

# THE TIME TO GREEN FINANCE

CDP Financial Services Disclosure Report 2020

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# CONTENTS

04	Key findings
06	The time is now
08	About this report
<b>12</b>	<b>1. Governance</b>
<b>18</b>	<b>2. Strategy</b>
<b>30</b>	<b>3. Risk management</b>
<b>34</b>	<b>4. Metric and targets</b>
42	TCFD overview
44	How CDP can help the finance sector unlock a new economy
46	Conclusions

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# KEY FINDINGS

## 49%

**of financial institutions indicate they do not conduct any analysis of how their portfolio impacts the climate at all.**



**To continue to thrive, financial institutions will need to align their portfolios with a net zero carbon world.**

## 76%

**of financial institutions see opportunities in offering sustainable finance products and services.**

**Almost all financial institutions' climate impact and risk is driven by the activities they finance in the wider economy, yet the data suggests that this is not yet where the focus is for a large number of institutions.**

- ▼ 49% of financial institutions indicate they do not conduct any analysis of how their portfolio impacts the climate at all.
- ▼ Only 25% of disclosing financial institutions report their financed emissions – 84 financial institutions worth US\$27 trillion of assets.
- ▼ For those 25%, on average, reported financed emissions are over 700x larger than reported operational emissions.

**On top of providing green finance, the finance sector must become green. While there are signs of financial institutions committing to align their portfolios with a net zero carbon world, much work still needs to be done.**

- ▼ The analysis shows just how key portfolio alignment is for financial institutions, those that have a low-carbon transition plan are mostly already taking actions to align their portfolio.
- ▼ 45% of banks are taking actions to align lending portfolios. 48% of asset owners and 46% of asset managers are aligning investments. Only 27% of insurers are aligning underwriting portfolios, suggesting insurers' transition plans are currently focused on their investments.
- ▼ To continue to thrive, financial institutions will need to align their portfolios with a net zero carbon world; clear short- and mid-term milestones such as science-based targets for their portfolios can help them in achieving this.

**Financial institutions definitely see opportunities for returns on financing the transition to a low carbon, deforestation free, water secure future – 76% see opportunities in offering sustainable finance products and services.**

- ▼ They highlight opportunities including sustainability-linked loans, green and transition bonds, sustainable investment funds and insurance solutions – with potential financial impact up to US\$2.9 trillion
- ▼ There are indications these opportunities could be realized, with potential impact outweighing the cost to pursue for most opportunities.

# KEY FINDINGS

Continued



**Some banks, asset owners, asset managers and insurance companies have not yet identified climate-related risks in their financing portfolios.**

# 82%

**of banks and 67% of insurers engage their clients on climate-related issues.**



**Boards are less likely to have oversight of their climate impact than risks and opportunities affecting their bottom line.**

## Disclosures suggest financial institutions are underestimating their climate-related risks.

- ▼ It is more common for financial institutions to identify climate-related risks they classify as operational risks (41% of financial institutions) than credit risks (35% of financial institutions) and market risks (26% of financial institutions).
- ▼ Yet the credit and market risks identified have a much higher reported potential financial impact - up to US\$1.05 trillion between credit risks and market risks.
- ▼ It follows that some banks, asset owners, asset managers and insurance companies have not yet identified risks in their financing portfolios, which will be of a greater magnitude than those in their own operations.

## Financial institutions can create a feedback loop to de-carbonize and enhance resilience of the economy as a whole; engagement with portfolio companies is a key part of this. It is more common for banks to indicate they are engaging with their portfolios on climate-related issues, compared to other industry activities.

- ▼ 82% of banks and 67% of insurers engage their clients on climate-related issues, most commonly to educate clients about their own climate strategies and sustainable finance products.
- ▼ 46% of asset owners and 50% of asset managers engage, most commonly as active owners.
- ▼ For some, this will be because they use external asset managers. If investors do not have direct shareholder relationships, they should ensure their external asset managers are engaging companies, so the feedback loop is not broken.

## Most financial institutions now have some board-level oversight of climate-related issues, however there are signs boards could sharpen their focus on issues that really matter.

- ▼ Board oversight covers climate risks and opportunities in financial institutions' own operations more often than it does their financing activities, across all financial industries.
- ▼ Boards are less likely to have oversight of their climate impact than risks and opportunities affecting their bottom line, again across all financial industries.



**The industry should focus on both sides of the balance sheet as insuring the low carbon transition will be important.**



**63% assess exposure to water risks and only 52% assess exposure to deforestation risks, compared to 81% assessing climate.**

- ▼ These trends are most extreme in the insurance industry - board-level oversight covers the impact of insurance underwriting on climate change at only 31% of insurers.
- ▼ Use of financial incentives could also improve to focus senior leaders on the issues that matter.

## When it comes to incorporating climate-related considerations, insurance companies are currently more focused on their investments than the underwriting they provide.

- ▼ On multiple topics including effective governance, aligning portfolios for net zero, engaging with the real economy and transaction due diligence, insurance companies perform much better for their investment portfolios than they do for their underwriting portfolios.
- ▼ The industry should focus on both sides of the balance sheet as insuring the low carbon transition will be important.

## Environmental impact of financing portfolios goes beyond climate change, but currently the issues of deforestation and water security are assessed by fewer institutions in making financial decisions, compared to climate change.

- ▼ 63% assess exposure to water risks and only 52% assess exposure to deforestation risks, compared to 81% assessing climate.
- ▼ CDP intends to expand its questionnaires to include a full range of environmental factors. For financial institutions, this means covering all climate- and nature-related risks, opportunities and impacts in their portfolios.

## CDP alignment with the Taskforce on Climate-related Financial Disclosures

- ▼ Financial institutions will be among some of the first companies required to disclose in line with the TCFD framework as regulators move towards mandatory disclosure.
- ▼ CDP was an early supporter and adopter of the TCFD recommendations and this report is organized into sections to aid an assessment of how ready the global finance sector is for TCFD-aligned reporting.

# THE TIME IS NOW



The transition to a net zero economy – critical in avoiding the most catastrophic effects of climate change, is dominating discussions in the world’s most influential boardrooms and governments. This is evident from Blackrock Chairman Larry Fink’s [recent letter](#) to CEOs, and from preparation for the UK’s upcoming presidency of [COP26](#). Rather than diverting attention, the ongoing COVID-19 pandemic is focusing minds in business and government on the need to meet global systemic threats such as climate change<sup>1</sup>.

Every company, in every sector, has a part to play - such is the scale of change needed. However, the finance sector is especially critical. The transition to net zero will require huge amounts of capital directed at decarbonizing the economy and enhancing resilience to changes already in the system. It is clear the finance sector needs to play a major role in this.

The time is now for the sector to step up. What is required is, yes, green finance; but also, for finance to become green. Financial institutions’ largest climate impact stems from the activities they enable through their loans, investments and insurance underwriting. It is these financing portfolios that must be aligned with 1.5 degrees Celsius world, for financial institutions to continue to thrive. With so much long-term capital still being directed at fossil fuels<sup>2</sup>, and our time and carbon budget running out, the sector must act now. Financial institutions that do not align their portfolios face enormous risks, including from stranded assets<sup>3</sup>.

The importance of the finance sector’s role in achieving the low carbon transition is recognized directly in the Paris Agreement. Its aims include *“making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development<sup>4</sup>. ”*

The Taskforce for Climate-related Financial Disclosures (TCFD) also directly recognized how critical the sector is. It released [guidance](#) for banks, asset owners, asset managers and insurance companies, along with its recommendations.

As regulators move towards mandatory climate disclosures in line with the TCFD framework, it is likely that financial institutions will be among some of the first market participants required to comply. In

**The CDP system has provided the most comprehensive, comparable and TCFD-aligned environmental data and insights to capital markets for over 20 years.**

the UK’s [“Roadmap towards mandatory climate-related disclosures”](#), banks, insurance companies and the biggest pension schemes will be required to align their disclosures with the TCFD recommendations in 2021, ahead of most listed companies. The EU Sustainable Finance Disclosure Regulation, set to roll out in several stages over the next two years, contains reporting obligations at both the company and product level, and entails a comply-or-explain assessment of the main negative impacts their investments will have on the environment and society<sup>5</sup>.

Regulation on mandatory climate disclosures for financial institutions will only be accelerated by the Network for Greening the Financial System (NGFS) – a group of Central Banks and Supervisors willing to share best practice in incorporating climate considerations into financial regulation.

An assessment is needed of how ready the global finance sector is to play the role required of it; whether it has the tools to manage climate-related financial risks, whether it is positioned to provide the capital flows needed for low carbon technologies and enhanced resilience. An assessment is also urgently needed of how ready the global finance sector is for reporting in line with the TCFD recommendations.

CDP is ideally positioned to provide this assessment. The CDP system has provided the most comprehensive, comparable and TCFD-aligned environmental data and insights to capital markets for over 20 years. It is now expanding to serve more of the capital markets; leveraging a broad range of asset classes as authorities to request environmental disclosures – such as through the bond markets or banks requesting disclosures from their lending clients. Beginning with the [Financial Services Climate Change Questionnaire 2020](#), CDP asks for disclosures from financial institutions on the impacts they finance in the wider economy. The disclosures allow for a baseline assessment of climate-related risks, opportunities and impacts in financing portfolios; and of how banks, asset owners, asset managers and insurance companies are preparing for the net zero carbon transition.

There is strong evidence disclosure leads to action. A Banque de France [working paper](#) from January 2021 found 40% of financial institutions subject to mandatory climate reporting reduced funding of fossil fuels compared to a control group.

<sup>1</sup> For example, Canada announcing businesses will be required to make climate-related disclosures in order to receive Covid-19 economic aid  
<sup>2</sup> [https://www.ran.org/wp-content/uploads/2020/03/Banking\\_on\\_Climate\\_Change\\_\\_2020\\_vF.pdf](https://www.ran.org/wp-content/uploads/2020/03/Banking_on_Climate_Change__2020_vF.pdf)  
<sup>3</sup> <https://www.tandfonline.com/doi/pdf/10.1080/20430795.2016.1266748?needAccess=true>  
<sup>4</sup> [https://unfccc.int/files/meetings/paris\\_nov\\_2015/application/pdf/paris\\_agreement\\_english\\_.pdf](https://unfccc.int/files/meetings/paris_nov_2015/application/pdf/paris_agreement_english_.pdf)

<sup>5</sup> Further examples of policy to mandate climate disclosures applying to financial institutions can be found in New Zealand, Switzerland, Brazil and Hong Kong.

**Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.<sup>4</sup>**

Paris Agreement

# ABOUT THIS REPORT

The **CDP Financial Services Climate Change Questionnaire 2020** fills a critical data gap in climate reporting.

The TCFD highlighted that the finance sector needs to be seen as producers of environmental data, as well as users. The questionnaire meets this demand. For the first time, CDP is asking financial institutions to disclose the impacts they have on the wider economy through their financing portfolios, in addition to their operational impacts. Through the questionnaire, CDP aims to build a structured, comparable dataset of financial institutions' Scope 3 financed emissions.

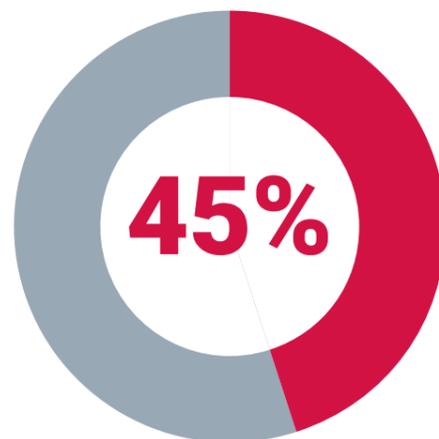
In a market first, this report presents insights from the **CDP Financial Services Climate Change Questionnaire**.

It can therefore be seen as a baselining report on the current state of the finance sector, and where it needs to improve. This will support the ambitious [private finance agenda for COP26](#).

CDP allows for TCFD-aligned reporting and results in a structured dataset of TCFD-aligned disclosures.

This report is organized into sections based on the areas of the TCFD recommendations – governance, strategy, risk management, and metrics and targets. Organizing the findings in this way aids an assessment of how ready the global finance sector is for TCFD-aligned reporting.

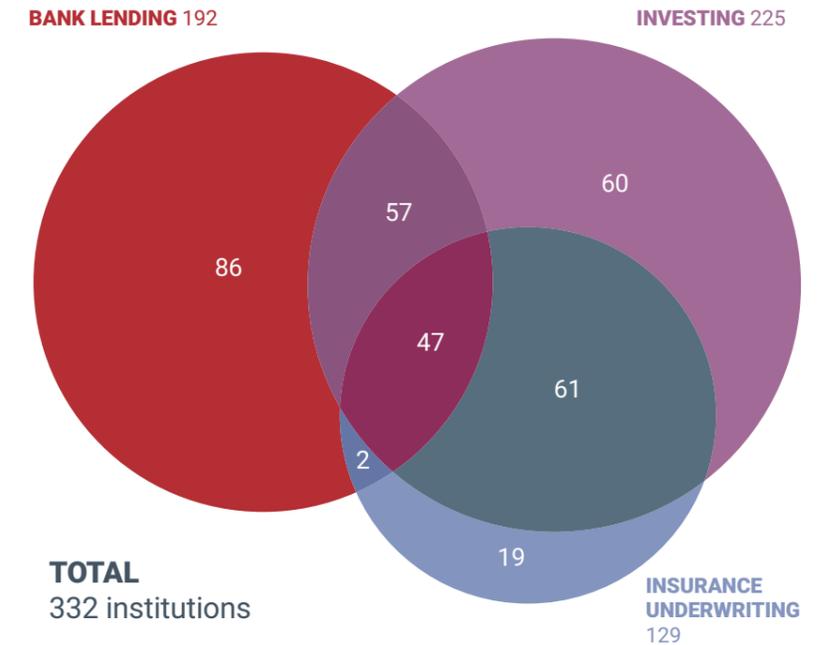
The insights presented here cover a significant section of the global finance sector.



