and governance structures and therefore is an important basis for engagement.

5. DECARBONIZATION STRATEGY

To deliver on their targets and commitments, banks should independently establish and disclose their own individual protocols and strategies specific to each business activity. The precise approach adopted will vary by bank, but the underlying expectation is that banks should support their clients to align their strategies with a 1.5 °C pathway. This will involve (i) planning for phasing out financing of inconsistent activities which present particular risks, (ii) changes to the bank's enterprise risk management policies, such as industry and geographical exposure tolerances and other credit approval processes as well as (iii) the development and provision of transition and sustainable finance products and services (see *Climate Solutions* below).

More specific commitments are expected for hard-to-abate and carbon-intensive activities, which have been identified as generally inconsistent with the Paris Goals, indicating heightened financial risks. Based on current scientific understanding, and subject to any exceptions that are demonstrated to be consistent with a 1.5 °C pathway, banks may wish to consider policies covering the details of how they will avoid financing or facilitation of:

- New unabated coal-fired power stations and new coal mines, and phase out financing of the use of unabated thermal coal by 2030 in advanced economies and 2040 globally[24,25]
- New long lead-time oil and gas expansion projects; projects that fail to adopt necessary standards of methane emissions management[26 27;]; and measures to ensure that financing/facilitation of unabated gas-fired power infrastructure can be consistent with the electricity sector reaching net zero emissions by 2035 in advanced economies and 2040 globally[28]
- Deforestation[29] or other natural ecosystem conversion as soon as possible, and no later than 2025[30]

24 IEA, 2021 www.iea.org/commentaries/key-lessons-for-phasing-out-co2-emitting-coal-plants-from-electricity-sectors [date accessed: March 8, 2023].

25 As per IEA NZE, A Roadmap for the Global Energy Sector, p.26 https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf [date accessed: March 8, 2023].

26 The Oil & Gas Methane Partnership 2.0, developed by the UN Environment Programme contains best practice guidelines: https://ogmpartnership.com/ [date accessed: July 18, 2023].

27 Certain categories of new or existing unconventional sources of oil and gas are generally likely to be inconsistent with 1.5 °C pathways due to their high costs, often related to their high energy and carbon intensity of production under carbon pricing scenarios – see e.g., www.mckinsey.com/industries/oil-and-gas/our-insights/the-big-choices-for-oil-and-gas-in-navigating-the-energy-transition [date accessed: July 18, 2023].

28 As per IEA NZE, p. 117 https://iea.blob.core.windows.net/assets/deebef5d-0c34-4539-9d0c-10b13d840027/NetZeroby2050-ARoadmapfortheGlobalEnergySector_CORR.pdf and WEO 2022, p. 137: "Electricity sectors in advanced economies reach net zero emissions by 2035 in the NZE Scenario, and globally by 2040." https://iea.blob.core.windows.net/assets/830fe099-5530-48f2-a7c1-11f35d510983/WorldEnergyOutlook2022.pdf [date accessed: March 8, 2023]. For more details on decarbonising the electricity sector see IIGCC/CA100+ sector report: www.climateaction100.org/wp-content/uploads/2021/10/Global-Sector-Strategy-Electric-Utilities-IIGCC-Oct-21.pdf [date accessed: May 10, 2023].

29 As per https://racetozero.unfccc.int/wp-content/uploads/2021/11/DFF-Commitment-Letter-.pdf [date accessed: March 8, 2023].

30 Including natural savannahs, grasslands, peatlands and wetlands, p. 20 "Commitments should be timebound, with an ambitious target date and timebound milestones. The AFi recommends that companies set or strengthen commitments to no-deforestation and no conversion supply chains to include a target date that is as early as possible and no later than 2025." https://accountability-framework.org/wp-content/uploads/2022/09/AFI-LUC-and-Emissions-Guidance-09_2022.pdf [date accessed: March 8, 2023].

Across all resource-related (e.g., fossil fuel, raw materials) finance and facilitation, banks should additionally have policies that offer appropriate robust protections to socially and/or environmentally sensitive areas[31].

The above is not intended to be exhaustive or preclude financing that would enable alignment with a 1.5 °C future (e.g., decarbonizing steelmaking, retiring coal assets, or carbon capture and storage). Investors wish to have clear disclosures on how banks are approaching these particularly sensitive activities and have reassurance that any financing would not contravene the broader commitment to align with a 1.5 °C pathway.

