

NET ZERO

AN INTRODUCTORY GUIDE FOR FINANCIAL
INSTITUTIONS JULY 2021

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The navigator Isabelle Autissier has been President of WWF France since December 2009, and Véronique Andrieux was named Chief Executive Officer in 2019.

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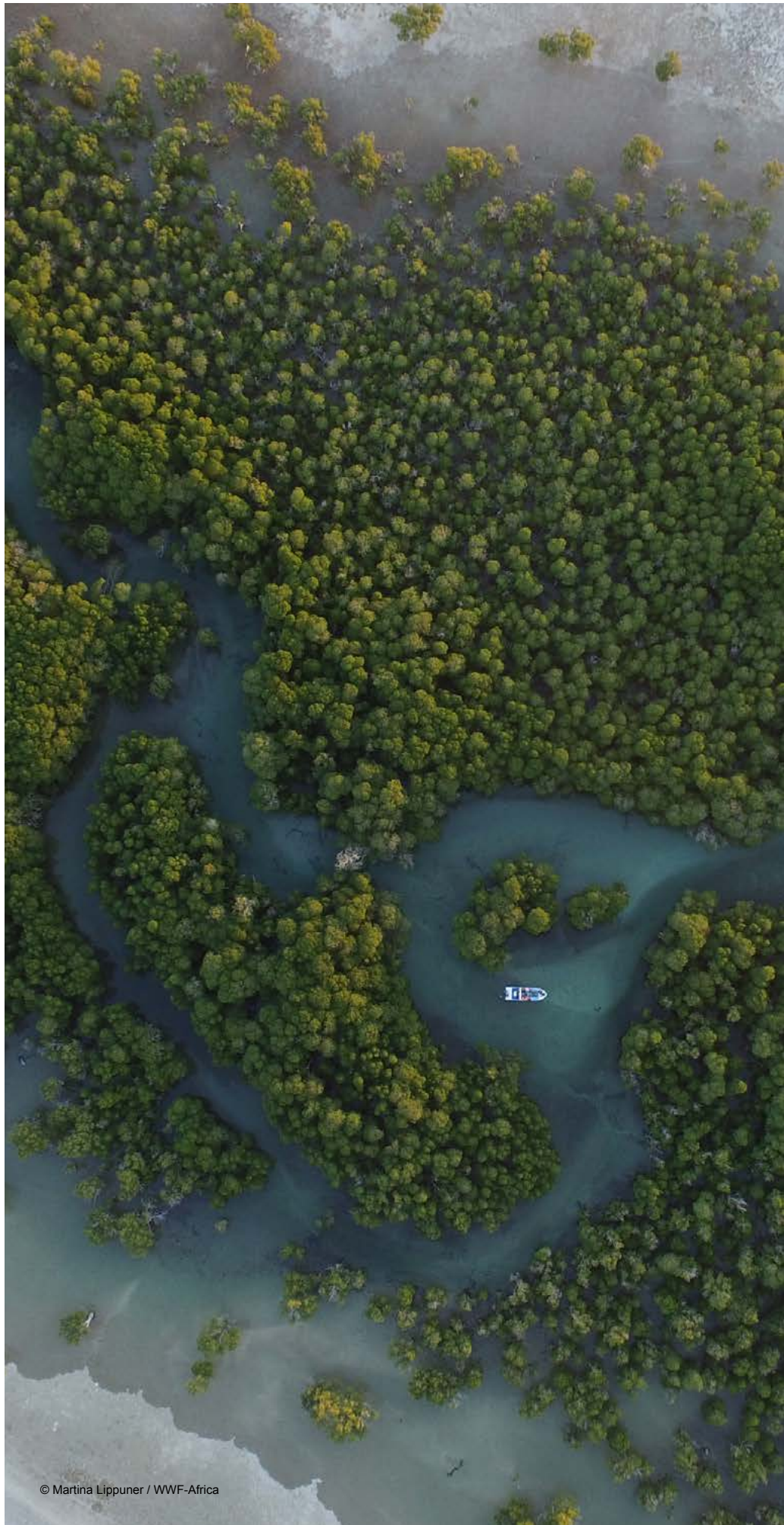
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Based in Paris and led by Simon Messenger, an experienced sustainability reporting and sustainable finance expert with 15 years' experience, its mission is to catalyse society's transition towards a more sustainable and low-carbon world.

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Design by Muscade

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INTRODUCTION

Over the past decade, climate change has increasingly been integrated into business strategies and operational plans: this reflects both the impact that climate change will have on business (for instance through creating stranded assets or changing consumer preferences), as well as the impact that business have on the climate (for instance, through their direct emissions, or the emissions of their investees).

Leadership in the field of sustainable finance is therefore increasing in ambition and robustness: while a decade ago, merely considering climate change as a material topic was noteworthy, a minimum expectation of financial institutions, and society as a whole, since COP21 has been to align the economy and business decisions with the goals of the Paris Agreement (to limit global warming to well below 2°C and strive for 1.5°C by the end of the century compared to pre-industrial levels).

Shifting capital flows to support the transformation of the economy at a pace consistent with science-based scenarios (i.e. ‘aligning your portfolio’) is a minimum expectation of all types of financial institutions, alongside the disclosure of clear actions to support these targets, such as engagement activities or financing certain industries in order to accelerate the transition.

In 2021, ahead of COP26, the level of ambition is being ratcheted up to reflect the urgency of the need to shift capital and align portfolios, both in terms of reducing global systemic economic risks but especially in terms of supporting the long-term viability of current societal norms.

Many initiatives, described in Section 4, are driving the public commitments of financial institutions and the developments of technical methodologies and principles, as well as laying the ground for minimum levels of ambition in order for commitments to be deemed credible. These are driven ahead of COP26 by the Race to Zero campaign, and three of their principal initiatives are the *UN-convened Net Zero Asset Owner Alliance (NZAOA)*, the *Net Zero Asset Manager Initiative (NZAMI)*, and the *UN-convened Net Zero Banking Alliance (NZBA)*.

This guide looks to support financial institutions in navigating the technical questions they may ask themselves when assessing their portfolio for alignment with a Net Zero scenario and answer some of the key technical challenges which will support the implementation of robust, science-based strategies.

WHAT IS NET ZERO?

While financial actors calling for - or making, Net Zero commitments broadly agree with the intent of a 'Net Zero' level of ambition (to reduce their financed net emissions to zero), there remains a significant level of variability in the practical meaning of Net Zero commitments by financial institutions: for instance, how to capture Scope 3 emissions? What asset classes are covered? What timeframes should be set? How much onus should be given to carbon capture technologies in one's assumptions, if any?

The following examples highlight some of the nuances in the language used to describe Net Zero:

*'The members of the Alliance commit to **transitioning their investment portfolios to net-zero GHG emissions by 2050 consistent** with a maximum temperature rise of 1.5°C above pre-industrial temperatures, taking into account the best available scientific knowledge including the findings of the IPCC, and regularly*

reporting on progress, including establishing intermediate targets every five years in line with Paris Agreement Article 4.9' UNEP FI Net Zero Asset Owner Alliance (NZAOA)

*'Investors can **decarbonise investment portfolios and increase investment in climate solutions**, in a way that is consistent with a 1.5°C Net Zero emissions future'* IIGCC Paris Aligned Investment Initiative (PAII)

Net-zero is a point where 'anthropogenic emissions of greenhouse gases to the atmosphere are balanced by anthropogenic removals over a specified period' International Panel on Climate Change (IPCC)

While no answer is 'correct', several key principles should be common ground in order to ensure that the range of commitments meets the level of urgency of action required in order to reach Net Zero GHG emissions by 2050 at the latest in order to limit global warming to 1.5°C.