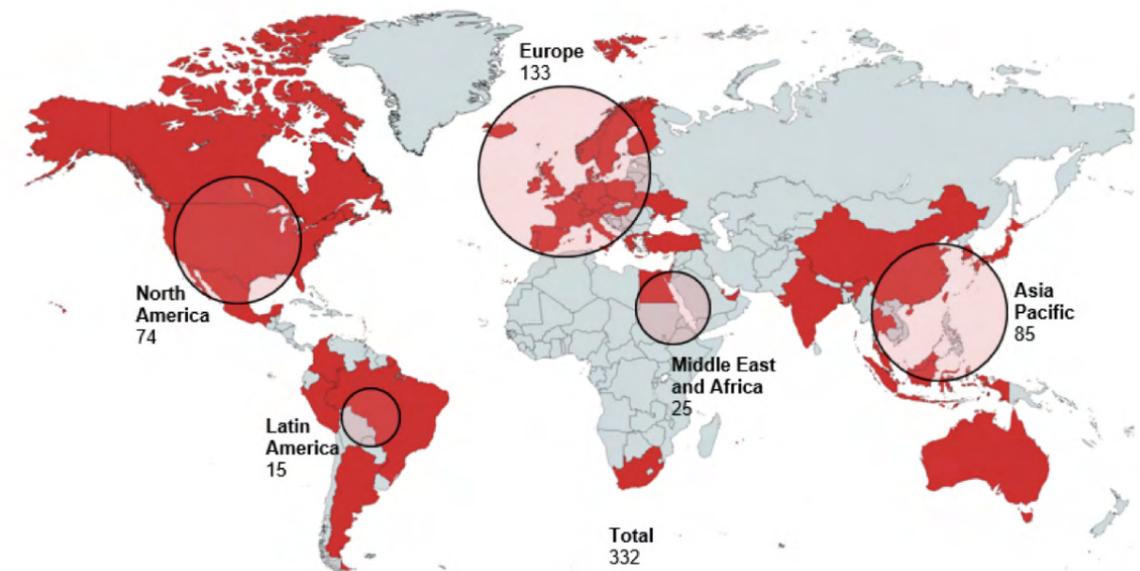
The response rate for financial institutions to the CDP information request from investors was

- ▶ Responded to CDP
- ◀ Did not respond to CDP

Disclosures cover the major industry activities making up the finance sector. Many financial institutions undertake more than one activity.



Disclosures cover all six continents



In total, financial institutions disclosing have combined assets of over **US \$109 TRILLION**

# ABOUT THIS REPORT

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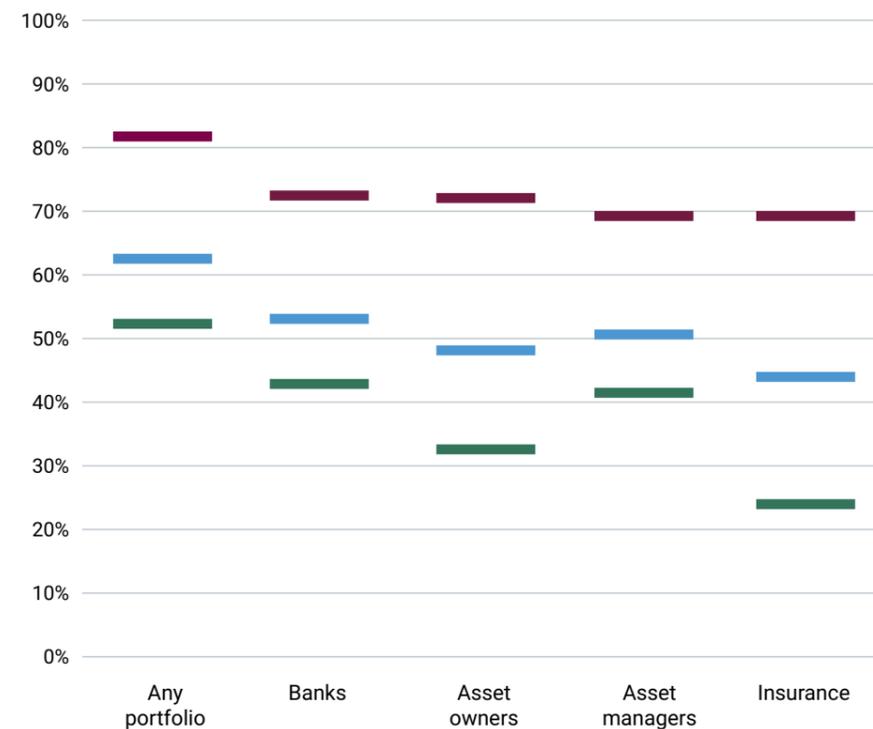
## Going beyond climate change

The first CDP Financial Services Questionnaire was focused on climate change, reflected in the insights presented here. However, the largest banks, investors and insurers are universal, meaning they have exposure to every sector of the economy. The consequence of this is that portfolios can be exposed to, and impact on, environmental concerns far beyond climate change. Social issues also present risks to financial institutions as the COVID-19 crisis has shown acutely.

Disclosures from financial institutions to exploratory questions in the 2020 questionnaire suggest that the issues of deforestation and water security are currently assessed by fewer financial institutions in making lending, investment and insurance underwriting decisions, when compared to climate change.

### Do you assess your portfolio's exposure to environmental risks and opportunities?

- Climate
- Water
- Forests



## BEST PRACTICE



**BNP Paribas Asset Management started a natural capital assessment of its portfolio in 2017. It focuses its assessment on water and forests, in addition to other issues such as soil and biodiversity.**

*BNP Paribas Asset Management: has two key targets to improve the water and forests footprints of its portfolios.*

... is committed to improve the water efficiency of portfolios, in particular in water-stressed areas, as well as to measure and disclose the water footprint of its portfolios.

... has undertaken to ask companies in its portfolios to comply with No Deforestation, No Peat and No Exploitation (NDPE) commitments; by 2020 for agricultural commodities, and by 2030 from non-agricultural sectors.

CDP intends to expand its questionnaires to include a full range of environmental factors as we are committed to accelerating global environmental ambition and driving action. Protecting natural ecosystems and the benefits they provide is crucial for retaining resilience. For financial institutions, this means covering all climate- and nature-related risks, opportunities and impacts driven by their lending, investments and insurance underwriting.

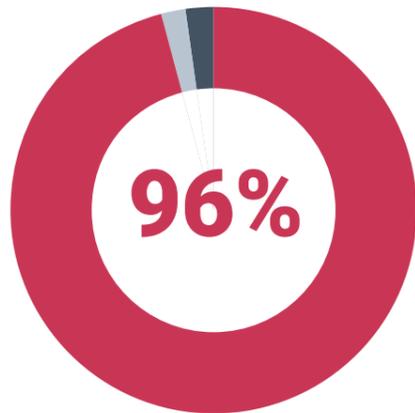
As a first step towards that goal, forests-related metrics were piloted with a limited number of banks in 2020, with encouraging results. Similarly, CDP is now engaging with the financial sector to establish which water-related metrics should be included in disclosures of financial institutions.

There is a strong business case for why the financial sector should care about nature – globally, the total economic value of ecosystem services is estimated to be between US\$125 and 140 trillion per year<sup>6</sup>. In 2020, the total potential financial impact of water risks reported to CDP was up to US\$333 billion. These numbers paint a compelling case for financial institutions to consider nature in financial decisions.

<sup>6</sup> <https://www.oecd.org/environment/resources/biodiversity/G7-report-Biodiversity-Finance-and-the-Economic-and-Business-Case-for-Action.pdf>

# 1 GOVERNANCE

## Is there board-level oversight of climate-related issues within your organization?



- ▾ Board-level oversight of climate-related issues within your organization?
- ▾ Plan to introduce board-level oversight in the next two years
- ▾ No and no plan to do so

## Coverage of board-level oversight and management-level responsibility

Almost all financial institutions reporting to CDP have some board-level oversight of climate-related issues. Oversight is most commonly maintained by a board-level committee, at 47% of financial institutions, or the Chief Executive Officer (CEO), at 39% of financial institutions.

However, it is illuminating to investigate what is covered by the boards' oversight.

Board-level oversight covers climate-related issues in financial institutions' own operations more often than it covers those in financing activities. This trend appears across all industry activities, but is most stark for insurance companies and their boards' oversight of insurance underwriting activities.

This is concerning as financial institutions' major climate-related risks, opportunities and impacts occur in their financing portfolios. They should be given adequate time and attention by boards; at least as much attention as operational concerns related to climate change, and ideally more.

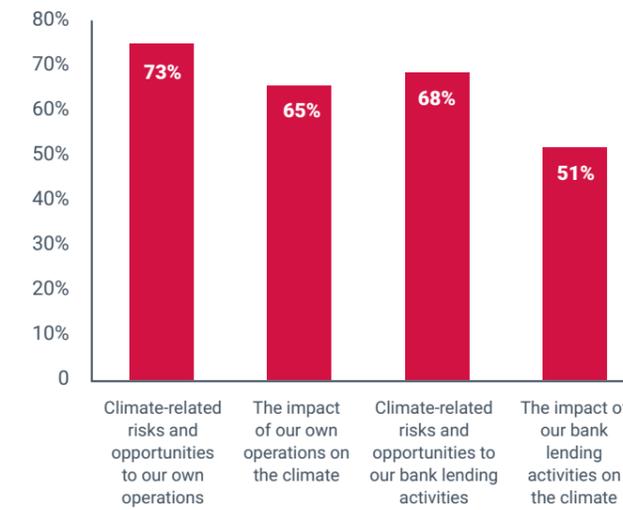
Furthermore, board-level oversight covers the climate-related risks and opportunities to financial institutions more often than it covers the climate-related impact of financial institutions.

This is not unexpected, as boards' primary duty is to shareholders. But in focusing on the impact on financial institutions and not the impact of financial institutions, boards may be neglecting one side of the 'double materiality approach' at the heart of the EU Non-Financial Reporting Directive. A 'double materiality approach' leads to assessing environmental issues as material if either they can influence the development, performance and position of the company materially, or if the company's activities have a material environmental or social impact<sup>7</sup>.

Taken together, these two trends mean that board-level governance at financial institutions most often covers climate-related risks and opportunities in financial institutions' own operations; and least often covers the climate-related impact of financial institutions' financing portfolios. Most extremely, board-level oversight covers the impact of insurance underwriting on climate change at only 31% of insurers.

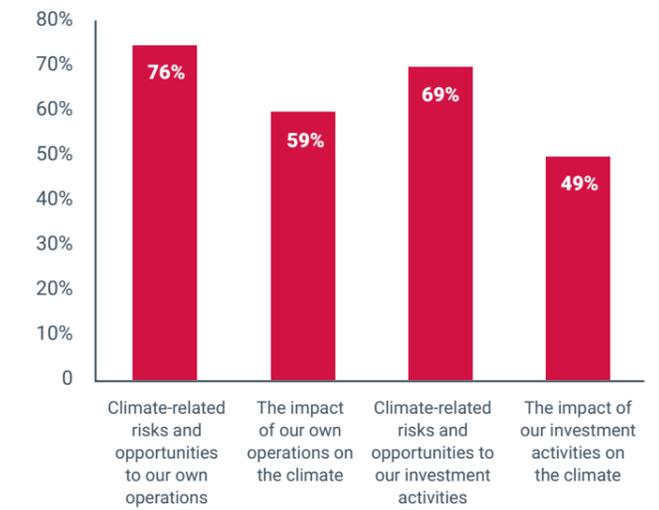
## Banks coverage of board level oversight

% of banks



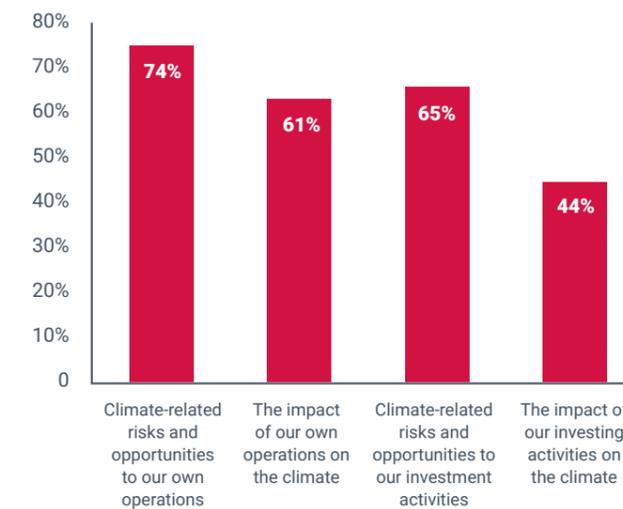
## Asset Owners Coverage of board level oversight

% of asset owners



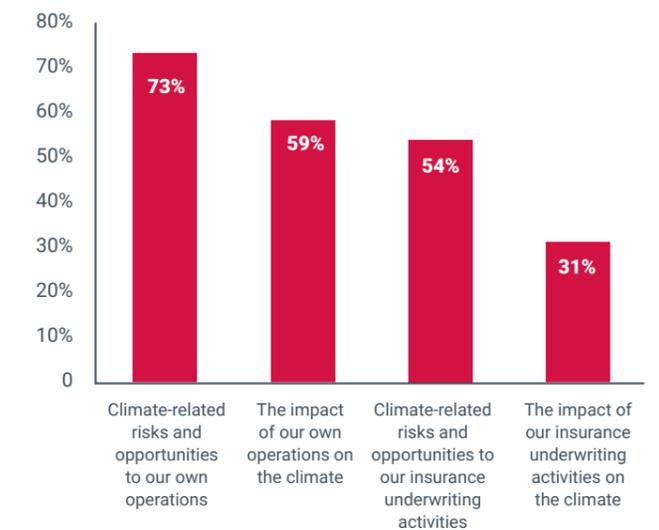
## Asset Managers Coverage of board level oversight

% of banks



## Insurance Coverage of board level oversight

% of insurers



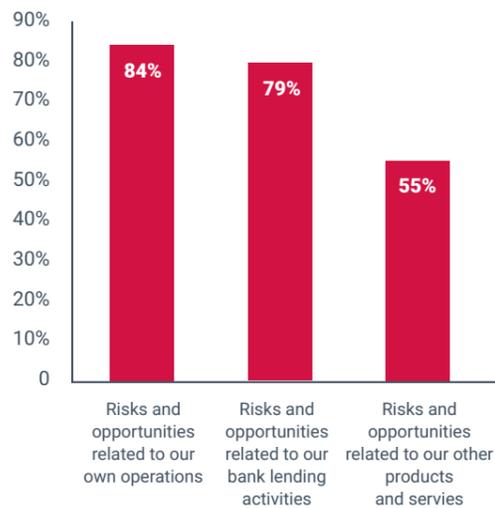
<sup>7</sup> [https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L\\_.2018.328.01.0082.01.ENG&toc=OJ.L:2018:328:TOC](https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=uriserv:OJ.L_.2018.328.01.0082.01.ENG&toc=OJ.L:2018:328:TOC)

# 1 GOVERNANCE

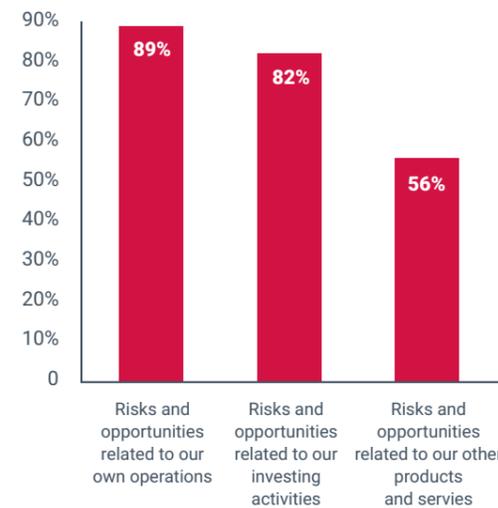
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The TCFD recommends that companies describe management’s responsibilities in assessing and managing climate-related risks and opportunities, in addition to the board’s oversight. At financial institutions reporting to CDP, management responsibility for climate issues is most often given to a management-level sustainability committee (at 40% of financial institutions), followed by the CEO, Chief Risk Officer (CRO) or a range of other C-suite executives.