The mechanisms through which banks will achieve their decarbonization strategy will inevitably vary by business activity and bank. Investors expect to see clear disclosures as to the approach adopted and how this will deliver the targeted decarbonization, together with key assumptions and critical dependencies. Potential mechanisms include, where relevant:

- Client engagement to obtain credible 1.5 °C-aligned transition plans, and regular review of credit relationships on this basis[32]
- Developing sector-specific initiatives to work with stakeholders across value chains and achieve decarbonization in hard-to-abate sectors
- Support for low-carbon technologies and solutions, as provided for in the Inflation Reduction Act, such as green renovation of buildings and retrofit supply chains in real estate[33]
- Financing covenants and conditions holding borrowers to the standards of a policy covering the issues bulleted above (p. 8) in both project and corporate finance
- Limitations that prohibit project finance and underwriting of inconsistent activities
- Entity-level corporate finance limitations based on whether or not borrowers derive material revenues from inconsistent activities (e.g., a stated threshold percentage of revenue)
- Provision of safeguards[34] within mergers and acquisitions advisory on transfers of high-carbon assets (e.g., coal mines) away from public capital markets
- Asset management decarbonization plans, in line with the Net Zero Investment Framework (NZIF)[35]

In all cases, investors expect banks to integrate just transition principles (see *Just Transition* below).

As stated above, carbon credits should not be used to count against financed/facilitated emissions. Any offsetting used against operational emissions should be minimized in favour of gross emissions reductions, but where offsetting is used, emphasis should be placed on long-term carbon removal[36].

Banks should provide a clear plan, with milestones, as to how they will achieve their net zero goals across financing and facilitated emissions, and operational emissions, together with critical assumptions and dependencies for the successful delivery of the strategy and achievement of their targets.

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31 As a guide, see these databases of protected areas www.protectedplanet.net/en/thematic-areas/wdpa?tab=WDPA [date accessed: March 8, 2023]; www.landmarkmap.org/data/ [date accessed: January 24, 2023] and others.

32 See e.g., www.cisl.cam.ac.uk/business-action/sustainable-finance/banking-environment-initiative/client-engagement-reshaping-the-bank-client-relationship-to-accelerate-the-transition-to-a-net-zero-economy [date accessed: March 8, 2023].

33 See, e.g., www.bankersfornetzero.co.uk/wp-content/uploads/2022/05/Tooling-up-the-Green-Homes-Industry_FINAL.pdf [date accessed: March 8, 2023].

34 E.g., standards requiring that purchasers are committed to 1.5 °C-aligned production curves, have financial means to cover decommissioning and rehabilitation, and are committed to a just transition.

35 Please see the Net Zero Investment Framework for guidance: www.parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Investment-Framework_Implementation-Guide.pdf [date accessed: March 8, 2023].

36 As per Oxford Offsetting Principles: www.smithschool.ox.ac.uk/sites/default/files/2022-01/Oxford-Offsetting-Principles-2020.pdf [date accessed: March 8, 2023].

These would be expected to include advances in public policy engagement, and changing consumer demand. This plan should be embedded into the bank's strategy, as set out to shareholders in the statutory Annual Report and Accounts (see below on *Annual Reporting and Accounting Disclosures*).

Rationale: For a bank's targets or commitments to be considered credible, they must be supported by a detailed decarbonization strategy. It is essential that this strategy covers all areas of activity in which banks play a significant role in the real economy.

Especially relevant are bank clients with assets at high risk of becoming impaired, or 'stranded', before the end of their anticipated operating life, resulting in financial risks for banks and their investors. These assets also risk locking in carbon-intensive operations, making decarbonization both more difficult and also likely more disorderly when it comes[37]. The above examples provide a non-exhaustive list of such assets and banks should carefully review individual projects for their consistency with 1.5 °C pathways.

A strong decarbonization strategy goes hand in hand with ensuring that banks are well positioned to support and benefit from the growth of transition and sustainable finance products and services, while avoiding transition risks. We turn to this in the next section.

Additional Resources: For more information on measuring and addressing climate risk for banks, please see the Ceres reports on **transition risk** and **physical risk**, as well as Ceres' work on developing **climate transition action plans**.

6. CLIMATE SOLUTIONS

Investors expect banks to be mindful of their micro- and macroprudential responsibilities and to support the decarbonization of the economy by providing (a) climate solutions (including all forms of low-carbon technologies and infrastructure needed to build a low-carbon economy), as well as (b) transition finance that will accelerate the net zero transition. There are a wide variety of ways for banks to do this (Ceres will be publishing a report on this topic in late 2023).