WHY SET A NET ZERO TARGET?

An underlying question for any financial institution might be *'why should I set a Net Zero target?'*. There are many reasons, of which 3 are:

- **To address the global climate urgency:** the difference in environmental and societal impacts of 1.5°C of warming by the end of the century and 2°C are significant, notably with hundreds of millions of people severely affected by environmental and social impacts.
- **To manage one's business risks and leveraging strategic opportunities:** as part of the planned transition agreed by all countries in the world through the Paris Agreement, some sectors' value may rapidly fall (raising the risk of 'stranded assets') while others grow. In parallel, regulatory and policy developments will incentivise value growth in certain sectors over others. Operationalising

a Net Zero commitment through short-term actions can support financial institutions in managing their risks and leveraging opportunities.

- **And to play a key role in facilitating the transition to a low-carbon economy:** financial institutions have a critical role to play in catalysing the transition towards a low-carbon economy as the providers of capital. Making a Net Zero commitment and setting out short-term actions sends a strong signal to policy makers, market regulators, peers, investees and other actors of long-term strategic plans.

The rest of the guide provides answers to some initial questions financial institutions may face in shaping their targets and associated actions.



OPERATIONALISING NET ZERO TARGETS



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WHAT IS THE DIFFERENCE BETWEEN (GROSS) ZERO AND NET ZERO EMISSIONS?

A 'Net Zero' target is one where there is an overall balance between emissions produced and emissions taken out of the atmosphere.

A 'Gross Zero' target would be one where all Greenhouse Gases (GHG) emissions from all sources are reduced uniformly to zero.

For instance, if you were putting water in a bath, with the aim of achieving a stable water level, a Net Zero target is one where the water flowing in balances out with the amount going out of the drain: to achieve this target, you can either reduce the amount of water flowing in or, as a secondary resort, increase the amount going down the drain

(it is important to note that the primary focus should be on reducing the inflow, not growing the outflow).

A 'gross zero' target would mean turning the tap off altogether.

A 'Net Zero emissions target' is therefore deemed to be more realistic as it allows for some residual emissions, in particular for hard-to-abate sectors, such as aviation. In these sectors, such residual emissions which can't be abated would need to be 'netted' via some carbon removals (see offsetting section on [page 12](#)).

WHAT IS THE DIFFERENCE BETWEEN A NET ZERO COMMITMENT AND A PARIS AGREEMENT ALIGNMENT COMMITMENT?

In practical terms, a financial institution's Net Zero commitment is often shorthand for 'Net Zero by 2050 (1.5°C warming by end of century)'. Indeed, all credible climate commitments made by financial institutions require reaching Net Zero at some point before the end of the century and must be supported by verifiable, transparent actions. The level of ambition pushed ahead of COP26 is for this milestone to be reached by 2050 at the latest.

Such a commitment might for some institutions have already been implied as part of their broader Paris Agreement Alignment commitment ('well below 2°C and striving for 1.5°C warming by end of century') as the former does not preclude the latter.

However, the broader range of outcomes possible under 'well below 2°C' means that, for many actors, their Paris Agreement alignment commitment might imply carbon neutrality around 2065, (see diagram on [page 8](#)), whereas a 'Net Zero' commitment would imply carbon

neutrality by 2050 at the latest: the primary difference is therefore the ambition and speed of implementation (and consequentially the amount of carbon released in the atmosphere). The tools, datasets, methodologies are the same in both instances, but one looks to limit global warming to 1.5°C above pre-industrial temperatures by the end of the century ('Net Zero'), while the other will limit warming to 'well below 2°C, striving for 1.5°C' by the end of the century.

Consequently, for a similarly shaped reduction path, a Net Zero commitment will mean reducing CO₂ emissions in one's portfolio by half approximately 5 years sooner (around 2030) than for a 'Paris Alignment' commitment.

The difference between the two, while potentially appearing marginal, is significant in terms of long-term impact for the planet and human civilisation, hence the ratcheting up of general expectations in 2021 ahead of COP26.

Legend

- Likely 2°C Pathways
- Medium-chance 1.5°C Pathways

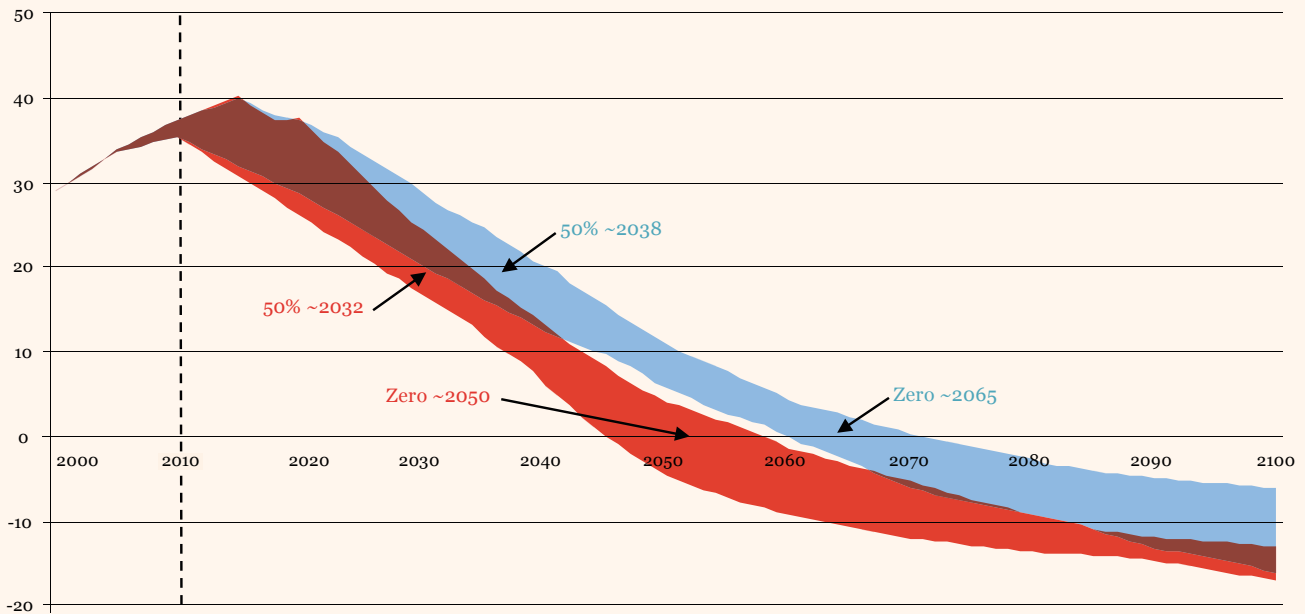


Figure 1: Range of Global Emissions Pathways in Scenarios Consistent with Likely Chance of 2°C or Medium Chance of 1.5°C.
Source: Joeri Rogelj et al, 'Energy system transformations for limiting end-of-century warming to below 1.5°C,' *Nature Climate Change*, Vol.5, June 2015, p.520 cited in [OCI The Sky's the Limit](#)

WHAT METHODOLOGICAL APPROACHES SHOULD I TAKE TO SET MY TARGETS?

A number of different methodological approaches exist for target setting, and there are no specific methodologies which 'must' be used in order to set Net Zero targets, in so far as the methodological landscape is rapidly evolving.