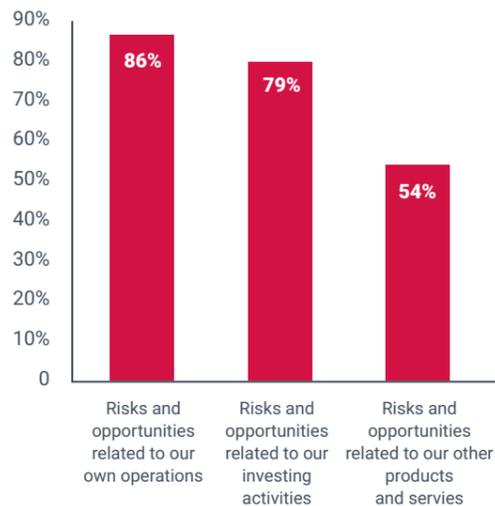
**Banks** Coverage of management level responsibility  
% of banks



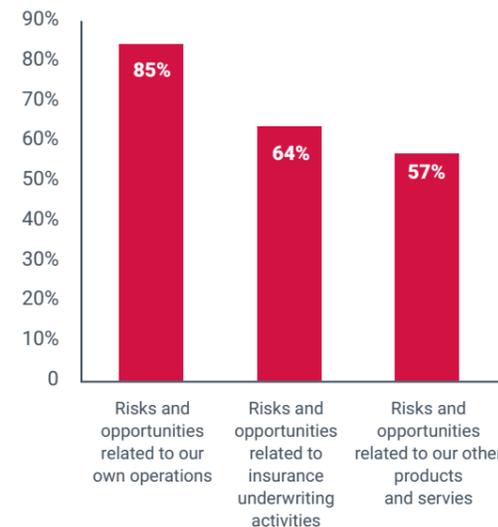
**Asset Owners** Coverage of management level responsibility  
% of asset owners



**Asset Managers** Coverage of management level responsibility  
% of assets managers



**Insurance** Coverage of management level responsibility  
% of insurers



A similar trend emerges that management-level responsibility covers financial institutions’ own operations more often than it does their financing activities. Again, the trend is most stark for insurance companies.

It is encouraging to see that climate-related issues are being considered in the governance structures of financial institutions. However, CDP would encourage boards and senior managers to shift their attention more towards the risks and opportunities in financing portfolios.

## Incentives for the management of climate-related issues

As mentioned, board-level oversight and management-level responsibility for climate-related risks and opportunities affecting financial institutions is most often given to the CEO, CRO or a range of other C-suite executives. Putting in place incentives, especially monetary ones, for managing climate-related issues well is likely to improve outcomes, as it gives the executives responsible a stake in the outcomes.

For financial institutions, incentives should work best if:

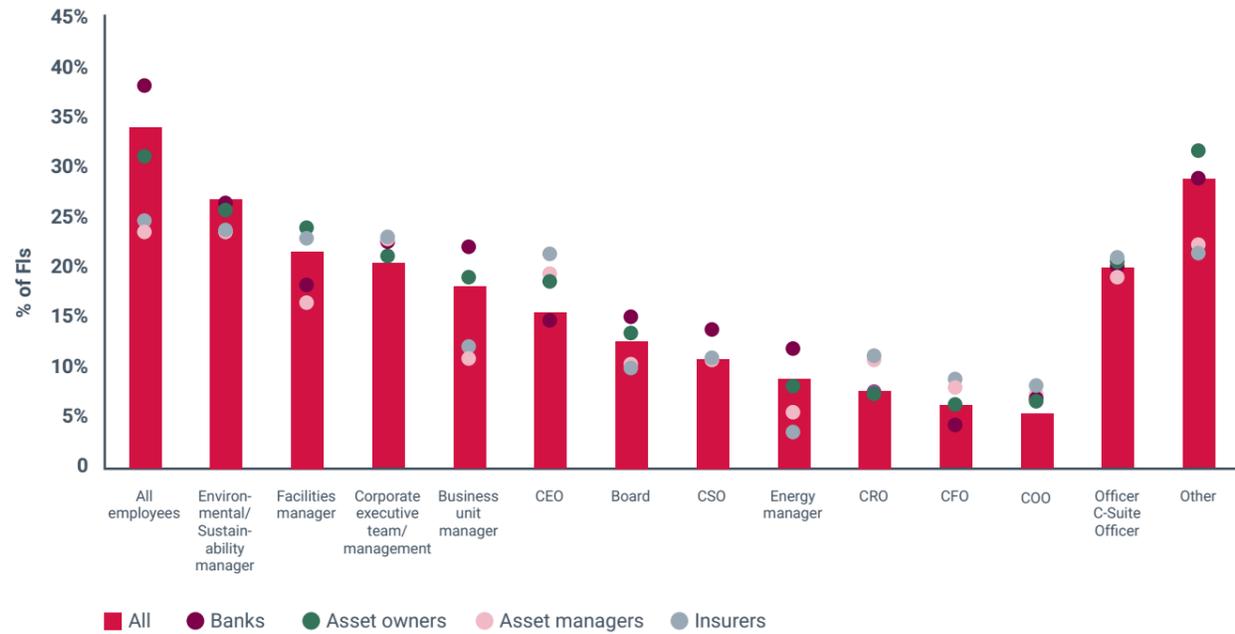
- A. they are offered to those with responsibility for climate-related issues, and:
- B. they are offered on the basis of aligning financing activities with climate-related goals.

Disclosures to CDP by financial institutions suggest that on both counts financial institutions are under-utilising incentives for the management of climate-related issues; and there is still too much focus on operational impact. Incentives for the management of climate-related issues are more often offered to Facilities Managers (those that manage and operate office locations) than they are to both CEOs and CROs, despite the latter two’s wider responsibilities relating to climate change. Further, following achievements against an emission reduction target, the most common metric used in incentive structures is achievements against an energy or efficiency target (incentivized by 45% of financial institutions). This is much more common than incentivizing portfolio alignment to climate-related objectives (21% of financial institutions).

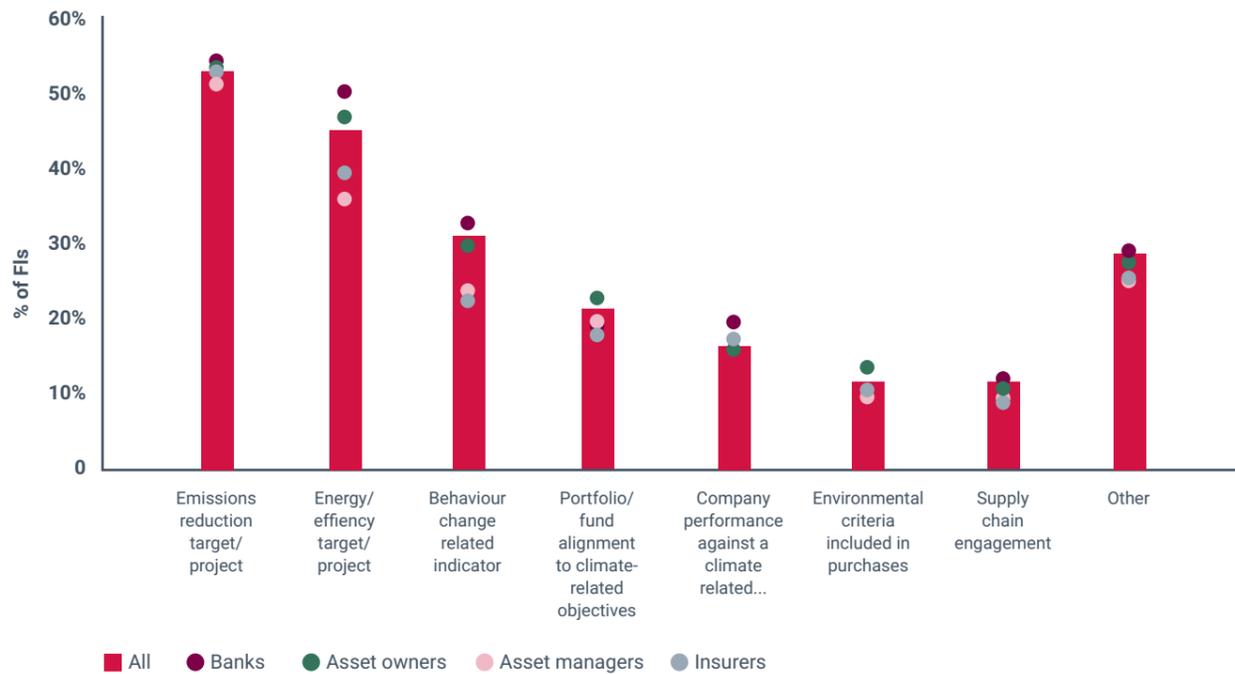
# 1 GOVERNANCE

Continued

Position(s) entitled to incentives for the management of climate-related issues



Activity(s) incentivised by incentives for the management of climate-related issues



It is by no means negative to incentivize energy or efficiency targets. But climate-related metrics should also be incorporated for senior executives responsible for financing activities. Currently, it seems incentive structures for these staff are commonly based entirely on financial metrics. There were also options to disclose where incentive structures for the Chief Investment Officer (CIO) and fund managers were linked to climate metrics, but these were selected by even fewer financial institutions.

CDP urges financial institutions to include metrics related to the climate performance of financing portfolios in the incentive structures of staff managing portfolios. This should be easier now there are some accepted metrics for measuring climate-related risks and impacts in financing portfolios.

## BEST PRACTICE



The highest governing body for climate-related issues at Allianz is the Group ESG Board, made up of Allianz board members including those responsible for Investment Management, Asset Management, Insurance, the CRO and the Chief Operating Officer (COO). These same executives have their remuneration linked to the attainment of climate-related targets. This includes portfolio alignment to climate-related objectives, such as exiting coal for both investments and insurance.

▾▾ The remuneration of all members of the Board of Management are tied to the attainment of sustainability- and climate-related targets, including the successful delivery of our climate change strategy and oversight of implementation of our different climate-related commitments. ▾▾

# 2 STRATEGY

## Inherent risks and opportunities for financial institutions

The TCFD recommends that companies describe their climate-related risks and opportunities, and how they impact strategy. It is interesting to compare the total reported potential financial impact of all risks and opportunities disclosed by financial institutions in 2020<sup>8</sup>.

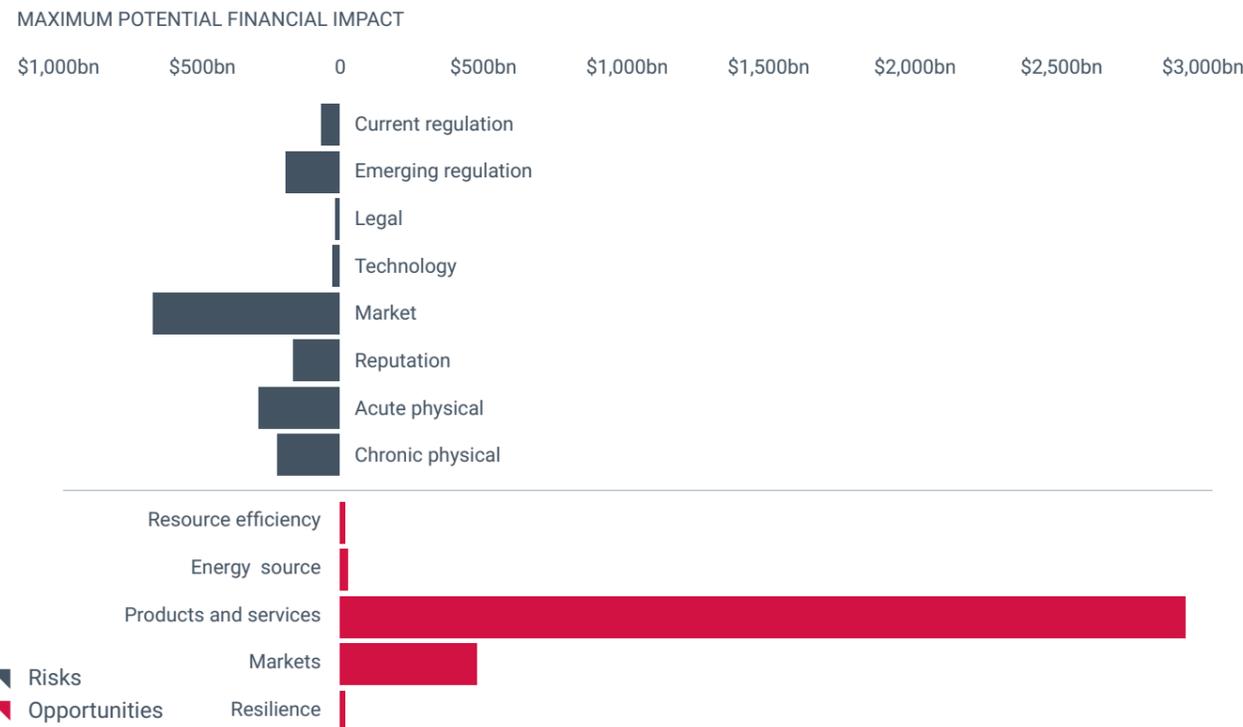
The reported potential financial impact of opportunities far outweighs the reported potential financial impact of risks, almost entirely driven by opportunities related to products and services. This illustrates that financial institutions recognize the need to direct investment towards low carbon technologies, and that there will be commensurate returns on the investments. It explains the explosion in products such as sustainability-linked loans that the market has witnessed recently. Further analysis of the opportunities disclosed reveals positive signs on the likelihood of this financing being realized.