Banks should aim to scale up climate solutions and transition-aligned[38] products and services (such as on-balance sheet products like lending and off-balance sheet financial services like M&A Advisory) and provide clear reporting on their uptake. In order to demonstrate this aim, banks should establish specific targets and milestones related to these activities, and report progress on them at least annually. Ultimately, sustainable finance products and services should account for an increasing percentage of banks' total activity, and over time these products should become part of banks' standard offering rather than a specialty product or service.

Stakeholders also have an interest in consistent and comparable reporting on climate solutions and transition-related finance. As the United States does not have a government or regulator-provided framework or taxonomy for sustainable finance at this stage, we encourage industry to develop one. Alternatively, U.S. banks could make use of the existing **Canadian** or **European Union** taxonomies.

Rationale: A substantial acceleration in the flow of capital to low-carbon technologies and infrastructure will create opportunities for profit as well as helping achieve the transition to net zero.

37 Fisch-Romito et al. 2021. Systematic map of the literature on carbon lock-in induced by long-lived capital. Environmental Research Letters, 16. https://doi.org/10.1088/1748-9326/aba660 [date accessed: May 22, 2023].

38 The IEA NZE scenario sets out investment gap to aligning with a 1.5 °C future. "The NZE expands annual investment in energy from just over USD 2 trillion globally on average over the last five years to almost USD 5 trillion by 2030 and to USD 4.5 trillion by 2050," p. 81 www.iea.org/reports/net-zero-by-2050 [date accessed: March 8, 2023].

Banks have a central role to play in this through the deployment of products that can help to mitigate climate risk and create new, productive infrastructure. Investors encourage and recognize banks' activities in this area, but equally want to ensure that these activities are transparent and held to that same rigorous standards that apply to all other parts of a bank's business model.

Additional Resources: For more information on how banks can better access revenue-accretive sustainable and transition finance opportunities, please consult Ceres' website for the upcoming brief on sustainable business development and client engagement for banks.

7. POLICY ENGAGEMENT

Banks should establish a clear, group-wide position to conduct lobbying activities in line with the goal of limiting warming to 1.5 °C and assign board level responsibility for oversight of lobbying approach and activities. As recommended in Ceres' **2022 Responsible Policy Engagement** report, banks should clearly disclose their direct and indirect lobbying activities on policy issues material to climate change.

Further, banks should evaluate whether the associations, alliances, and coalitions they are a part of lobby in line with 1.5 °C climate objectives. Banks should disclose annually which trade associations they materially contribute to and what roles they play within them. Banks should conduct reviews of their trade associations' positions on climate change and associated policy issues, and disclose actions taken as a result of these reviews where any material misalignment is identified[39].

Banks should leverage their industry expertise in support of sound and effective regulation that can support the net zero transition.

Rationale: Stronger climate policies are needed in both the financial sector and the real economy to support the achievement of the Paris Goals. Due to their central role in the economy, banks exert considerable influence over policymaking. Given this, investors want to understand if the lobbying activities of banks are aligned with net zero.

Banks' role in policy engagement extends beyond their own lobbying activities to those of the trade associations, alliances, and coalitions that they are part of, as well as to other organizations (e.g., think tanks, advocacy bodies) that they support financially or otherwise. Investors also want to understand the policy engagement implications of these relationships.

Additional Resources: For more information on Responsible Policy Engagement for banks, please review Ceres' **2022** and **2020** reports on this subject.

8. CLIMATE GOVERNANCE

Banks should ensure that there is dedicated and expert oversight of delivery of their transition strategy at the board level and should establish strong oversight policies. Board-level committees should ensure they cover climate as part of their responsibilities, for instance committees responsible for audit, risk, remuneration, nomination and governance.

Banks should put in place incentive structures to encourage achievement of transition plan goals and amend or remove incentives that run contrary to those goals; executives should not be rewarded for actions that result in climate harm. Such structures should at least apply across senior executives/heads of business divisions, and preferably be extended deeper into the business.

39 These expectations are consistent with the Global Standard on Corporate Climate Lobbying: https://climate-lobbying.com/about/ [date accessed: March 8, 2023].

Banks are expected to allocate sufficient resource and train employees to achieve transition plan goals[40]. Below the board level, training for the broader workforce is a vital strategy to advance a shift towards greater climate-related financial risk awareness and action. To support the governance transition in line with a net zero future, banks should consider how longer term, climate-related metrics can be integrated throughout the organization.

Rationale: Delivering a transition to net zero requires banks to integrate climate considerations into strategy and operating activities. Investors want to understand what oversight measures and incentive structures exist to drive these plans forward.