The broad categories of approaches or initiatives which are currently regularly used by financial institutions include:

- **Carbon accounting-based methodologies**, which look at current and future forecasted absolute and sector-intensity emissions to build required trajectories for decarbonising the portfolio. These approaches require to measure and track financed emissions, using for instance the Partnership for Carbon Accounting Financials (PCAF) methodology. See [pages 15-17](#) for further analysis regarding how to account for Scope 3 emissions in target setting.
- **Capacity-based methodologies**, such as the *Paris Agreement Capital Transition Assessment (PACTA)* tool, which looks at forward-looking production plans of clients' assets by technology and by sector and maps alignment with climate scenarios.
- **Temperature-based methodologies**, which give an implied degree of warming for portfolios, such as the *Science-Based Targets initiative – Financial Institutions (SBTi-FI)* temperature tool.
- **Percentage of companies** meeting a science-based requirement or technical criteria: for instance, percentage of companies in a portfolio aligned with the EU Taxonomy, share of companies with Science-Based Targets, share of companies with Paris Agreement-Aligned transition plans.

Such approaches may be supported by further actions, such as setting specific financing targets for certain sectors or technologies. As methodologies develop, the data and technical limitations will diminish and the accuracy of newer methodologies, in particular temperature-based rise methodologies which currently only give a point-in-time picture, should increase.

Currently, many financial institutions individually use more than one methodology in order to set targets and assess progress against them: the multi-pronged approach allows methodologies to complement each other and support the decision-making processes of financial institutions.

WHAT IS FAIR? ARE THESE MY EMISSIONS OR ARE THESE ANOTHER FINANCIAL INSTITUTION'S EMISSIONS?

A key question for financial institution is how they decide what are the emissions (or another metric) which they have financed versus those which a peer has financed?

For some types of financial activities, such as project finance, it may be reasonably easy, for example, to determine the associated carbon footprint of a specific infrastructure project which they should account for. However, it becomes much more complicated as a financial institution to decide whether they should allocate themselves a percentage of the client's emissions which corresponds directly to the percentage of shares

they own, or whether they might want to use a different approach for a loan to a non-listed entity.

Recently, the *Partnership for Carbon Accounting Financials* (PCAF) has published the Global GHG Accounting and Reporting Standard for calculating and allocating emissions depending on asset classes and financial activities. Other methodologies and approaches exist too, which will have different variations of approaches based on 'portfolio weight' (what percentage of my portfolio does this company represent?) or 'ownership weight' (what percentage of this company do I own?).

WHAT COVERAGE OF MY PORTFOLIO SHOULD I ACCOUNT FOR?

Setting climate targets can require significant human and financial resources for collecting, tracking and analysing the data linked to these targets. As such, it is important that the target's coverage appropriately reflects the materiality of the sector or industry both in terms of carbon emissions and balance sheet.

Simply put, if a sector emits (comparatively) very few emissions, it may be extremely time-consuming to collect and track emissions data for this sector in view of the impact this will have on overall emissions. Likewise, a sector may be classified as 'carbon-intensive' but the financial institution only has one relatively minor exposure

to this industry: developing and tracking a sector-wide target for this one exposure could be considered immaterial.

Financial institutions should therefore balance the carbon intensity of sectors with their financial coverage to set targets and focus in priority on their hotspots. However, to ensure sufficient coverage for the targets, initiatives such as the SBTi-FI set minimum coverage thresholds (for instance, 67% of their lending activities).

The following initiatives define the following sectors as carbon-intensive or priority sectors:

SECTOR	NET ZERO ASSET OWNER ALLIANCE (in Scope of first iteration of protocol)	PAII NET ZERO INVESTMENT FRAMEWORK	NET ZERO BANKING ALLIANCE
REAL ESTATE	●		●
POWER / UTILITIES	●	●	●
CEMENT		●	●
CHEMICALS		●	
IRON			●
STEEL	●	●	●
ALUMINIUM		●	●
OIL & GAS	●	●	●
PULP & PAPER		●	
COAL MINING		●	●
DIVERSIFIED MINING		●	
TRANSPORT	●	●	●
AGRICULTURE			●

Legend

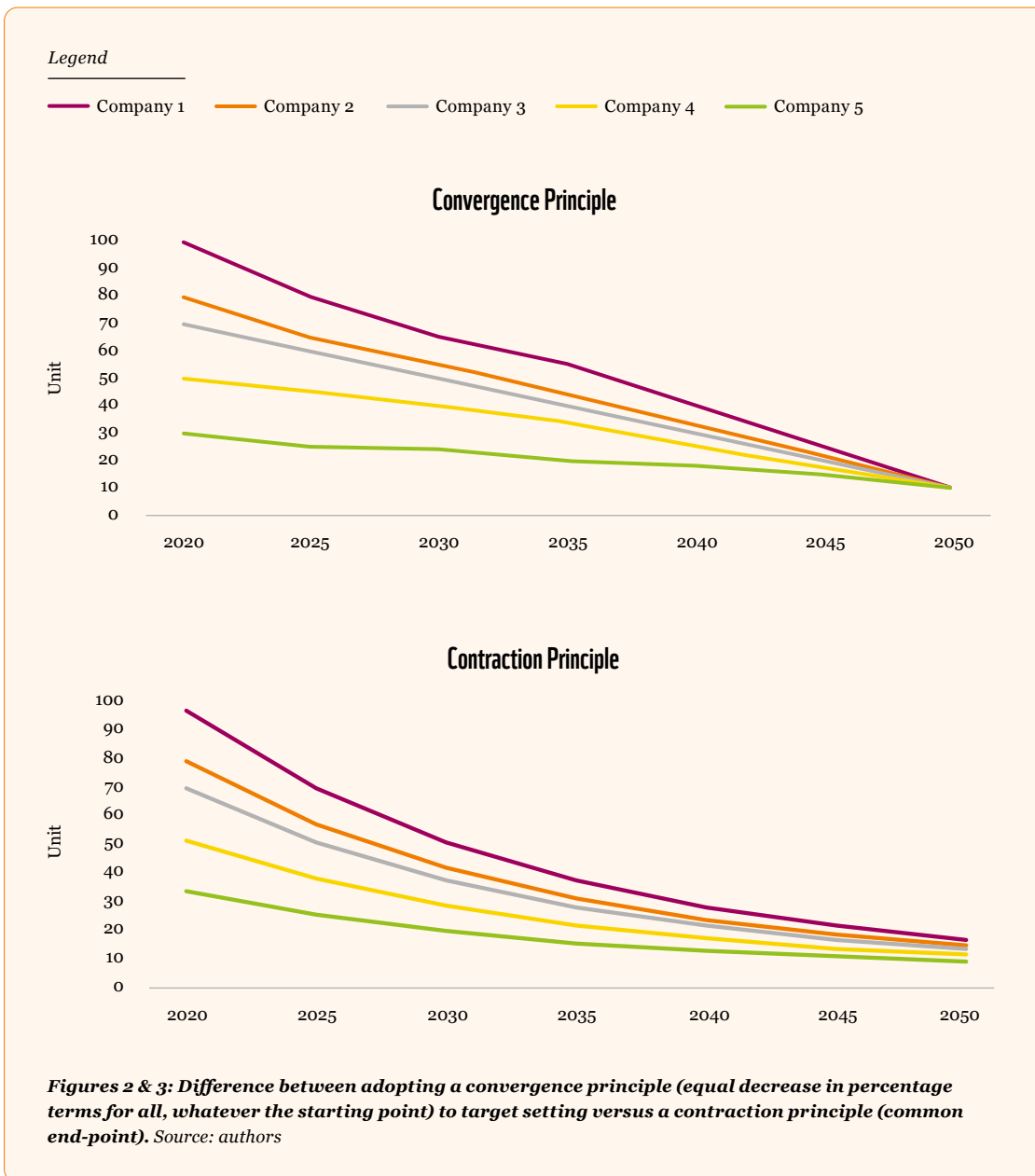
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Table 1: Carbon-intensive or priority sectors by initiative

I UNDERSTAND THE END POINT (NET ZERO BY 2050): HOW DO METHODOLOGIES GET US THERE?