However, the reported opportunities outweighing the risks leads to questions around whether all financial institutions are demonstrating awareness of, and accurately disclosing, the risks in their financing

portfolios. A deeper dive into the risks disclosed suggests some financial institutions are underestimating their risks by continuing to focus on operational concerns. **There should be a focus on both the opportunities and risks in financing portfolios to ensure that we achieve not just green finance, but also finance as a whole becoming green.**

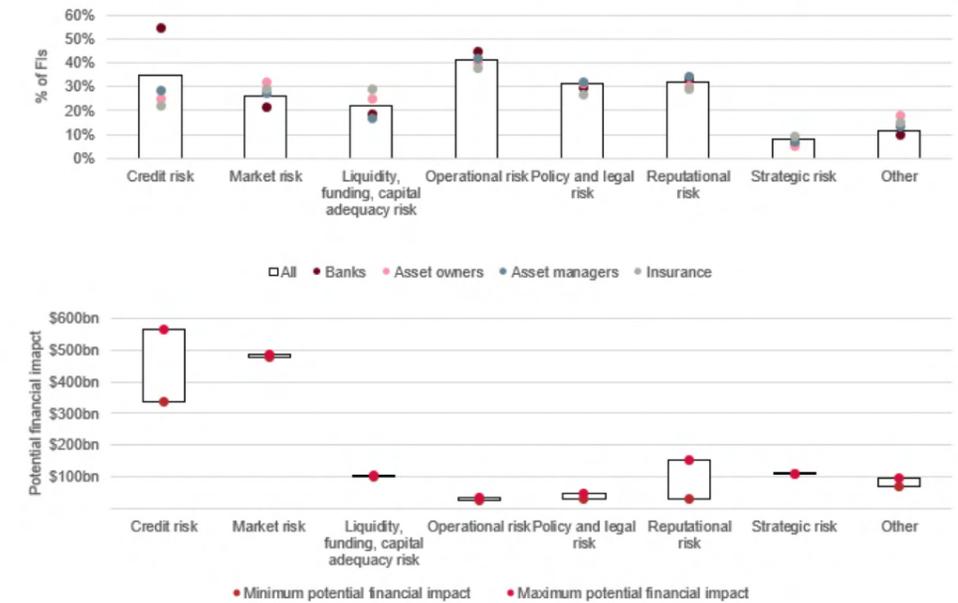
The TCFD recommends that financial institutions consider characterizing their climate-related risks in the context of traditional industry risk categories such as credit, market and operational risk. Characterized in that way, it is most common for financial institutions to identify operational risks (41% of financial institutions) – which would include disruption to their own operations from weather events. These are more commonly identified than credit risks<sup>9</sup> – of loss from a counterparty’s failure to repay (35% of financial institutions), and market risks – of loss from movements in market prices (26% of financial institutions).

Despite operational risks being reported by the most financial institutions, the total potential financial impact is relatively low (up to US\$34bn). The credit and market risks disclosed by financial institutions have the highest potential financial impact (up to US\$1,054bn between credit and market risks). It therefore follows that some banks, asset owners, asset managers and insurance companies have identified risks to their own operations, but have not yet identified risks in their financing portfolios, which will be of a greater magnitude. They therefore underestimate their climate-related risks.



<sup>8</sup> Financial institutions were able to estimate a maximum potential impact for 55% of their reported risks and 58% of their reported opportunities.

Climate-related risks categorized by financial services classification



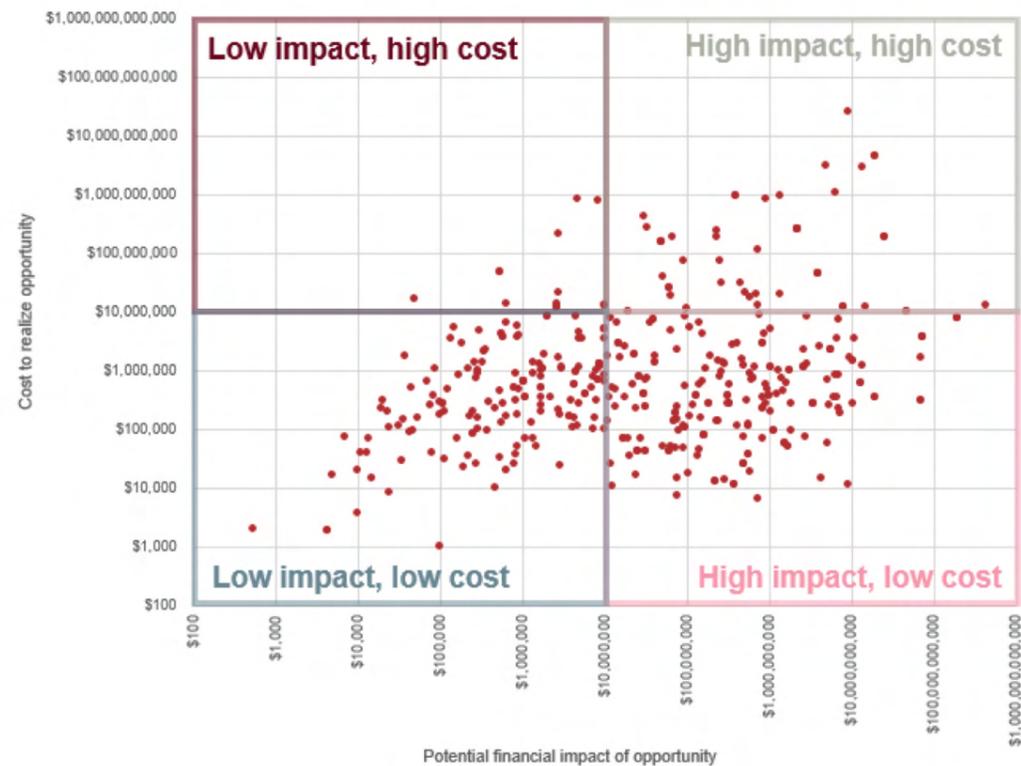
## 2 STRATEGY

Continued

Comparing the reported potential financial impact of opportunities disclosed to the reported cost to realize those opportunities (where both are available<sup>10</sup>) shows encouraging signs that financial institutions will pursue the opportunities around financing products and services. In most cases the potential impact of the opportunity is greater than the cost to realize.

The market should expect sustainable finance products and services to continue to gather momentum. This includes sustainability-linked loans, green and transition bonds, sustainable investment funds and insurance solutions; all opportunities highlighted by disclosing financial institutions. It is important that green finance frameworks remain rigorous as they develop – to ensure that investments result in changes which support the low carbon transition in the real economy. If not, they may be open to accusations of ‘greenwashing’.

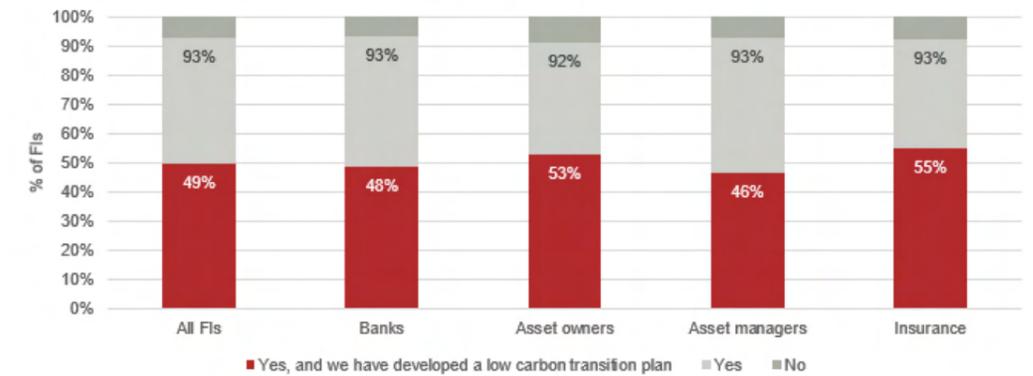
Climate-related opportunities disclosed by financial institutions



### Aligning financing portfolios with low carbon

Financial institutions' strategies should take into account climate-related risks and opportunities. The gold-standard is a low-carbon transition plan – outlining how they can reach net zero emissions and transition their business model to thrive once net zero is reached; 49% of the financial institutions disclosing to CDP indicate they have developed one.

Have climate-related risks and opportunities influenced your organizations's strategy?



### TRANSITION PLANS

Low carbon transition plans outline how a company can reach net zero emissions and transition their business model to thrive once net zero is reached.

Key drivers on corporates and financial institutions of the need for a transition plan are heightened focus from investors, regulation and increased pressure to set ambitious public commitments for net zero, especially in light of the upcoming COP26. The Spanish government is about to require large companies to publish

climate transition plans with emissions reductions targets and the actions planned to achieve them<sup>12</sup>.

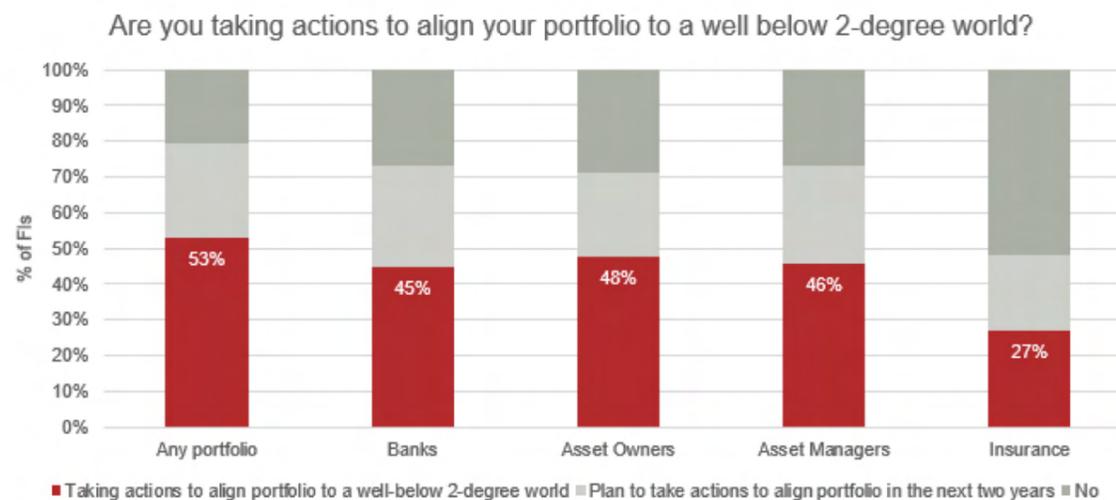
The Say on Climate initiative is calling on companies to publish a low carbon transition plan and put it to an annual shareholder vote. Financial institutions will face the same scrutiny of transition planning from their own shareholders if the initiative is successful. CDP is asking whether transition plans are subject to a shareholder vote for the first time in 2021.

## 2 STRATEGY

Continued

For financial institutions, transitioning their business model means aligning their financing portfolios with a low carbon future. The disclosures show that portfolio alignment are a key part of a low carbon transition plan for financial institutions. Over half (53%) of financial institutions are taking actions to align at least one of their portfolios (lending, investment or insurance underwriting) to a well below 2 degrees Celsius world, and a further 27% plan to do so in the next two years. Financial institutions that have a low carbon transition plan are mostly taking steps to align, while those without a plan are yet to do so.

However, that trend is broken by insurance underwriting. **Insurance companies are the most likely to disclose having a low carbon transition plan (55% of insurers) but only 27% are taking action to align their underwriting portfolio with a well below 2 degrees Celsius world.** Even amongst insurers with a low carbon transition plan, less than half are taking action to align their underwriting portfolio. **This suggests that insurers' transition plans and climate strategies are currently focused on their investments.**



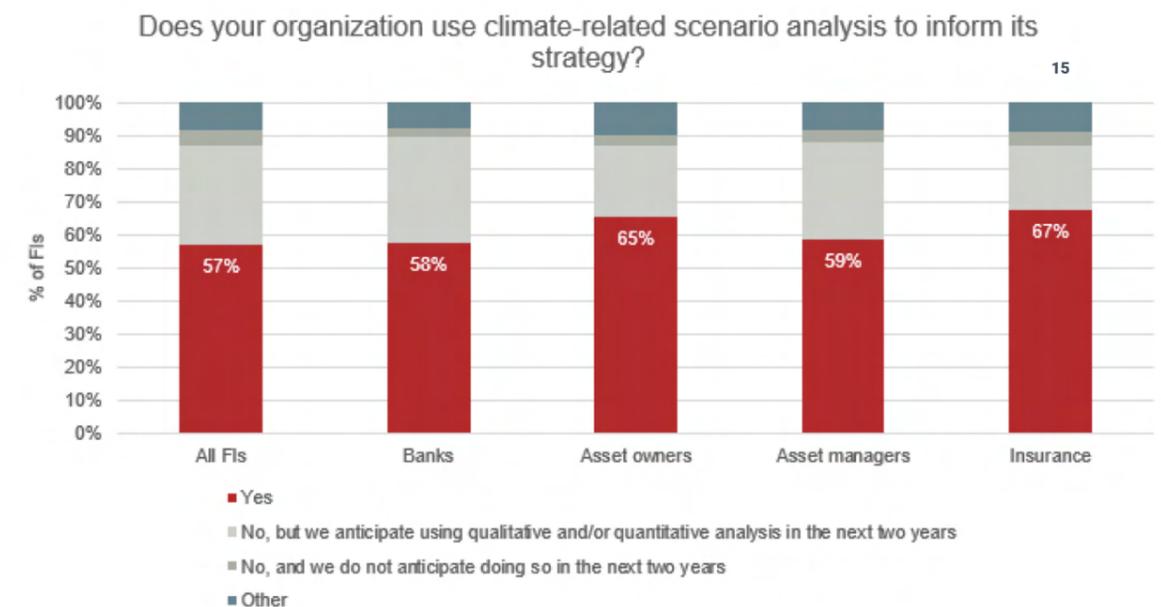
11 [https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment\\_data/file/943723/Letter\\_to\\_Financial\\_Institutions.pdf](https://assets.publishing.service.gov.uk/government/uploads/system/uploads/attachment_data/file/943723/Letter_to_Financial_Institutions.pdf)

12 <https://www.lavanguardia.com/cultura/20210408/6637343/teatros-salas-reclaman-salvoconducto-cultural-causa-confinamiento-comarcal.html>

**CDP believes that aligning financing portfolios with a low carbon future is the key step for financial institutions; and urges them to do so for all their portfolios. Regulators should facilitate this where possible.**

An important tool for aligning portfolios with a low carbon future is scenario analysis. The disclosures show financial institutions track above other industries in their use of scenario analysis<sup>13</sup>. Insurance companies are especially likely to use scenario modelling, likely because climate modelling is a traditional part of their business of risk quantification.

There is also a significant group of financial institutions that plan to start using scenario analysis in the next two years. An effort by financial regulators to include climate scenario stress testing in macroprudential supervision is likely driving this. The Bank of England 2021 [Biennial Exploratory Scenario](#) (BoE CBES) will test the balance sheets of the UK's biggest banks and insurers against scenarios involving different combinations of physical and transition risks over the next 30 years<sup>14</sup>. Other NGFS members are likely to conduct similar exercises in the future.



