For directors of companies that issue securities on public markets. Capital at risk.

Net-zero: Banks

48% of global financial assets are in banking and insurance, which have a significant climate impact through their associated emissions.[1] What does the **banking sector** need to do to reach net-zero?

LGIM will vote and implement investment sanctions against companies falling short of our climate expectations. LGIM expects companies' boards to oversee and publicly disclose answers to the following:

Net-zero commitment

- Does the company have a comprehensive target for net-zero by 2050 or earlier, covering scopes 1, 2 and material scope 3, including financed emissions?[2]
- Has the company made a commitment to certify/certified this target with the SBTi or other external independent parties as it develops?
- Does the company have a net-zero transition plan that includes short- and medium-term targets?[3]

Strategy

- What are the explicit criteria for restricting financing to non-1.5°C-aligned activities, including the financing of thermal coal, oil, gas and deforestation activities?
- What is the company's approach to carbon credits in the accounting of financed emissions, and does it include a commitment to limit its use to residual emissions only?
- To what extent is the company providing finance for climate solutions and products and services to accelerate the decarbonisation of sectors where change is complex?
- Is executive remuneration aligned with the company's short- and/or medium-term emission targets, as set out in the net-zero transition plan?
- Does the company's decarbonisation strategy address and incorporate the impact of the Just Transition?

Resilience

- Has the company analysed its business model resilience to climate-related risks and opportunities using scenario analysis (including the IEA's net-zero by 2050 scenario and a 'Business as usual' scenario) and disclosed how the output has influenced its strategy?
- Has the company analysed the physical climate risks to its assets, operations, and value chain, including potential financial impacts, and evidenced measures to mitigate or adapt to them?

Targets

- Does the company have targets to grow revenue in relation to 'low/zero-carbon' financial products and services where there is clear alignment with the existing business model?

Collaboration

- How is the company working to encourage emission reductions in the real economy through climate-aware financing and engagement with clients?
- Is the company advocating meaningful policy action, including from regulators, to meet global net-zero targets (e.g. carbon pricing)?

Red lines

- Does the company have restrictions around financing/investing in thermal coal, including new thermal coal projects?
- Does the company disclose its scope 3 emissions associated with its financed emissions?
- Does the company disclose its climate-related lobbying activities, including trade association memberships, and explain the action it will take if these are not aligned with a 1.5°C scenario?

1. FSB (2021), data as at end-2018.
2. Aiming to cover all high-risk sectors, across all material business segments. A high-risk sector is defined by TPI's list of coverage as: oil & gas, power, mining, airlines, shipping, auto manufacturing, steel, aluminium, paper, cement, food and real estate.
3. Short-term refers to 2022 - 2025, medium-term 2026-2035 and long-term 2036-2050.

Further areas for company consideration

Biodiversity expectations

Why? The climate and nature crises are inextricably linked.[4] Net-zero requires both emission avoidance and sequestration. Functioning natural systems are essential to this, but increasingly vulnerable due to climate change.

LGIM's expectations: An assessment of the impacts and dependencies on nature and biodiversity, and appropriate mitigation actions.

Sector-specific considerations: Indirect impacts could result from lending, investing and project financing activities. Financial flows harmful to biodiversity range across all sectors with negative influences on their operating environments.

Company levers

- Transitioning away from financing high-carbon activities
- Building climate considerations into risk management frameworks to reduce and reprice carbon exposure
- Climate risk disclosure
- Increasing intermediation of capital into low-carbon activities
- Climate-supportive products and advisory services; customer education

Government policies

- Carbon pricing
- Capital requirements and stress-testing aligned with rising carbon risks
- Mandatory climate change disclosures

Challenges

Data and compatibility with risk frameworks

Mismatch of timings, incentives, maturity of investments

Regulatory divergence and competing priorities

Political and counterparty risk

Fungible, fragmented sources of capital

Opportunities

Anticipating - and benefiting from - future policy and regulatory action on climate

Growth in demand for sustainable banking products

Improved reputation and stronger relationships with customers/ governments

What is needed?

Company leadership

Alignment of investments/ financing with net-zero global trajectory, with targets for financed emissions increasing in stringency over time

Research and innovation

Investment innovation to allow capital flows at scale into low-carbon solutions, including collaboration with regulators and development agencies

Consumer behaviour

Growing market for sustainable/ low-carbon financial products

4. UN IPCC-IPEBS, Biodiversity and Climate Change workshop report (2021)

Sources of emissions

'Scope 3' Upstream

Indirect GHG emissions from a company's supply chain, employee travel etc.

'Scope 1'

Direct GHG emissions from companies' operations, including facilities and vehicles

'Scope 2'

Indirect GHG emissions from purchased energy

'Scope 3' Downstream

Other **indirect** GHG emissions from lending, investment and advisory activities

Sources: FSB (2021), data as at end-2018.

'Just Transition' considerations

Potential implications for employees, supply chain, customers and communities from the transition to a lower-carbon business model

Ending financing in certain sectors creates risk of job losses; increased need to finance emerging markets and technologies

Physical risk impacts

Direct risks in property investments and project financing

For more information and to see how companies are rated

[LGIM Climate Impact Pledge score]

[LGIM Climate Impact Pledge]

Important information

Source: LGIM as at September 2023. The value of an investment and any income taken from it is not guaranteed and can go down as well as up, you may not get back the amount you originally invested. The above information does not constitute a recommendation to buy or sell any security.