When assessing the impact of a climate scenario target on an individual client or portfolio, the end point (Net Zero by 2050) is the same: however, there are two broad ways to model how individual clients or sector-level portfolios should evolve: a *convergence approach*, where the speed of change is affected by the starting point (i.e. less carbon

intensive clients have a lower rate of decrease to achieve because their starting point is 'better'), and a *contraction approach*, where every actor/ portfolio in the market is assumed to have to decrease their emissions at the same rate (e.g. 2%/ year), irrespective of previous decarbonisation.



WHEN SHOULD I SET A TARGET FOR?

In setting a Net Zero target, financial institutions commit to achieving Net Zero by 2050 at the latest: there should therefore be a target for 2050 or the year at which they expect to reach Net Zero, if sooner than 2050.

All three primary Net Zero initiatives for asset owners (NZAOA), asset managers (NZAMI) and banks (NZBA) require interim targets with one

set for 2030 or earlier. As a reminder, by 2030, emissions should have been reduced by ~50% under a majority of Net Zero scenarios.

This ensures that the timeframe for the target is actionable and underlines the accountability and responsibility for delivery on the current management and leadership teams of the financial institutions.

CAN I USE OFFSETS OR AVOIDED EMISSIONS TO JUSTIFY MEETING MY TARGETS?

It is generally accepted that offsets should only be used under specific circumstances and where there are no alternatives, for instance in hard to abate sectors in order to balance residual emissions where there are limited technologically or financially viable alternatives. In addition, these offsets should lead to net sequestration of carbon in the mid or long term. The GHG Protocol (Chapter 8), the Oxford Guidelines for carbon offsetting¹ and the WWF position paper² on the

topic provide detailed explanation of the rationale behind this.

It is also generally accepted that ‘avoided emissions’ (where you equate an investment in a technology which produces fewer emissions than a presumed baseline as giving you ‘avoided emissions’ which you then subtract from your total) should not be used as an accounting mechanism to justify a reduction in emissions.

DO I NEED TO PROVIDE ACTIONS ALONG WITH MY TARGETS?

For targets to be credible, it is expected that actions to meet these targets are disclosed by financial institutions.

This additionally makes it easier for a financial institution to track and measure their progress.

Different types of financial institutions will have different tools at their hands to use as actions, for instance through covenants inserted in bank loans or stewardship policies for asset owners. Other actions may include engagement, capital reallocation, or targeted investment in new low-carbon technologies. Divestment is an action, though initiatives such as the NZAOA put a strong onus on engagement in order to support the (rapid) transition to a new economy.

In terms of engagement, there are many actors with whom a financial institution might chose to

engage such as credit rating agencies, auditors, stock exchanges, proxy advisers, investment consultants, and data and service providers.

Financial institutions are encouraged to identify the areas where they have the strongest levers and the biggest area of impact: for instance, as the significant majority shareholder of a company, an institutional investor can have a significant sway on this company’s future strategy. Conversely, a retail banker with a majority of its loan book attributed to mortgages may have a bigger impact through engaging with the national utilities provider to change energy source for electricity provision to the housing stock or upgrading infrastructure than through trying to encourage each homeowner to improve the home’s energy efficiency.

WHERE SHOULD I REPORT MY TARGETS AND PROGRESS AGAINST TARGETS?

While setting a Net Zero target doesn’t come with disclosure requirements, it is important that financial institutions who are serious about

meeting their commitment publish their targets and progress against targets in publicly available reports.

¹ <https://www.smithschool.ox.ac.uk/publications/reports/Oxford-Offsetting-Principles-2020.pdf>

² https://wwfeu.awsassets.panda.org/downloads/wwf_1_5c_position_paper_carbon_dioxide_removal_including_carbon_sequestration_in_natur.pdf

If material to the business model, financial institutions should follow jurisdictional reporting requirements and other international initiatives' recommendations, such as the Taskforce for

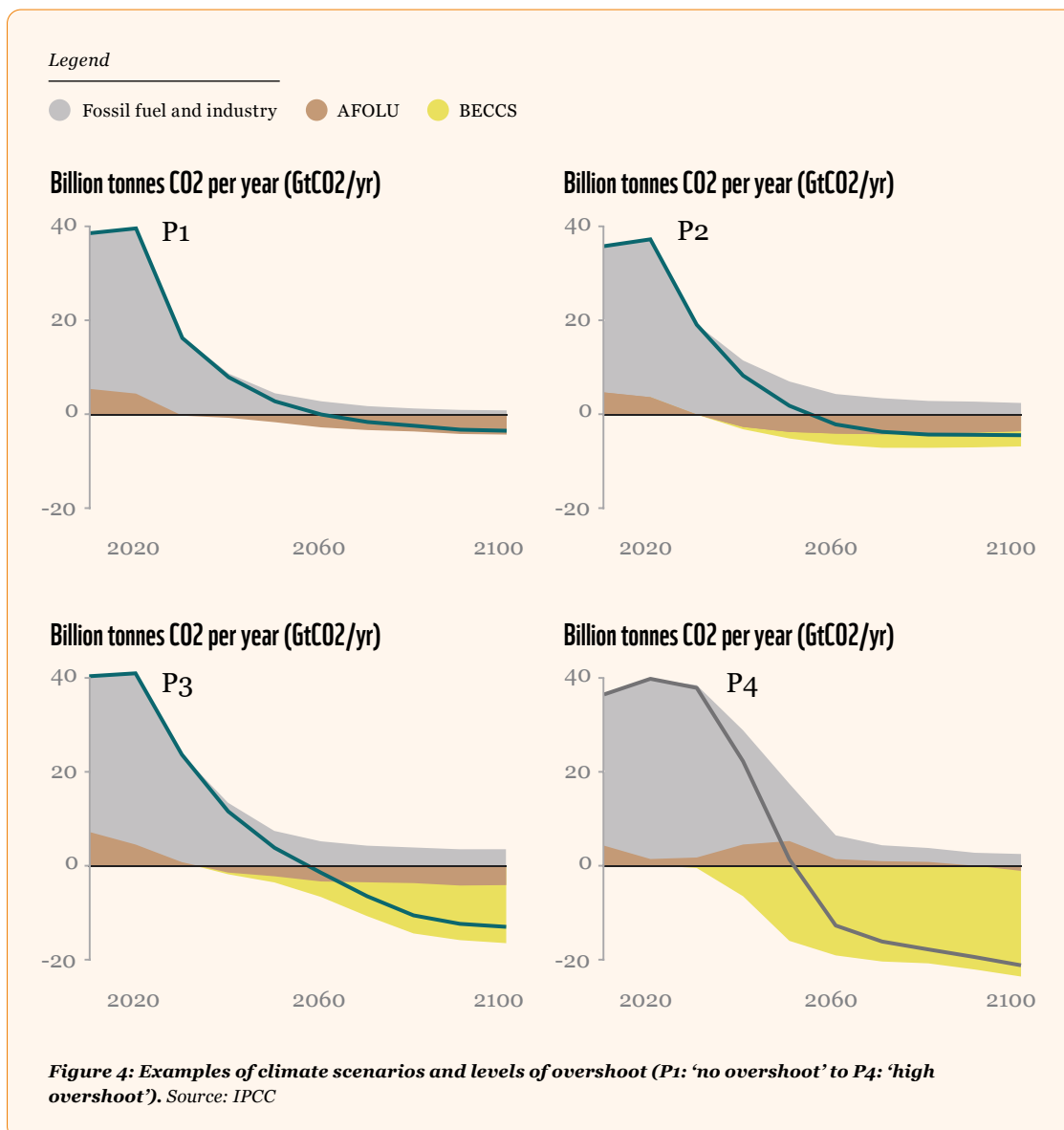
Climate-Related Financial Disclosures (TCFD) and should most likely look to publish related information in the annual report and their website.