15 'Other' includes financial institutions that did not see the question due to questionnaire conditional logic and financial institutions that left the question blank.

13 41% of all companies responding to the full CDP questionnaire indicate they use scenario analysis.

14 CDP has been involved in providing company data and temperature ratings to banks and insurers for the BoE CBES.

## 2 STRATEGY

Continued

# 82%

indicate they are engaging with their portfolios on climate-related issues

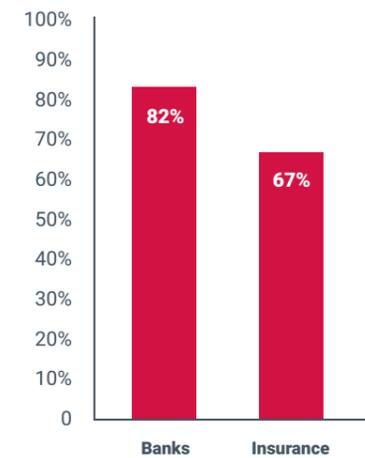
### Engaging with portfolio companies to create a feedback loop and drive de-carbonization

Any strategy to align financing portfolios with a low carbon world will be achieved through some combination of engagement and divestment. The two strategies are mutually reinforcing; not mutually exclusive as they are sometimes viewed – engagement with portfolio companies will be more effective if financial institutions have real red lines and not just empty threats<sup>16</sup>.

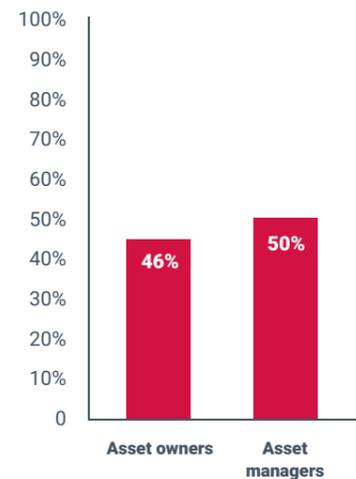
With effective portfolio engagement, financial institutions can be a feedback loop to de-carbonize and enhance the resilience of the economy. They can insist companies are prepared for the low carbon transition. Banks and insurers should be doing this with their clients; investors should be doing it with their investee companies.

It is more common for banks (82% of banks), compared to other industry activities, to indicate they are engaging with their portfolios on climate-related issues.

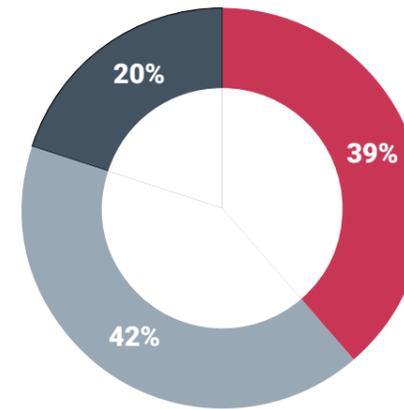
**Do you engage with your clients on climate-related issues?**  
% of FIs



**Do you engage with your investee companies on climate-related issues?**  
% of FIs



### Are climate-related issues factored into your external asset manager selection process?



- ▼ Yes, for all assets managed externally
- ▼ No, for none of our externally managed assets
- ▼ Yes, for some assets managed externally

Fewer institutional investors reported they engage with their portfolios on climate-related issues. For some, this will be because they do not have direct relationships as shareholders but instead use external investment managers or invest through a fund of funds. In those cases, investors should be engaging with their investment managers to ensure the feedback loop is not broken, and their expectations around the need for a low carbon transition reach underlying portfolio companies.

CDP also asks about engagement with external investment managers. The gap in portfolio engagement between banks and institutional investors is not entirely bridged by investors engaging indirectly – only 75% of investors engage either with their investee companies directly or indirectly through their external investment managers. The below chart shows levels of climate-related engagement with external investment managers among just those investors with externally managed assets.

The most commonly disclosed engagement strategy with investee companies is exercising active ownership (19% of investors indicate they do this). Other active ownership related activities including encouraging better disclosure practices, initiating dialogue on climate strategies and supporting climate-related issues in voting are also amongst strategies disclosed, especially by asset managers.

Collective engagement initiatives such as [CDP's Non-Disclosure Campaign](#) and [Science-Based Targets Campaign](#) offer investors an entry-level step into being active owners and using their influence to promote climate action by their portfolio companies.

Closer inspection of investors' disclosures reveals even where they are being active owners, it is not always with all their portfolio. The [Say on Climate](#) initiative can help regularise active ownership across entire portfolios – the initiative's aim is to have all public companies put a low carbon transition plan to an annual shareholder vote as a standard practice.

<sup>16</sup> <https://www.scientificbeta.com/#/publicsurvey?slug=esg-engagement-and-divestment>

## 2 STRATEGY

Continued

The most commonly disclosed engagement strategies with client portfolios are campaigns to educate clients about financial institutions' own climate change strategy (19% of banks and insurers) and climate-positive financing products and services they offer (17% of banks and insurers). It is clear to see how such campaigns are in financial institutions' interest, and they should have a positive effect in driving green finance; but CDP would encourage more financial institutions to also use targeted engagement strategies that incentivize specific desired behaviours. For example, only 3% of banks and 1% of insurers say they encourage better disclosure practices from their clients.

Banks are ahead of insurance companies on almost all engagement strategies with clients. The one exception being engaging with clients on measuring exposure to climate-related risks, which more insurance companies indicate they do.

### BEST PRACTICE



A

Through voting and actively engaging with investee companies, Legal and General encourages companies' management to control risks and benefit from emerging opportunities; and holds them to account on their decisions.

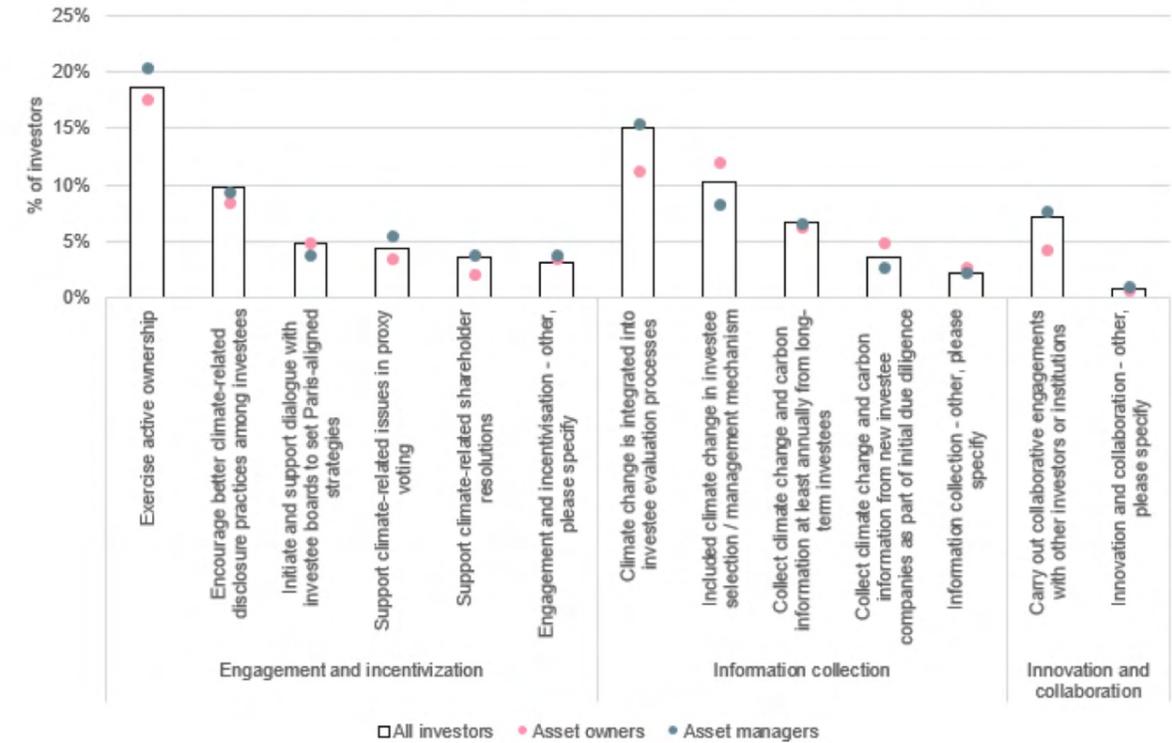
Legal and General reported to CDP in 2020 that it held 739 engagements with companies on their ESG standards. One example is their engagement with ExxonMobil:

▾▾ The company's refusal to disclose and set targets for its total carbon emissions is a source of concern as the energy transition accelerates. In May 2020, we announced we will be supporting

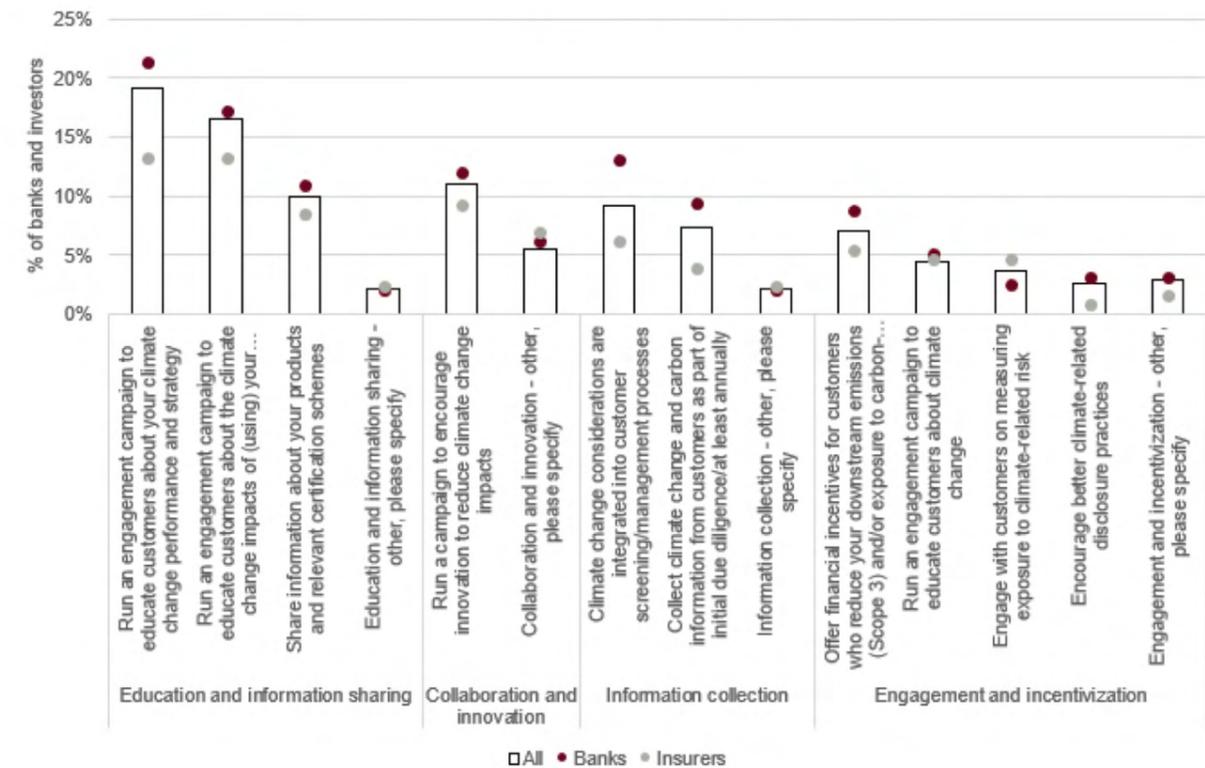
shareholder proposals for an independent chair and a report on the company's political lobbying. Our voting intentions were the subject of over 40 articles in major news outlets, with a number of asset owners in Europe and North America also declaring their intentions to vote against the company. We believe this sends an important signal, and will continue to engage, both individually and in collaboration with other investors, to push for change at the company ▾▾

Legal and General also engages through both the [Non-Disclosure Campaign](#) and [Science-Based Targets Campaign](#).

Climate-related engagement strategies with investee companies



Climate-related engagement strategies with clients



## 2 STRATEGY

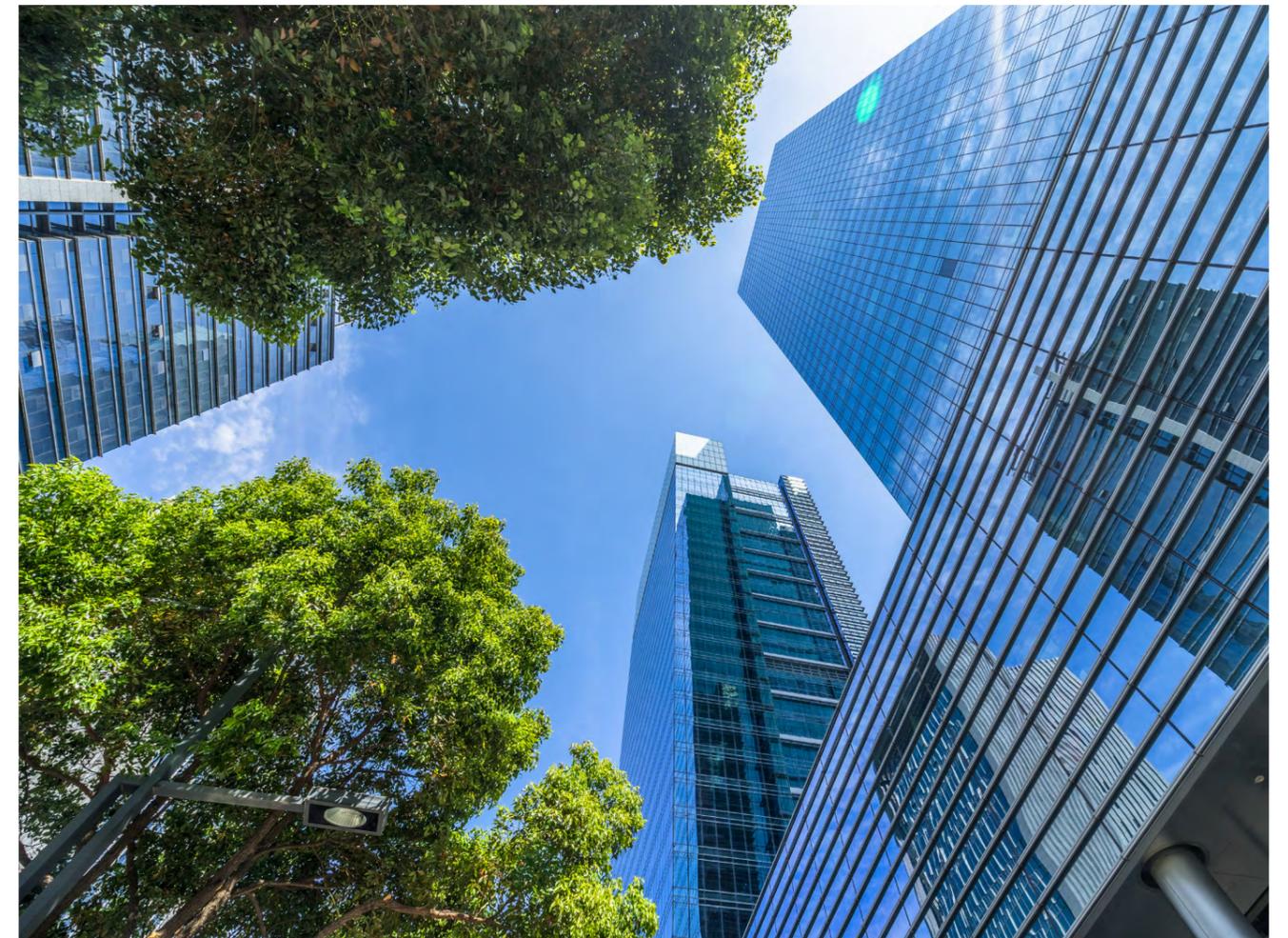
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### Diverting capital away from activities contributing to climate change