Additional Resources: For more information on effective governance of climate-related financial risks for your bank, please consider participating in the University of Michigan Ross School of Business' new **Sustainability Education Program for Corporate Boards**. Also see the **Blueprint for Responsible Policy Engagement**.

9. JUST TRANSITION

A just transition decarbonizes the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities and leaving no one behind. It involves maximizing the social and economic opportunities of climate action, while minimizing and carefully managing any challenges.

Banks have a key role to play in helping their clients move through the energy transition, and must understand the social impacts of that work. Potential negative impacts that need to be considered range from job losses (due to changes in how energy is produced and consumed), to exposure to pollutants (from the opening of new mines for critical minerals), to the slowing of development in any parts of emerging and frontier markets that are prevented from accessing clean, affordable energy.

Banks should publish policies that support just transition-related outcomes across different activities, e.g., just transition-related requirements in covenants and conditions, and pre-investment screening. To assist with this, banks should appropriately incorporate relevant recommendations in the **ILO Guidelines for a Just Transition**, and engage with clients to help ensure adherence to the UN Declaration on the Rights of Indigenous Peoples Article 44, including the right to free, prior, and informed consent.

While creating a just transition is a forward-looking endeavor, this work can also help banks address the impacts of past lending and investment practices, including redlining, that have exacerbated racial inequities and disproportionately exposed communities of color to extreme heat, higher flood risk, and poor air quality. As mentioned in the Financial Stability Oversight Council's **Report on Climate-Related Financial Risk**, climate-related financial risks exacerbate these existing inequities, leaving these communities "**less likely to have the resources to protect and guard against**" the impacts of climate events and creating an additional layer of financial burden.

Financing can play a critical role in helping communities remediate past harms and build resilience to future climate disasters. However, building that financial resilience requires sufficient liquid resources and engagement with the impacted communities. As such, banks should identify potential social impacts associated with their net zero strategy and take action to reduce or limit these impacts within the scope of their existing Community Reinvestment Act obligations (as well as outside of them)[41].

40 NGFS, 2019, p. 30 www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf [date accessed: March 8, 2023].

41 See e.g., www.lse.ac.uk/granthaminstitute/publication/financing-climate-action-with-positive-social-impact-how-banking-can-support-a-just-transition-in-the-uk/ [date accessed: March 8, 2023].

Rationale: The transition to a net zero economy, while undeniably beneficial for the world overall, will significantly impact local economies and communities. Ensuring that it is just requires that principles of equity and sustainable development are incorporated; it does not imply slowing the pace of decarbonization. This includes that workers and local communities are respected, empowered, and included in the conversation.

The decarbonization agenda and development of climate solutions will generate new jobs that can contribute to social inclusion and poverty alleviation. This in turn can support environmentally sustainable, competitive economies. Investors encourage banks to support these objectives through just transition policies.

An unjust transition could also lead to increased social unrest and economic disparities that could undermine both the success of transition itself and increase legal and reputational risk for the companies that fail to act in accordance with just transition principles and/or violate human and labor rights.

Additional Resources: For more information on the Community Reinvestment Act, and how it could be further strengthened, please review comments submitted to the Federal Deposit Insurance Corporation, Office of the Comptroller of the Currency and Federal Reserve by Ceres.

10. ANNUAL REPORTING AND ACCOUNTING DISCLOSURES

Disclosure is critical so that stakeholders can understand a bank's position on all the items previously discussed in this Standard. As with any benchmark, the Net Zero Assessment Framework can only consider what is disclosed publicly, meaning that while the priority is for banks to take action, it is also critical that they disclose that action, along with related strategies, tactics, metrics and targets. Investors are especially interested in the disclosure of forward-looking information (in addition to historical data), as a bank's goals and transition plan are critical indicators of its ability to manage climate risk and capture transition-related opportunities.

TCFD Reporting

Banks should comply with the Task Force on Climate-related Financial Disclosures (TCFD)[42] recommendations and include TCFD reporting in their annual report or as a standalone disclosure. In keeping with TCFD guidance, this should cover the four pillars of the TCFD recommendations: governance, strategy, risk management, and metrics and targets[43]. As noted above, this should incorporate a detailed articulation of the decarbonization strategy.

In keeping with local prudential regulation, large U.S. banks will be undertaking climate scenario analysis to better understand their climate-related financial risks. We expect this to gather pace upon completion of the Federal Reserve's pilot climate scenario analysis later this year and as recommendations from the Network for Greening the Financial System (NGFS) are reflected in national oversight regimes[44]. Investors have an interest in the results of this work. This would also normally feed into financial statement assumptions and disclosures (see below).