WHAT SCENARIOS SHOULD I USE TO SET A NET ZERO TARGET?

There are a handful of international bodies who have developed science-based scenarios to meet a Net Zero by 2050 objectives such as the IPCC and the IEA.

However, while all scenarios may agree on the same end goal (Net Zero by 2050 in order to limit global warming to 1.5°C by 2100), there

are different approaches which can be taken: for instance, the IPCC model has 4 'sub-scenarios': P1, P2, P3 and P4. Each of these has a varying level of 'overshoot'. Some scenarios (P1 and P2) assume immediate action and therefore 'no overshoot' or 'low overshoot' (i.e very limited dependence on negative emissions after 2050) while P3 and P4



assume that emissions reductions will be limited initially before a sudden drop between 2040 and 2050. After 2050, there will be significant ‘negative emissions’ (for instance, carbon capture and storage or other technologies to extract carbon from the atmosphere): this is perceived by many as a risky strategy which relies too heavily on unproven technologies.

Some initiatives, such as the Net Zero Banking Alliance, therefore note that organisations should only use ‘no’ or ‘low overshoot’ scenarios³.

In selecting a scenario, a financial institution should ensure that it is ‘science-based’ and deemed to be robust. The institution should regularly review the model for updates to climate science.

WHAT FINANCIAL ACTIVITIES SHOULD I INCLUDE IN MY TARGET?

The answer will be specific to each financial institution. Nevertheless, in setting a target, a financial institution should account for areas over which it has control and in doing so, consider whether a financial activity has an actual bearing on the real economy. Broadly speaking, where possible, financial institutions should look to cover what is on their balance sheets as this can be deemed to be within their sphere of control. While sector exclusions should cover all financial activities, including certain financial activities in targets may only be practical in certain instances.

For instance:

- Is it possible to assess the impact of an action set to meet a target for a derivative?
- How would one set a target for advisory services?

In addition, where does a financial institution ‘hold power’? For fixed income, can a financial institution actually steer the decisions made by a company?

Several Net Zero initiatives - for asset owners (NZAOA), asset managers (NZAMi) and banks (NZBA) – have developed approaches for net-zero target setting: these can provide further information to financial institutions which are interested in setting such targets. Further information about each initiative is available on page 27.

EXAMPLES OF FINANCIAL ACTIVITIES

- Retail lending (not incl. personal loans)
- Corporate loans
- Revolving credit facilities
- Project finance
- Listed equity
- Corporate Bonds
- Sovereign/government/agency bonds
- Private equity and debt, including venture capital
- Securitized fixed income (ABS, MBS, covered bonds)
- Debt and equity underwriting
- Trading book securities
- Credit guarantees
- Off balance sheet activities
- Advisory services (e.g., M&A)
- Brokerage-securities
- Insurance contracts
- Transaction services
- Derivatives
- Trading commodities

Table 2. Source: GHG Protocol

³ <https://www.unepfi.org/net-zero-banking/>

DEEP DIVE ON CARBON ACCOUNTING METHODOLOGIES

This box provides specific additional detail on points to consider if choosing to use Scope 3 emissions for setting Net Zero targets. Note that this is not the only way to set and measure Net Zero targets.

If setting targets based on carbon accounting methodologies, what Scope of emissions should I include in my targets?

In almost all financial institutions, the significant majority of their emissions will come from their Scope 3 emissions, and in particular their 'Category 15 Financed Emissions' category, i.e. the emissions which come from their portfolio, as defined by the GHG Protocol.

In order for a Net Zero commitment of a financial institution to have any credibility, it is therefore a necessity that Scope 3 Category 15 emissions are included in the Scope of the target, which may also include Scope 1, Scope 2 and Scope 3 Categories 1-14 emissions, though their materiality in terms of impact of the business on the climate will normally be much lower.

Other methodologies or approaches (for instance, looking at metrics beyond carbon accounting, such as financing for different sectors, or the forward-looking production plans in physical units of investees) can support the establishment of a Net Zero target.