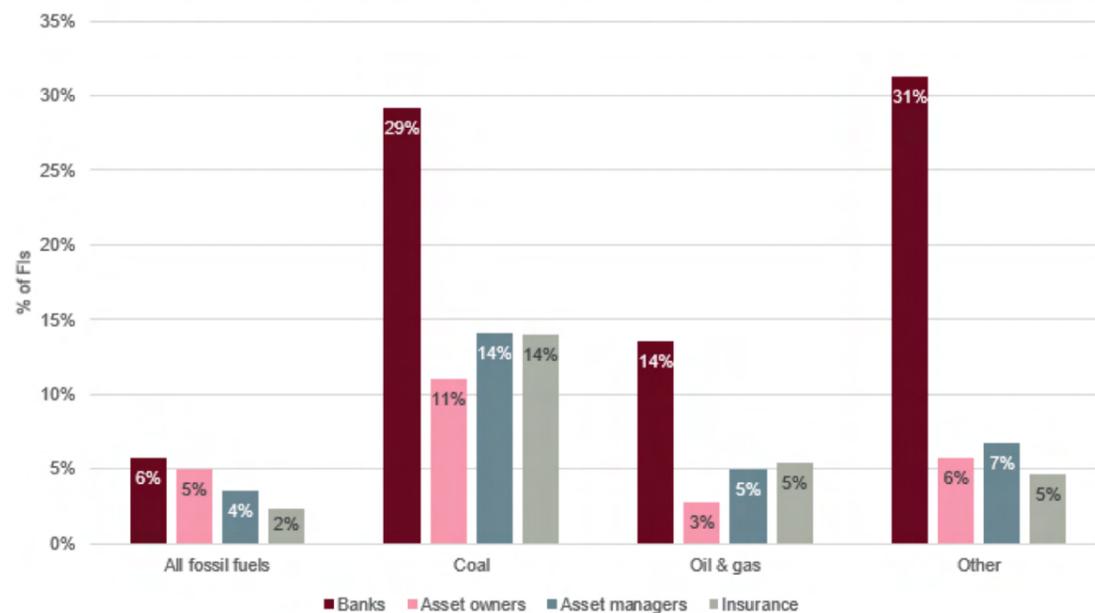
The other strategy for aligning financing portfolios with a low carbon world is divestment, often achieved in practice through exclusion policies. It is true that divesting leaves financial institutions with less leverage to enact change in the real economy and may also leave polluting companies in the hands of owners less concerned about climate change. But some activities are not compatible with limiting global average temperature rises to 1.5 degrees Celsius above pre-industrial levels, and capital must be directed away from those. All financing of fossil fuel companies should now be focused on how they transition their business model towards renewables.

Disclosures to CDP show exclusion of coal is easily the most prominent divestment tactic. They also show the banking industry is currently using exclusion policies much more than the other industries with 29% of banks reporting an exclusion policy related to coal. For other industry activities, it is less than 15%.

Apart from fossil fuels, 31% of banks disclosed environmental exclusion policies related to various other industries including agri-industries, forestry, metals and mining.



Exclusion policies related to activities contributing to climate-related risks

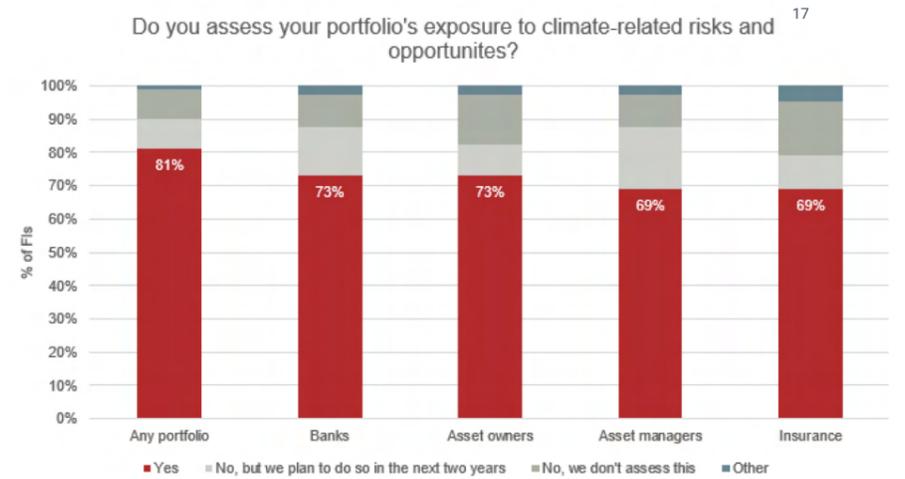
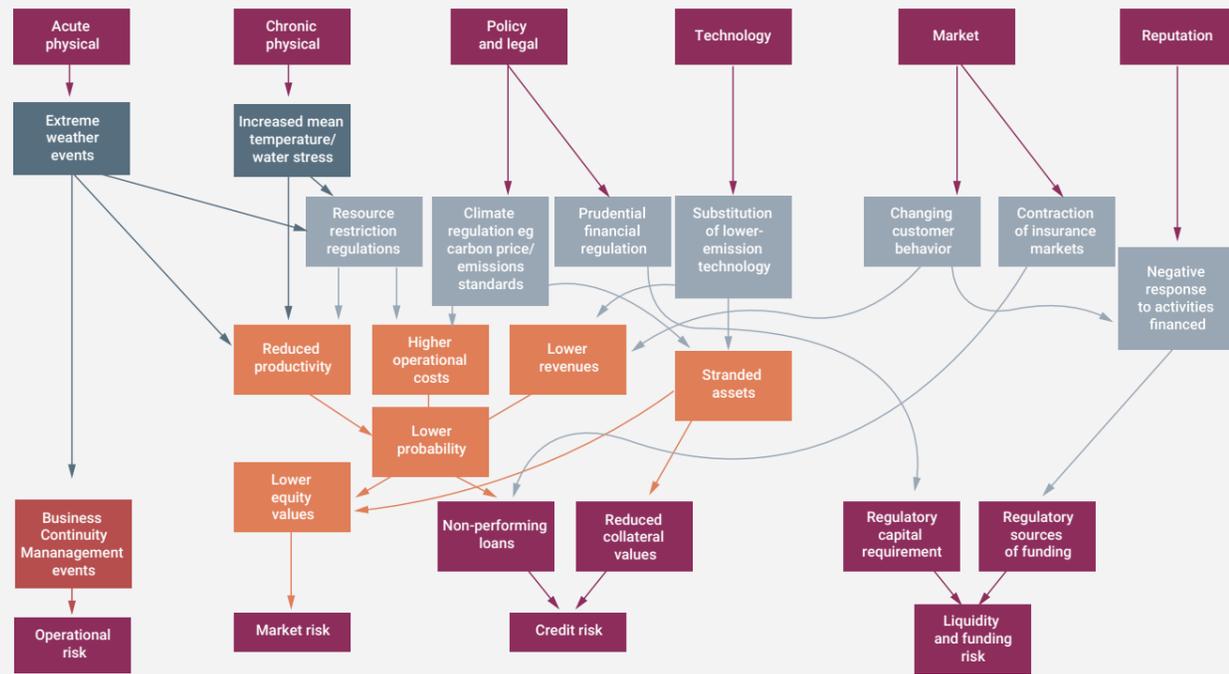


# 31%

**Apart from fossil fuels, 31% of banks disclosed environmental exclusion policies related to various other industries including agri-industries, forestry, metals and mining.**

# 3 RISK MANAGEMENT

Examples of climate-related risks for financial institutions



Risk management in the financial sector is a complicated and much-scrutinized undertaking. Financial institutions often apply a three-lines-of-defence model – business teams being the primary risk owners, risk teams as the second line, and audit teams providing assurance that risk management processes are adequate and effective.

Climate risk is not diversifiable for financial institutions, as it affects nearly all industries and geographies. This means it is critical they manage it effectively, incorporating climate-related considerations across all three lines of defence. Most important is that climate change is considered in processes to identify, assess and manage risks in financing portfolios, such as portfolio analysis and transaction or investment due diligence and risk assessments.

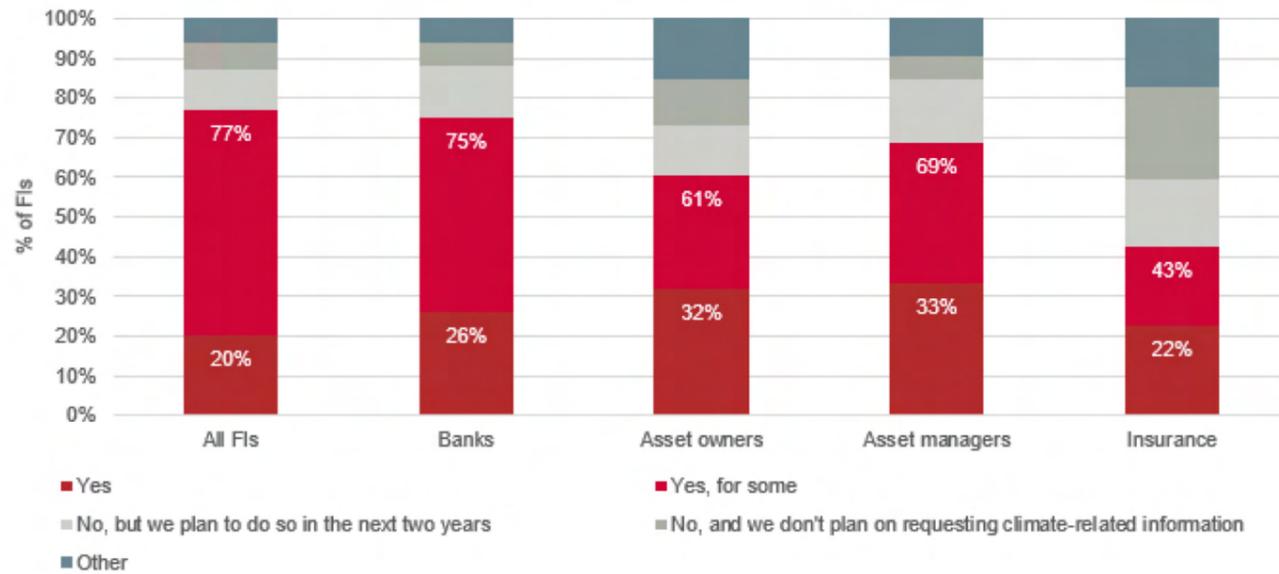
81% of disclosing financial institutions assess exposure to climate-related risks in at least one of their portfolios (lending, investment or insurance underwriting). Portfolio assessments range from descriptive analyses of which client or investee segments will be most impacted by the net zero carbon transition, to detailed numeric analysis of how assets perform under possible future scenarios, involving probabilistic or stochastic modelling. Disclosures indicate most assessments conducted by financial institutions already involve a quantitative element.

<sup>17</sup> 'Other' includes financial institutions that do not believe climate change is applicable to their portfolio and financial institutions that left the question blank.

# 3 RISK MANAGEMENT

Continued

Do you request climate-related information from your clients/investees as part of your due diligence/risk assessment practices? <sup>18</sup>



Surprisingly, there is a significant minority of institutions that do not assess their exposure to climate-related risks. Some indicate that they believe climate change is not relevant or applicable to them. Investors and stakeholders should be asking questions of these institutions.

77% of financial institutions request climate-related information from their clients or investees when conducting transaction or investment due diligence and risk assessments. Banks are the most likely to collect information from at least some of their clients (75% of banks), while investors are the most likely to collect information from all their portfolio (32% of asset owners and 33% of asset managers).

Environmental leaders are not just using due diligence to check companies meet the minimum acceptable environmental standards<sup>19</sup>, but are assessing whether clients and investees have strategies for the net zero carbon transition. Requesting this information up front will not only identify risks, but will massively help financial institutions in engaging with companies and structuring the financial products they need to realize their transition plans. 30% of disclosing banks assess if their borrowers' strategies are aligned to a well below 2 degrees Celsius world. 34% of disclosing asset managers assess

<sup>18</sup> 'Other' includes financial institutions that do not believe climate change is applicable to their portfolio and financial institutions that left the question blank.

if their investees' strategies are aligned to a well below 2 degrees Celsius world. Understanding this will be crucial in achieving financial institutions own transition plans – and CDP data is a useful way to assess portfolio companies' strategies for aligning with net zero.

Insurance companies are less likely to request climate-related information from their insurance clients. Some of the gap is attributable to line of business – it is unclear what climate-related information insurers should be requesting from life and health customers. However, some of the gap is possibly attributable to the ultimate holders of insurance risk not having direct relationships with the insured party. Instead, exposure is sourced through insurance brokers or using re-insurance arrangements. (Re)insurance companies should insist their brokers incorporate environmental considerations in their processes. This is analogous to asset owners insisting external investment managers do the same – but has so far been given much less attention.

## BEST PRACTICE



**BNY Mellon uses an ESG research process that requires consideration of climate risk factor as part of due diligence. Environmental risk considerations are part of the process of ongoing review and monitoring company risk scores.**

Investment teams review company reports, third-party data, dedicated climate change research, and they speak to company management, external analysts, consultants, subject matter experts or NGOs to better understand and evaluate potential risks. Once an investment is made, Newton20 monitors an investment's climate change performance through regular engagements and annual ESG data updates.