42 Here we refer to TCFD or an appropriate successor framework, such as IFRS S2. A comparison of TCFD and IFRS S2 can be found here www.ifrs.org/content/dam/ifrs/supporting-implementation/ifrs-s2/ifrs-s2-comparison-tcfd-july2023.pdf [date accessed: July 24, 2023].

43 www.fsb-tcfd.org/publications/ [date accessed: March 8, 2023].

44 www.ngfs.net/sites/default/files/medias/documents/ngfs_guide_for_supervisors.pdf [date accessed: March 8, 2023].

Climate accounting and auditing
In keeping with existing accounting standards and local laws, banks should ensure all material climate risks are reflected in critical accounting assumptions and judgments, including expected impacts from the physical effects of climate change, accelerating decarbonization, and their own climate-related commitments[45]. Where possible, and as per existing internal controls, banks should obtain third-party assurance for material climate relevant financial data.

Investors expect banks to disclose all critical quantitative and qualitative assumptions, including those that have been modified to reflect material climate factors. Banks should ensure their forward-looking metrics (for instance relating to credit loss provisioning) consider how climate change will impact future economic growth, asset valuations, and financing conditions. It is likely that future economic conditions will be impacted by climate change, so investors would expect assumptions to change to reflect this.

Banks should provide sensitivity analyses in the Notes to their Accounts to provide visibility for how climate-related scenarios (such as those proposed by the NGFS[46]) would impact banks' financial positions. These sensitivities should include a 1.5 °C scenario, as well as testing the financial impacts of physical risk in higher warming scenarios.

The Audit Committee should task external auditors with testing management assumptions and judgments for consistency with climate-related disclosures, material climate-related impacts, and the credibility of the 1.5 °C sensitivity provided in the Notes to the Accounts. Any issues should be flagged in the auditors' report to shareholders.

Rationale: The disclosures outlined above are essential to ensure that financial climate-related risks are not hidden in banks' balance sheets. Climate-related risks—affecting a widening range of sectors and economies—are material to banks and are increasingly being underlined by prudential authorities such as the Financial Stability Board[47]. Many regulators are undertaking detailed climate stress testing to better understand banks' exposure and resilience to climate risks.

Investors have set out their expectations for improved disclosure on how climate risks are being considered in company accounts, including disclosures on the implications of a 1.5 °C pathway for capital positions[48]. For banks, investors do not currently have visibility of regulatory assessments of bank-level exposures but expect any material climate risks to be properly reflected in banks' financial statements in line with existing laws and accounting standards.

Additional Resources: For more information, please read Ceres' analysis on the **Federal Reserve's Climate Scenario Analysis Pilot Program**.

45 See: IASB, www.ifrs.org/news-and-events/news/2020/11/educational-material-on-the-effects-of-climate-related-matters/ [date accessed: March 8, 2023]; FRC, www.frc.org.uk/getattachment/65fa8b6f-2bed-4a67-8471-ab91c9cd2e85/FRC-TCFD-disclosures-and-climate-in-the-financial-statements_July-2022.pdf [date accessed: March 8, 2023]; ESMA, www.esma.europa.eu/sites/default/files/library/esma32-63-1320_esma_statement_on_european_common_enforcement_priorities_for_2022_annual_reports.pdf [date accessed: March 8, 2023].

46 See NGFS guidance: www.ngfs.net/ [date accessed: March 8, 2023].

47 www.fsb.org/work-of-the-fsb/financial-innovation-and-structural-change/climate-related-risks/ [date accessed: March 8, 2023].

48 IIGCC investor expectations for Paris-aligned accounts: www.iigcc.org/download/investor-expectations-for-paris-aligned-accounts/?wpdmdl=4001&refresh=63d00fdb343c11674579931 [date accessed: March 8, 2023]; A statement calling for Paris-aligned accounts was released by the Principles for Responsible Investment (PRI), the UN Environment Programme Finance Initiative (UNEP FI), the Chair of the Steering Group of the UN Convened Net-Zero Asset Owner Alliance initiative, Institutional Investors Group on Climate Change (IIGCC), Investor Group on Climate Change (IGCC), the Asia Investor Group on Climate Change (AIGCC), and the UK's Pensions and Lifetime Savings Association on 16th September 2020: www.unpri.org/accounting-for-climate-change/public-letter-investment-groupings/6432.article [date accessed: March 8, 2023].