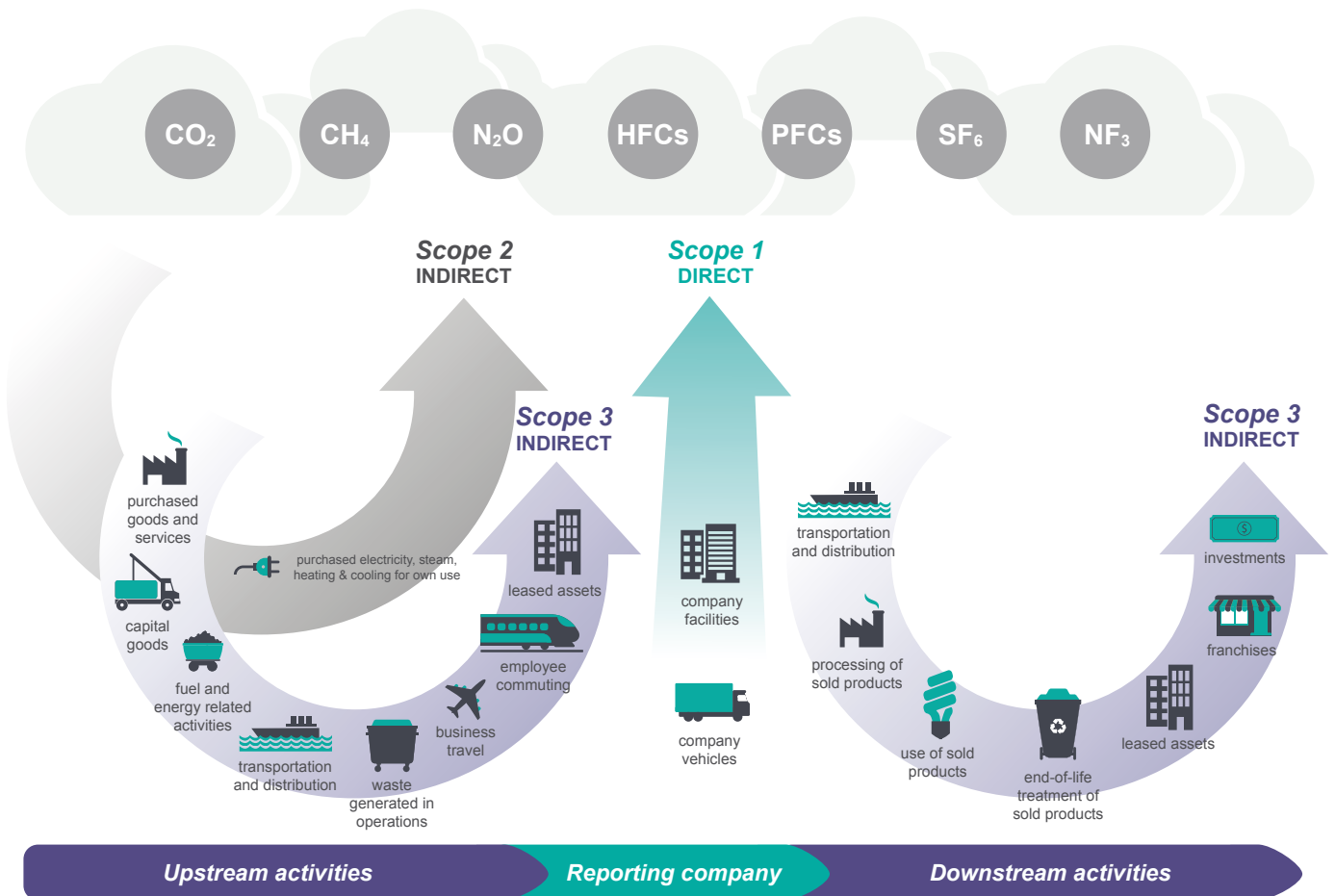


Figure 5. Source: GHG Protocol

If setting targets based on carbon accounting methodologies, should I include my investees' and clients' own Scope 3 emissions?

For all types of target setting methodologies, the impact of investees' or clients' value chain can be considered.

To date, for carbon-accounting methodologies, a majority of public initiatives on climate target setting for financial institution make the inclusion of clients' Scopes 1 and 2 emissions mandatory, while clients' Scope 3 emissions are optional or encouraged. For instance, the NZAOA for asset owners notes that 'Scope 3 should be included wherever possible'.

While it may initially seem uncontroversial to expect to include the entirety of clients' emissions (all 3 Scopes) in targets, the flexibility reflects a number of issues, both linked to data availability and to methodological uncertainties.

1) The availability of client Scope 3 data:

While the availability of Scope 1 and Scope 2 data is high for a majority of listed entities and is increasingly audited by the financial auditors of the companies, the availability of Scope 3 data for listed entities is more limited and the quality of this data is often criticised for being inaccurate, for instance due to clients' own data collection challenges. While outliers would be smoothed out in a large dataset, blindly using Scope 3 data, if unchecked, could potentially lead to wrong assessments.

More generally, data for unlisted entities across all 3 Scopes is hard to come by: for some financial institutions, this would represent the majority of the balance sheet.

2) The availability of data, more generally

As highlighted above, there are challenges in obtaining Scope 3 (and, in some instances, Scope 1 and Scope 2) data.

As such, a common means by third parties to fill this gap is to develop proxies, for instance based on sector breakdown, enterprise value, revenues or industry-specific activities. The proxy's accuracy increases in line with the number of variables assessed.

This can be a strong first step, but it remains an imperfect way of calculating a client's full emissions profile. Until regulation or market forces require public disclosures of robust and complete assessments of one's emissions, fully capturing an accurate picture of one's total financed emissions (including clients' Scope 3 emissions) will remain challenging.

3) How do you decide if these are my emissions or another financial institution's emissions?

This challenge is common whether you use carbon-accounting methodologies or another approach. See [page 8](#) for an explanation of methodological approaches.

4) How do I avoid double counting in my portfolio?

In addition to the data quality issues with Scope 3 accounting, double counting can occur. For instance, in a simplified example, if you invest in a tyre maker, a car manufacturer and a petroleum producer, you might count 'downstream' emissions for a single car 3 times.

In practice, this is a risk, which is why many methodologies advocate for industry specific intensity-based targets. This avoids the double counting which one may encounter between sectors. An additional way to avoid double-counting is to report these emissions separately in the financed emissions calculation.

5) Do my clients' Scope 3 emissions actually 'matter'?

It depends. While there might be an intrinsic academic value in calculating as comprehensive as possible a value for the emissions of one's portfolio, one of the ultimate goals⁴ – and most critical in this context - of doing so should be to have what is commonly referred to as 'an impact in the real economy': i.e. the financial institution – while maximising its own business performance – is steering capital towards an economic activity that supports a Net Zero economy in 2050.

Therefore, what matters in this context is assessing the materiality of the Scope 3 emissions for the client.

⁴ There are other, potentially financially material, reasons to do so, for instance around risk management or calculating potential exposure to future carbon taxes. Our position relates to the environmental consequences of a portfolio's emissions.

As an example, the Scope 3 emissions of a services company running a large data centre will likely be immaterial relative to their Scope 1 and 2 emissions. Therefore, a services company in a specific industry will, on average, have overall emissions of a similar order of magnitude to a peer of a similar size.

However, if you are investing in a car making company, while Scope 1 and Scope 2 emissions may be material relative to other sectors, the majority of the emissions for car makers producing Internal Combustion Engine (ICE) vehicles will come via the use of their vehicles over the next decade. Consequently, a manufacturer focusing on electric or hybrid vehicles will have significantly lower Scope 3 emissions.

As such, in the automotive sector, an investor solely looking at Scope 1 and Scope 2 emissions will see limited differences between peers of similar sizes and choosing a purely ICE manufacturer or a purely electric vehicle producer will have limited bearing on the investor's emissions profile.

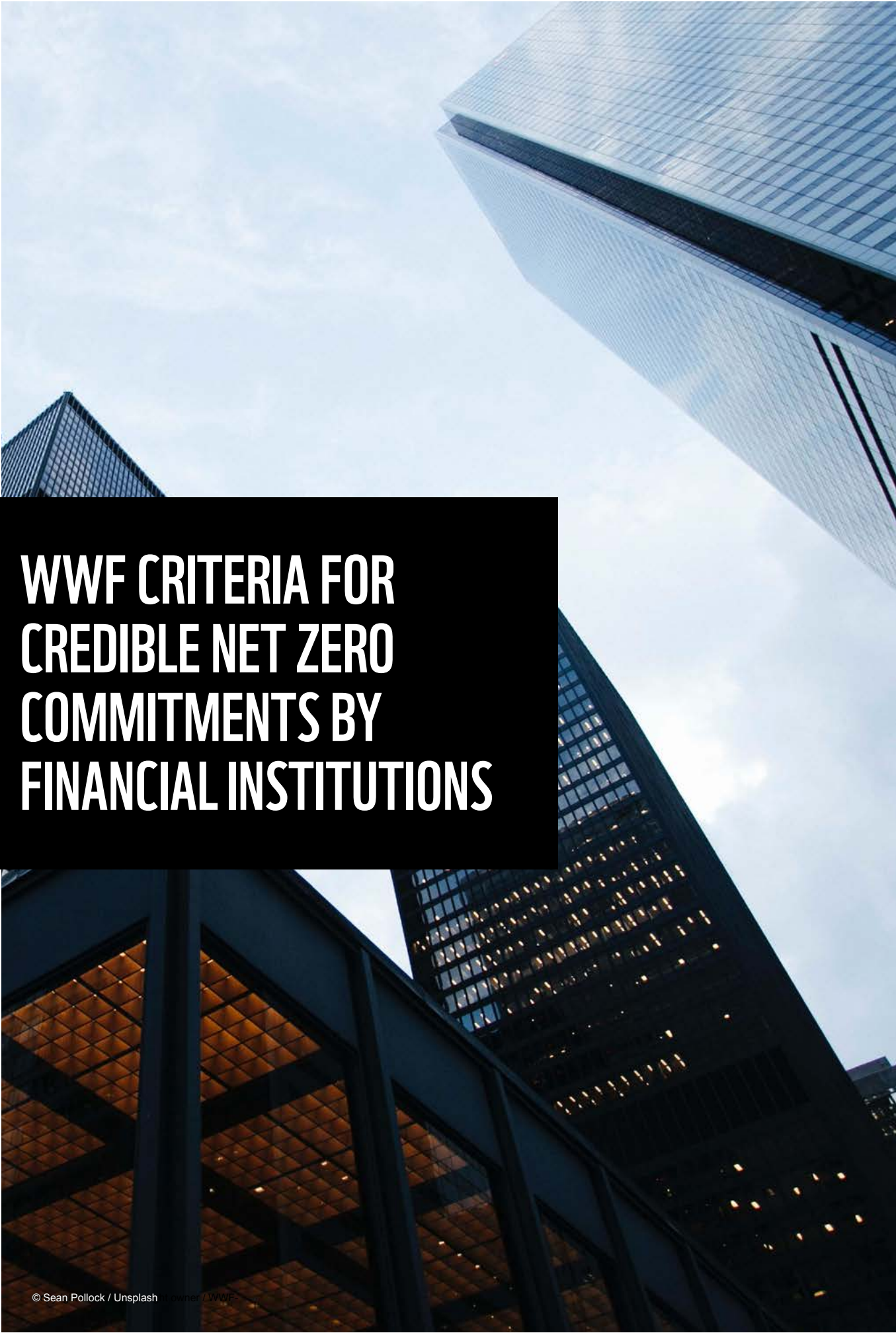
However, including Scope 3 emissions in the emissions profile will make a significant difference to the alignment profile of an investor and their ability to achieve a Net Zero target by 2050 with actual impact in the real economy.