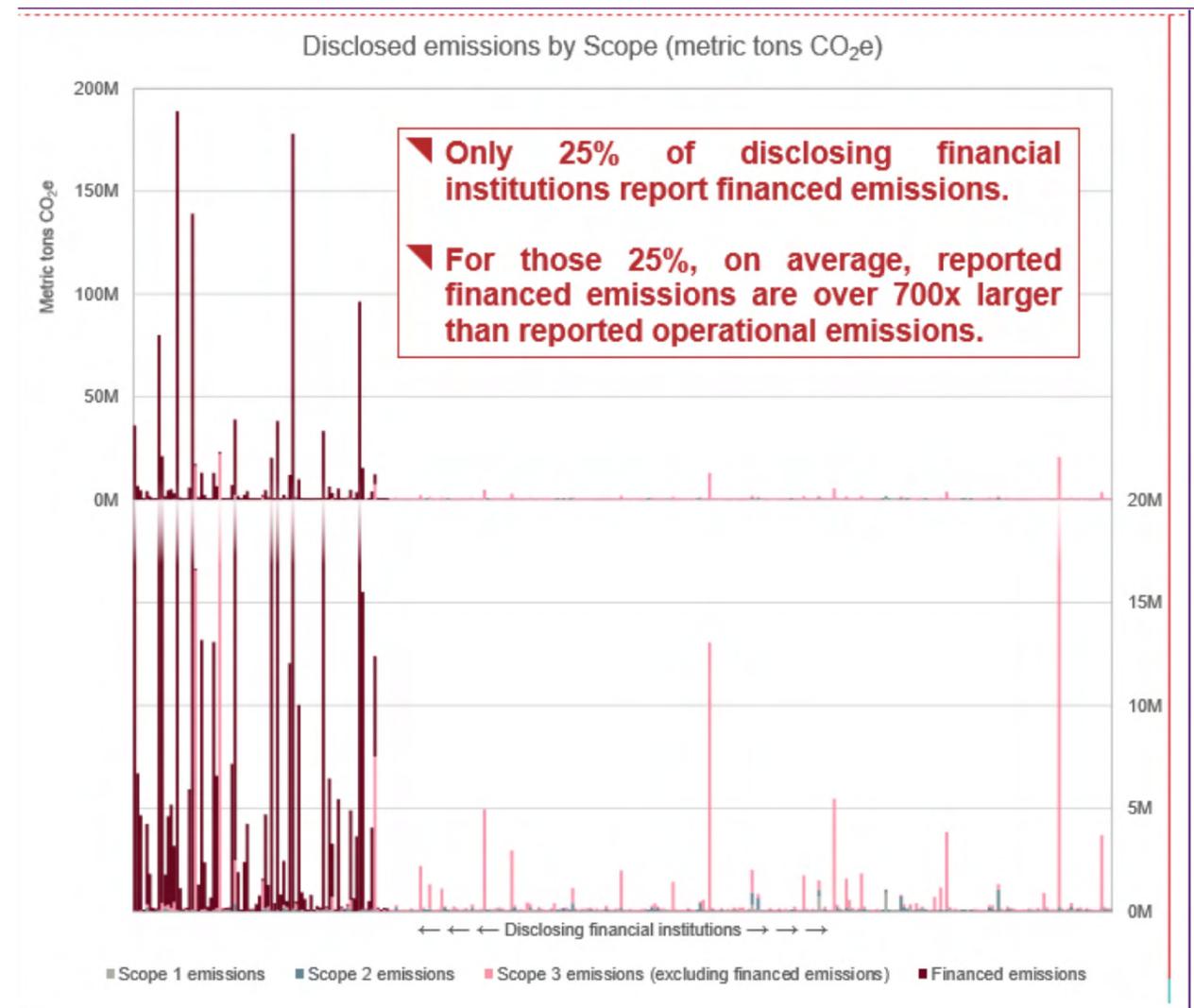
<sup>19</sup> This would be the outcome if environmental due diligence were seen only as an extension of traditional Know Your Client (KYC) requirements.

<sup>20</sup> A subsidiary of BNY Mellon.

# 4 METRICS AND TARGETS

Since the TCFD's recommendations, there have been important developments in climate-related metrics for assessing financing portfolios. The key metrics aim to describe the level of greenhouse gas (GHG) emissions in portfolios<sup>21</sup>. More recent developments build on this point-in-time assessment by aiming to describe how GHG emissions in portfolios are expected to evolve and what this means for the temperature alignment of portfolios.

## Financed emissions



<sup>21</sup> Financial institutions cause GHG emissions indirectly through their lending, investments and insurance underwriting. Under the GHG Protocol, these emissions are classified as indirect Scope 3 emissions in Category 15 – Investments. Elsewhere, they are often referred to as financed emissions or portfolio emissions.

# 49%

**of financial institutions indicate they do not conduct any analysis of how their portfolio impacts the climate at all.**

Given CDP's reach, it is ideally placed to provide data users with comparable disclosures of climate-related portfolio metrics. A core objective of the Financial Services Climate Change Questionnaire is to build a structured, comparable dataset of financial institutions' Scope 3 financed emissions.

Owing to the physics of climate change, the most intuitive way to measure the impact of financing portfolios is to measure the absolute financed emissions of the portfolio. This also helps quantify transition risks, as portfolio companies with significant emissions are likely to be impacted most by policy, market and technology responses to limit climate change.

Financed emissions must be calculated first to then calculate additional intensity metrics. There are good reasons to normalize financed emissions and report emissions intensities, but this should be *in addition* to reporting absolute emissions, not in place of. Otherwise, financial institutions are not adhering to the completeness principle in the GHG Protocol, or to the TCFD's recommendation "Disclose Scope 1, Scope 2, and if appropriate, Scope 3 GHG emissions."

CDP's analysis of the data makes it clear that disclosing scope 3 emissions is always appropriate for financial institutions. They are far and away the most significant source of emissions for these companies. This has been understood for a long time but is shown more clearly than ever by disclosures to CDP in 2020.

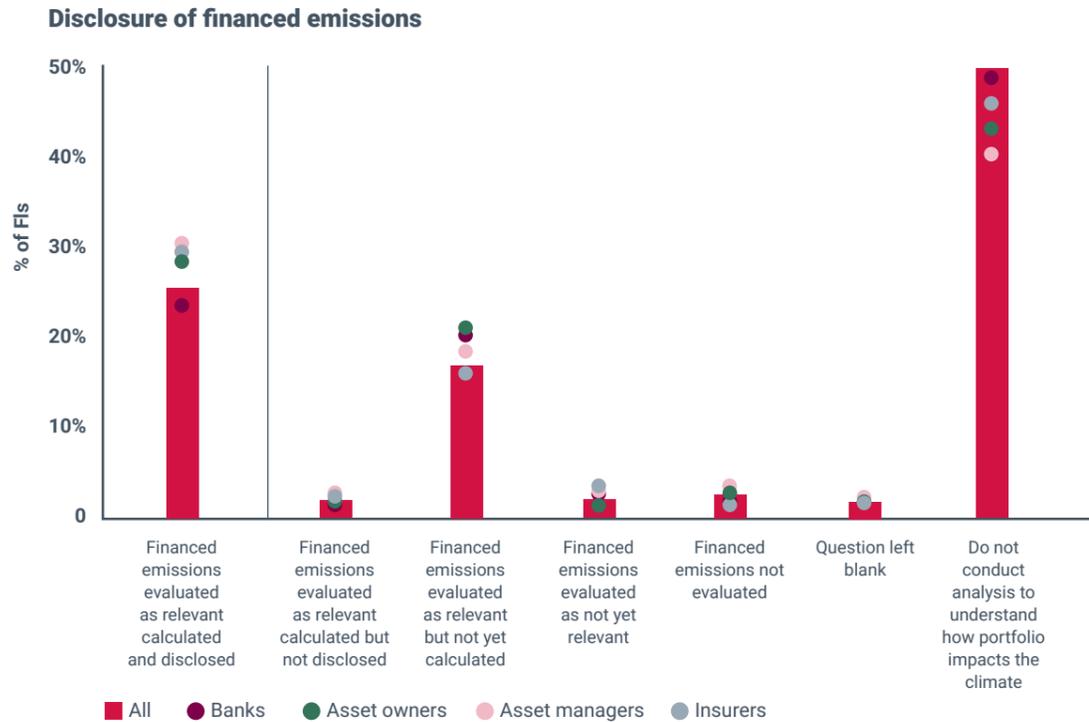
**For the 25% of financial institution that do report them to CDP, financed emissions are over 700x larger than operational emissions on average, despite the calculations not covering their entire portfolios. The most common response was that the calculation covered less than 10% of the portfolio.**

**49% of financial institutions indicate they do not conduct any analysis of how their portfolio impacts the climate at all<sup>22</sup>. This is striking as it indicates much of the sector's climate impact is lurking out of view.**

<sup>22</sup> Although 34% plan to start conducting analysis in the next two years. The emergence of a standard should aid this.

# 4 METRICS AND TARGETS

Continued



Asset owners, asset managers and insurers<sup>23</sup> are currently slightly ahead of banks in measuring financed emissions. This is unsurprising as portfolio footprinting methodologies developed for equities first, however the PCAF methodology is now available for lending and investment portfolios.

For financial institutions that do not currently measure their financed emissions the message is clear – they must start doing so to understand their overall impact on climate change; and the risks they face. CDP suggests they use the [Global GHG Accounting and Reporting Standard](#) developed by the Partnership for Carbon Accounting Financials (PCAF).

<sup>23</sup> In all cases insurers disclose financed emissions associated with their investment portfolio rather than their underwriting portfolio. There is currently no accepted methodology or standard for calculating emissions associated with insurance underwriting. This is a big gap, although some developments have been made by the CRO Forum recently: <https://www.thecroforum.org/wp-content/uploads/2020/05/CRO-Carbon-Foot-Printing-Methodology.pdf>



PCAF is an industry-led initiative created in 2015 by Dutch financial institutions and now includes a global group of bank and investor members. The partnership works together to develop and implement a harmonized approach to assessing and disclosing the GHG emissions associated with loans and investments. PCAF has developed its accounting methods into the Global Carbon Accounting Standard for the financial industry covering listed equity and bonds, business loans, private equity, project finance, commercial real estate, mortgages and motor vehicle loans.

Financial institutions can join PCAF by committing to assess and disclose the GHG emissions of their portfolio using the methodology. Those that join receive technical support in implementing carbon accounting. CDP's climate change questionnaire for financial institutions is aligned with the PCAF's Global Carbon Accounting Standard and allows financial institutions to report their financed emissions in a way compatible with the standard.

## BEST PRACTICE



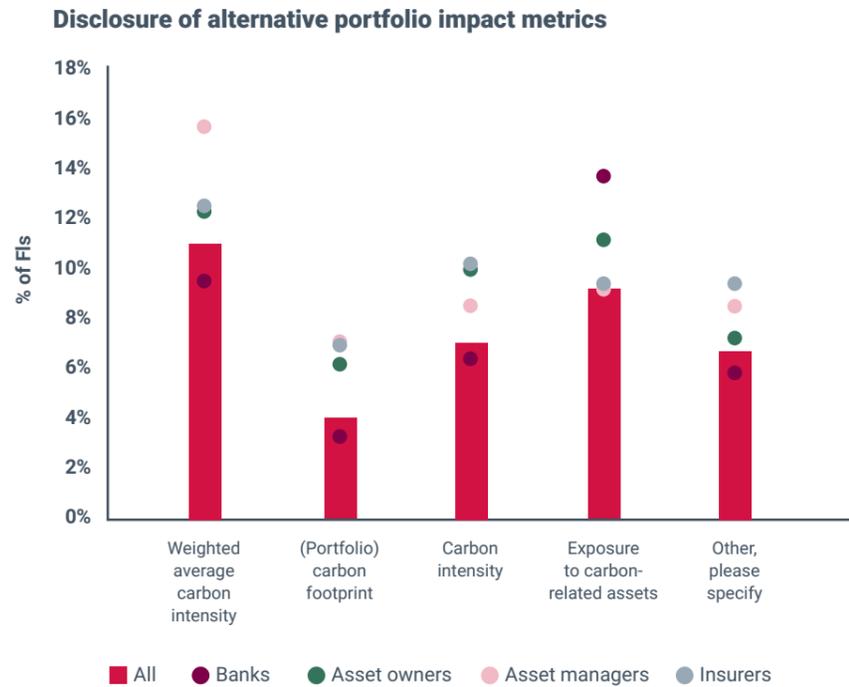
Using the methodologies it helped to develop as part of PCAF, ABN AMRO discloses the emissions associated with more than 70% of its portfolio exposure:

▾▾ For bank lending, the business lines commercial banking, corporate and institutional banking and retail mortgages are in scope. For asset management, listed equity and fixed income are included in the calculation. ▾▾

Reported financed emissions are 36 million metric tons CO<sub>2</sub>e – over 1,000x larger than its reported operational emissions.

# 4 METRICS AND TARGETS

Continued



## Additional portfolio impact metrics

Additional portfolio impact metrics normalize absolute financed emissions to calculate an emissions intensity metric for the portfolio<sup>24</sup>. This is useful for comparing portfolios of different sizes. How financed emissions is normalized depends on what is being analysed and communicated. For example, to understand a portfolio’s carbon footprint per amount invested, it is necessary to normalize by the portfolio market value. To understand the efficiency of a portfolio in emissions per unit of output, it is necessary to normalize by portfolio companies’ revenues.

The most common additional metric disclosed by asset owners, asset managers and insurers is weighted average carbon intensity (WACI) (15% of asset owners, 12% of asset managers and insurers<sup>25</sup>). The TCFD recommends it to asset owners and managers above other metrics.

It is worth noting that the figures disclosed by financial institutions for these intensity metrics are not always comparable to one another and this is for different reasons.

Firstly, financial institutions are not all defining and expressing the metrics in the same way. The TCFD has released very clear descriptions and definitions, including the units they should be expressed in. For example, WACI is expressed in tons CO<sub>2</sub>e per million units of currency revenue. It is clear from the disclosures that financial institutions are not using the terminology consistently; some define the metrics differently and express them in different units (e.g. tons CO<sub>2</sub>e per million units of currency invested or per unit of economic activity). This will make comparisons difficult for data users. WACI is the most consistently understood metric, with 72% expressing it with the correct units. But other portfolio impact metrics are less well understood.

Secondly, financial institutions are measuring different parts of their portfolios. For example, YES Bank calculate the WACI of their non-renewable electricity generation portfolio only – a very carbon intensive sector – so the disclosed WACI will naturally be higher than financial institutions disclosing a figure for all their portfolio.

For data users to have comparable data, the market must coalesce and adopt more consistently the terminology used by the TCFD for these metrics. Financial institutions should also work towards reporting on more of their portfolio, while giving breakdowns by fund, asset class or sector where these are useful. CDP has provided guidance in a [Technical Note on Portfolio Impact Metrics](#).

<sup>24</sup> Apart from exposure to carbon-related assets, which is a simpler metric not relying on emissions data at all.

<sup>25</sup> In all cases insurers disclose WACI associated with their investment portfolio rather than their underwriting portfolio.

# 4 METRICS AND TARGETS

Continued

METRIC	DESCRIPTION	UNITS
Weighted average carbon intensity	Portfolio's exposure to carbon intensive companies	tCO <sub>2</sub> e/million unit currency revenue
(Portfolio) carbon footprint	Total carbon emissions for the portfolio normalized by the market value of the portfolio	tCO <sub>2</sub> e/million unit currency invested
Carbon intensity	Volume of carbon emissions per million unit currency of revenue (carbon efficiency of a portfolio)	tCO <sub>2</sub> e/million unit currency revenue
Exposure to carbon-related assets	The amount of carbon-related assets in the portfolio	Million unit currency or % of portfolio value

The most common alternative metric disclosed by banks is exposure to carbon-related assets (14% of banks). Here too there are issues of comparability for data users as not all banks use the same definition for carbon-related assets. Although most are adopting the definition suggested by the TCFD<sup>26</sup>. It would help data users if this trend continued.

## CDP TEMPERATURE RATINGS

More recent developments in portfolio metrics build on those above by aiming to describe how GHG emissions in portfolios are expected to evolve and what this means for the temperature alignment of portfolios.

There has been a growing interest in temperature alignment<sup>27</sup>, partly because it is forward-looking and partly because it is intuitive and easy to explain to investors and other stakeholders, despite the underlying calculations being complex.

This interest is reflected in 2020 CDP disclosures; some financial institutions use the 'Other' option

in the questionnaire to disclose the warming potential of their portfolios.

There are challenges of data availability, as there will always be when dealing with future emission levels – much hinges on assumptions and extrapolations. CDP believes forward-looking metrics are however decision-useful. The CDP Temperature Ratings dataset helps overcome data availability challenges by using highly detailed company target data on all three GHG emissions Scopes and using a transparent, expert-reviewed protocol for translating it into an implied temperature rise.



## Climate-related targets for financial institutions

Financial institutions set many different types of targets to manage their climate-related risks, opportunities and impacts. This includes targets to reduce their own operational impact, targets to provide green financing and targets to align their portfolios with climate-related goals such as the Paris Agreement.

As most of financial institutions' impact occurs in their portfolios, it is those targets which will unlock the system-wide change needed to reach net zero.

CDP already collects extensive disclosures from financial institutions about their climate-related targets. In future years, targets related to financing portfolios will be broken out from existing questions into a stand-alone question on the topic. This is warranted given the importance, and timely given the multiple frameworks emerging for financial institutions to target portfolio alignment with climate goals. The Science Based Targets initiative (SBTi) launched its [framework for financial institutions](#) in 2020 and is preparing a net zero foundations paper for financial institutions that will be released in draft at COP26. In addition to this framework, protocols are being launched by the Net Zero Asset Owner Alliance, the Net Zero Banking Alliance and the Paris Aligned Investment Initiative. Both the Investor Agenda and the Net Zero Asset Manager Initiative require their members to report on the interim targets they set in transitioning their portfolios to net zero, and this can be through CDP.

*The SBTi's framework for financial institutions is a public and open protocol allowing financial institutions – including banks, investors, insurance companies and pension funds – to set science-based targets to align their lending and investment activities with the Paris Agreement.*

*A team of experts provide independent assessment and validation of the targets, to ensure ambitions are truly in line with the latest climate science.*

*CDP is a founding partner of the SBTi, along with the United Nations Global Compact (UNGC), the World Resources Institute (WRI) and the World Wide Fund for Nature (WWF).*

<sup>26</sup> The TCFD suggests defining carbon-related assets as those assets tied to the energy and utilities sectors under the Global Industrial Classification System, excluding water utilities, independent power and renewable electricity producer industries.

<sup>27</sup> <https://www.fsb.org/wp-content/uploads/P291020-4.pdf>

# TFCD OVERVIEW

Continued

	Banks	Asset owners	Asset managers	Insurance
<b>Disclosing financial institutions</b>				
Disclosing	192	142	181	129
Total assets	\$82 trillion	\$51 trillion	\$64 trillion	\$45 trillion
<b>Governance</b>				
Have board-level oversight of climate-related issues	96%	99%	97%	95%
Board-level oversight covers risks and opportunities to financing portfolio <sup>28</sup>	68%	69%	65%	54%
Board-level oversight covers impact of financing portfolio <sup>28</sup>	51%	49%	44%	31%
<b>Strategy</b>				
Total potential financial impact of risks disclosed	\$616 - 991bn	\$584 - 837bn	\$1,004 - 1,311bn	\$574 - 817bn
Total potential financial impact of opportunities disclosed	\$1,823 - 1,979bn	\$1,915 - 1,923bn	\$2,469 - 2,655bn	\$1,690 - 1,712bn
Have a low carbon transition plan	48%	53%	46%	55%
Are aligning financing portfolio with a well below 2°C world <sup>28</sup>	45%	48%	46%	27%
Use scenario analysis	58%	59%	65%	67%
Engage with portfolio on climate-related issues <sup>29</sup>	82%	46% <sup>30</sup>	50% <sup>31</sup>	67%
<b>Risk management</b>				
Assess portfolio exposure to climate-related risks <sup>28</sup>	73%	73%	69%	69%
Request climate-related information as part of portfolio due diligence <sup>28</sup>	75%	61%	69%	43%
<b>Metrics and targets</b>				
Disclose financed emissions	23%	30%	28%	29%
Disclose WACI	9%	15%	12%	12%
Disclose exposure to carbon-related assets	14%	9%	11%	9%
Committed to setting an SBT <sup>32</sup>	17%	13%	13%	15%

<sup>28</sup> Financing portfolio means bank lending portfolio for banks, investment portfolio for asset owners and asset managers, insurance underwriting portfolio for insurance companies.

<sup>29</sup> With clients for banks and insurance companies, with investee companies for asset owners and asset managers.

<sup>30</sup> 74% if asset owners that do not engage with companies but engage with external investment managers are included.

<sup>31</sup> 74% if asset managers that do not engage with companies but engage with external investment managers are included.

<sup>40</sup> Figure calculated using public commitments announced on SBTi website, not through the CDP questionnaire.

# HOW CDP CAN HELP THE FINANCE SECTOR UNLOCK A NEW ECONOMY

**To take the necessary actions highlighted in this report, financial institutions require accurate environmental data. CDP has provided the most comprehensive and comparable environmental data and insights to capital markets for over 20 years.**

Looking forward to the next ten years, there must be an important shift in how financial institutions are viewed. In addition to viewing financial institutions as users of environmental data, they must be seen as providers of disclosure and key actors in achieving the low carbon transition. In a sense, the mirror must be turned back on the financial sector to create a network effect and system wide change. The 2020 questionnaire signals the start of this shift at CDP. It can also be seen in the COP26 private finance agenda.

At the same time, CDP recognizes the impact its system has huge on helping financial institutions provide meaningful disclosures, manage the risks and take the opportunities the net zero carbon transition will bring. Financial institutions can work in partnership with CDP to get the disclosures they require, from specific companies and clients, for their specific purpose or need – be that measuring and disclosing their Scope 3 financed emissions, assessing transactions and investments, or stress testing their portfolios. CDP’s Supply Chain Program provides a model of how such partnerships could possibly work in the future.

As data is collected from portfolio stress-testing exercises, such as the BoE CBES, the systemic risks of climate change will be understood more clearly and financial supervisors will be better informed to factor them into institutions’ capital requirements, which keep the financial system stable and sustainable. Once that happens, financial institutions will have a direct and informed way of accurately accounting for and pricing in climate risk. The corollary is a direct effect on behavior in the real economy where capital for counterparties, assets and projects that do not align with net zero goals will either be expensive, incentivizing a realignment of activity, or in some cases not commercially viable. Here too, there will be potential for financial institutions to work in partnership with CDP. Financial instruments will need to be structured so conditions, covenants, undertakings and pricing depend on science-based rather than arbitrary targets, reflecting the underlying risk more accurately and in line with institutions’ balance sheet requirements. The CDP disclosure system could be used to measure companies against those targets – with financial institutions choosing which companies to measure.

Two examples of how partnerships with the financial sector could work in the future are:

## 1

### CURRENT

112 financial institutions are both CDP signatories and disclosers (40% report financed emissions).

Companies requested based on financial indices (largely equity) includes major public companies but may exclude smaller private companies or major bond issuing companies.

### CDP DATA AND INSIGHTS



### FUTURE STATE

Financial institutions use CDP to request emissions data from their portfolio companies, much like the Supply chain model.

Data feeds in to financed emissions calculations.

Increase in % of financial institutions reporting financed emissions and portfolio trajectory.

## 2

### CURRENT

Sustainability-linked loans tie to ESG scores (e.g. CIMB loan to StarHub tied to CDP score) or agreed KPIs.

Interest rate discounts applied accordingly, however, not reflective of the cost of capital and balance sheet risk weighting.

### CDP DATA AND INSIGHTS



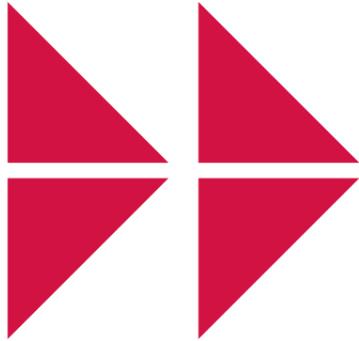
### FUTURE STATE

Climate risk factored into capital requirements, hence cost of capital, and reflected in pricing and underwriting decisions.

Sustainability-linked loans with KPIs reflective of actions in the real economy to reduce climate risk and associated weighting on banks' balance sheets

CDP platform used to track and measure KPIs for risk and pricing decisions

# CONCLUSIONS



Sustainable finance is in the spotlight more than ever before and is being pushed even higher up the agenda for financial institutions by increased pressure to set ambitious public commitments for net zero. Banks, asset managers, asset owners and insurance companies have such a large sway on economies that national climate commitments will not be met without their support – this explains why COP President Alok Sharma wrote to CEOs of financial institutions to join the Race to Zero ahead of COP26<sup>33</sup>.

Sustainable finance is also being pushed up the agenda by new regulation, including stress testing and mandatory reporting. An impact of upcoming regulations is that reporting requirements for financial institutions are coalescing around the TCFD recommendations.

This report has been an assessment of how ready the global finance sector is for the net zero carbon transition and for reporting in line with the TCFD recommendations. It used insights from the market first CDP Financial Services Climate Change Questionnaire 2020.

A key finding is that financial institutions are acutely focused on financing the transition to a low carbon, deforestation free, water secure future – 76% see opportunities such as sustainability-linked loans, green and transition bonds, sustainable investment funds and insurance solutions. These opportunities are worth up to US\$2.9 trillion.

However, while most financial institutions are focused on providing sustainable finance, they are less focused on ensuring the entirety of their business is aligned with net zero. Which means along with the sustainable finance, huge sums of capital are still being committed to financing fossil fuels without a focus on transition. 53% of financial institutions are taking actions to align at least one portfolio with a well below 2-degree world.

## FINANCIAL INSTITUTIONS SHOULD TAKE ACTIONS TO ALIGN THEIR PORTFOLIOS WITH NET ZERO:

- ▶ **Measure their Scope 3 financed emissions better. This makes up almost all financial institutions' climate impact as the research shows, yet only 25% of disclosing financial institutions report their financed emissions.**
- ▶ **Set a target to align their portfolio with a net zero carbon world by 2050 and interim targets for their portfolio to reach that goal. Science-based targets for financial institutions allow them to do this.**
- ▶ **Engage with their portfolio on de-carbonization and enhanced resilience; insist companies are prepared for the net zero carbon transition. Portfolios cannot de-carbonized unless the assets within them do. Asset owners must insist their investment managers are engaging if that is the lever they have.**
- ▶ **Validate how they intend to align with net zero by giving shareholders an annual vote on their transition plan.**

**Authors:**

**Joseph Power**, Senior Manager, Sustainable Finance, [joseph.power@cdp.net](mailto:joseph.power@cdp.net)

**Jordan McDonald**, Data analysis contributor

**So Lefebvre**, Data analysis contributor

**Tom Coleman**, Data analysis contributor

**Editors:**

**Nicolette Bartlett**, Executive Director, [nicolette.bartlett@cdp.net](mailto:nicolette.bartlett@cdp.net)

**Emily Kreps**, Global Director, Capital Markets, [emily.kreps@cdp.net](mailto:emily.kreps@cdp.net)

**With thanks to:**

**Claire Elsdon**

**Mahesh Roy**

**Davide Cerrato**

**Christian Lonnqvist**

**Christina Copeland**

**Contact:**

**Joseph Power**, [joseph.power@cdp.net](mailto:joseph.power@cdp.net)

**Nicolette Bartlett**, [nicolette.bartlett@cdp.net](mailto:nicolette.bartlett@cdp.net)

**Emily Kreps**, [emily.kreps@cdp.net](mailto:emily.kreps@cdp.net)

[investor@cdp.net](mailto:investor@cdp.net)

**Media enquiries:**

**Sara Firouzyar**, Senior Communications Manager, Capital Markets

[sara.firouzyar@cdp.net](mailto:sara.firouzyar@cdp.net)

**For more information please contact:**

**CDP Worldwide**

4th Floor

60 Great Tower Street

London EC3R 5AZ

Tel: +44 (0) 203 818 3900

@cdp

[www.cdp.net](http://www.cdp.net)

**About CDP**

CDP is a global non-profit that runs the world's environmental disclosure system for companies, cities, states and regions. Founded in 2000 and working with more than 590 investors with over \$110 trillion in assets, CDP pioneered using capital markets and corporate procurement to motivate companies to disclose their environmental impacts, and to reduce greenhouse gas emissions, safeguard water resources and protect forests. Over 10,000 organizations around the world disclosed data through CDP in 2020, including more than 9,600 companies worth over 50% of global market capitalization, and over 940 cities, states and regions. Fully TCFD aligned, CDP holds the largest environmental database in the world, and CDP scores are widely used to drive investment and procurement decisions towards a zero carbon, sustainable and resilient economy. CDP is a founding member of the Science Based Targets initiative, We Mean Business Coalition, The Investor Agenda and the Net Zero Asset Managers initiative. Visit [cdp.net](http://cdp.net) or follow us @CDP to find out more.

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