Put simply, the CO₂e/km emissions intensity of the ICE manufacturer will be significantly higher than the electric vehicle manufacturer, but only if the Scope 3 emissions are included.

6) So why use clients' Scope 3 emissions?

With a full dataset, appropriate methodologies and strong systems to avoid double counting, it is possible to set an accurate Scope 3 profile to be included in target setting.

Nonetheless, even without a 'perfect' profile, including clients' Scope 3 emissions may serve as a baseline from which to track progress, albeit acknowledging data gaps.



WWF CRITERIA FOR CREDIBLE NET ZERO COMMITMENTS BY FINANCIAL INSTITUTIONS

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INTRODUCTORY NOTE

WWF has developed five criteria to define the level of credibility, depth and robustness of net-zero commitments by financial institutions (investment managers, asset owners, commercial banks). These criteria are anchored in the latest climate science, as most notably provided by the [IPCC special report on 1.5°C warming](#).

We believe that all types of financial institutions can today adopt credible net-zero commitments for all their activities (investing, banking, insurance) and all asset classes⁵.

The five criteria aim to provide an initial high-level checklist. In the next iteration of the paper, WWF will provide further details for each of the criteria as well as refine the criteria per type of financial institution (i.e. investment managers, asset owners, commercial banks).

The five criteria are building on the [Starting Line Criteria](#) of the Race To Zero. The table below indicates where WWF has added criteria or alterations specific for financial institutions.

STARTING LINE CRITERIA	FINANCIAL INSTITUTIONS APPLICATION LOGIC
1. PLEDGE	Very similar to other actors; requires little alteration.
2. PLAN	Very similar to other actors; requires little alteration.
3. PROCEED	Further financial sector-specific criteria are needed, given the lack of a consistent understanding of what net-zero and near term targets mean for financial institutions. WWF suggestions build on operational target setting frameworks and other relevant resources.
4. PUBLISH	Very similar to other actors; requires little alteration.
5. CONTRIBUTE	New criterion: given the need for further methodological development and consolidation, we suggest financial institutions should commit to contributing to this need.

Table 3: WWF alterations to the Race to Zero Starting Line Criteria

⁵ WWF acknowledges that not all activities and asset classes are currently covered by tools and methodologies that allow to adhere to all the steps outlined in this document, but believes that by making net-zero commitments financial institutions are committing to contribute towards developing and applying such tools and methodologies over time.

CRITERIA FOR NET-ZERO COMMITMENTS BY FINANCIAL INSTITUTIONS

In order for net-zero commitments to be credible, WWF believes financial institutions should:

- 1/ **Pledge** at the head-of-organization level to reach net-zero by 2050 or sooner, in line with global efforts to limit warming to 1.5°C.
- 2/ **Plan**. Explain what steps will be taken toward achieving net-zero, and commit to calibrate all activities (see point 3 below) on science-based no/low overshoot 1.5°C scenarios (e.g. P1 or P2 pathways of the IPCC special report on 1.5°C warming) that do not rely on excessive carbon dioxide removal technologies, and hence require a global reduction in CO₂ of approximately 50% by 2030⁶.
- 3/ **Proceed**. Take immediate action toward achieving net-zero by COP26 – aligned with the scientific requirements set out in point 2 above – including:
 - Setting a combination of short-term targets that cover all (i.e. no cherry-picking) of the following levels and activities: (sub-) portfolio level targets, targets for sectors, targets for company engagement and green investments targets⁷.
 - Adopt investment policies for the most material sectors that involve fossil fuels⁸, deforestation- and conversion-related sectors (agriculture and forestry), high-carbon transport, high-carbon industry (e.g. cement, steel, chemicals, etc.).
- 4/ **Publish**. Commit to measure and report progress towards 1.5°C alignment at least annually, including via, to the extent possible, platforms that feed into the UNFCCC Global Climate Action Portal.
- 5/ **Contribute** to the development and application of credible portfolio alignment methodologies that drive and measure the financial institution's contribution to real-world reductions in line with a 1.5°C pathway. This notably implies going beyond measuring 'financed emissions', including the need for financial institutions to immediately avoid investments in new high-emitting infrastructure¹¹.

⁶ The IPCC P1 pathway forecasts a 54% reduction by 2030, and the P2 pathway a 47% reduction.

⁷ There is a growing number of target-setting frameworks that allow financial institutions to set short-term targets such as [the science-based targets for financial institutions initiative](#), the [UN-convened Net Zero asset owner alliance target setting protocol](#) and the [IIGCC Paris aligned investment initiative net-zero investment framework](#).

⁸ Based on an available carbon budget calculation for an IPCC scenario of 50-66% chance of staying below 1.5°C of global warming, with low or now overshoot and limited carbon dioxide removals, thermal coal should be phased out from the energy system by 2030 in OECD/Europe/Russia and by 2040 globally, oil and gas should be phased out by 2040 in OECD/Europe/Russia and by 2050 globally (IEA Beyond Two Degrees, 2017). Financial institutions should ensure that their own portfolio is free from fossil fuels by the same timelines, by assessing and taking action to guarantee (e.g. engaging and/or reducing exposure and/or divesting) that the companies they invest in and/or provide financial services to have corresponding transition plans in place.

⁹ An engagement strategy should include: engagement targets; a description of how sectors/companies for engagement were identified; the climate requests towards sectors/companies; the number and sectoral breakdown of engagement conducted with regard to climate change over the last 12 months; a description of the engagement escalation strategy (disclosure and rationale of voting on climate shareholder resolutions, votes against management for climate reason, divestment decisions in case of unsuccessful engagement, etc.)

¹⁰ For companies this can entail public messaging, filing/supporting shareholder resolutions, end participating in capital raising efforts through bond issuances/loans, vote against management, and ultimately divestment if the company remains unresponsive to demands.

¹¹ This includes direct investments in infrastructure projects and/or providing financing or services (e.g. project loans, financing through corporate instruments (corporate loans, equity, bonds), insurance underwriting, loan underwriting, etc.) to companies that are investing/planning to invest in high-emitting infrastructure.

SCIENCE-BASED TARGETS INITIATIVE – FINANCIAL INSTITUTIONS (SBTi-FI)

The Science Based Targets initiative (SBTi) mobilizes companies to set science-based targets and boosts their competitive advantage in the transition to a low-carbon economy. It is a collaboration between CDP, the United Nations Global Compact, World Resources Institute (WRI), and WWF.

SBTi launched a framework for financial institutions (SBTi-FI) in October 2020 which includes target setting methods, target validation criteria and recommendations, a target setting tool, and a guidance for financial institutions to align their lending and investment portfolios with the ambitions of the Paris

Agreement. Targets need to be set for a 5 to 15 year time horizon, and the current framework covers the following asset classes: real estate, mortgages, electricity generation project finance and corporate instruments (equity, bonds, loans).

Financial institutions can already implement (parts of) the SBTi-FI framework such that their short term targets are in line with their long-term net-zero ambition. In addition, SBTi is working on a foundations paper for net-zero target setting in the financial sector, which will form the basis for aligning the full SBTi-FI framework with the net-zero by 2050 ambition.



COUNTRY COMMITMENTS



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On a political level, an ever-growing number of countries and jurisdictions are making Net Zero commitments. The consequential rise in regulatory requirements, reporting expectations and general political and public pressure adds a level of urgency to the need for financial institutions to commit to aligning their portfolios with such goals.

As of May 2021, the 53 countries or jurisdictions listed in Table 1 have committed to Net Zero targets. While some commitments remain strategic, political, targets, others are already being supported by legislation.

In addition, there were 23 regions and 471 towns¹² who had made a Net Zero commitment under **Race to Zero**.

For instance, in **Europe**, the European Commission proposed in 2020, as part of the European Green Deal, the first European Climate Law. This sets into law the EU wide target to achieve economic climate-neutrality by 2050 and is supported by several broader EU-wide initiatives, such as the EU Taxonomy.

Under such a law, EU Member States are required to develop national long-term strategies on how they plan to achieve the greenhouse gas emissions reductions needed to meet their commitments under the Paris Agreement and EU objectives.

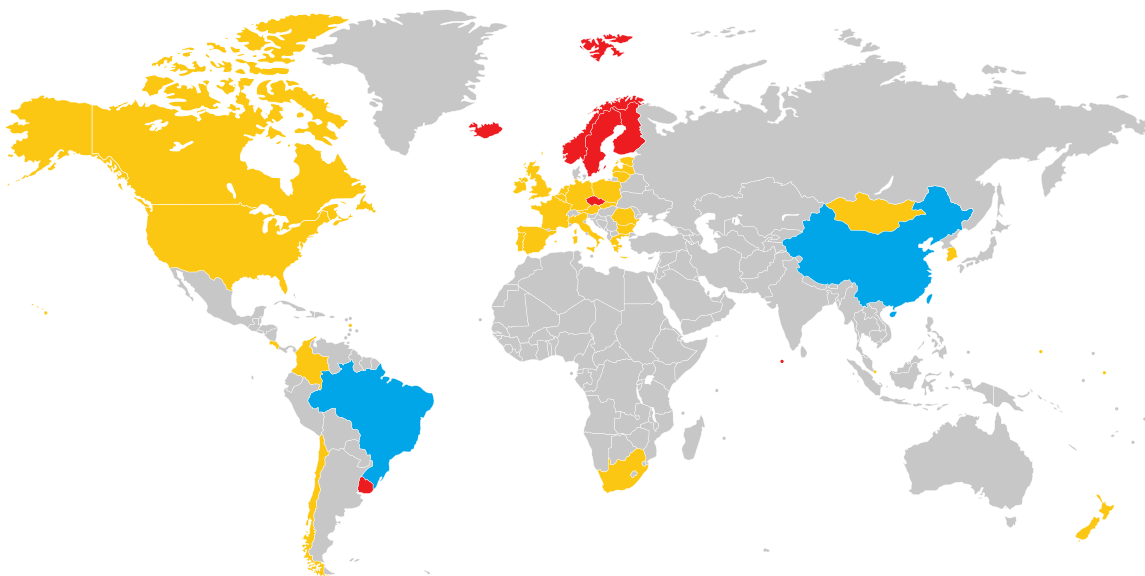
Sweden announced in 2017 its own targets to be carbon neutral by 2045 ahead of the EU requirements. In **France**, the Loi Energie et Climat (energy and climate law) announced in 2020 supports the implementation of the Stratégie Nationale Bas-Carbone (national low carbon strategy). In **Denmark**, a law was announced in 2019 to reach carbon neutrality by 2050. In **Hungary**, this came in 2020. In the **UK**, the 2008 Climate Change Act was updated in 2021 to increase its target to Net Zero by 2050 (-78% by 2035), while **Scotland** aims to reach this Net Zero level by 2045.

Spain proposed its Climate Change Bill in 2020 which would meet this objective, though it is still in approval stage.

Outside of the EU, **Canada** and the **United States** announced in early 2021 that they would align their policies to achieve Net Zero emissions by 2050. **New Zealand** passed the Climate Change Response (Zero Carbon) Amendment Act in November 2019 to reach net-zero emissions by 2050.

Legend

Before 2050 2050 2060



Map 1: Net Zero commitments made by countries.

¹² <https://unfccc.int/climate-action/race-to-zero/who-s-in-race-to-zero>

COUNTRY	TARGET	COUNTRY	TARGET
ANDORRA	2050	LAOS	2050
ARGENTINA	2050	LATVIA	2050
AUSTRIA	2040	LUXEMBOURG	2050
BARBADOS	2030	MALAWI	2050
BHUTAN	Achieved	MALDIVES	2030
BRAZIL	2060	MARSHALL ISLANDS	2050
CANADA	2050	MAURITIUS	2070
CAP VERDE	2050	MONACO	2050
CHILE	2050	NAURU	2050
CHINA	2060	NEPAL	2050
COLOMBIA	2050	NEW ZEALAND	2050
COSTA RICA	2050	NORWAY	2030
DOMINICAN REPUBLIC	2050	PANAMA	2050
DENMARK	2050	PORTUGAL	2050
EU	2050	SINGAPORE	2060
FIJI	2050	SLOVAKIA	2050
FINLAND	2035	SLOVENIA	2050
FRANCE	2050	SOUTH AFRICA	2050
GERMANY	2050	SOUTH KOREA	2050
GRENADA	2050	SPAIN	2050
HUNGARY	2050	SURINAME	Achieved
ICELAND	2040	SWEDEN	2045
IRELAND	2050	SWITZERLAND	2050
ITALY	2050	UK	2050
JAMAICA	2050	USA	2050
JAPAN	2050	URUGUAY	2030
KAZAKHSTAN	2060		

Table 4: Global country-level Net Zero commitments. Source: https://www.climatewatchdata.org/net-zero-tracker?indicator=nz_year



**INTERNATIONAL
INITIATIVES FOR
FINANCIAL INSTITUTIONS**

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The COP26 Private Finance Hub, led by Mark Carney in his capacity as UN Special Envoy and Adviser to the British Prime Minister, is focusing ahead of November 2021 on building a system that mobilises private finance to support the re-engineering of our economies for Net Zero.

The objective for the private finance work for COP26 is to ensure that every professional financial decision takes climate change into account.

This requires the right framework so that the financial sector can allocate capital to manage risks and seize opportunities in the transition to Net Zero. To this end, the **COP26 Private Finance Hub** is working with the private sector and other stakeholders to develop workplans for:

- Reporting
- Risk management
- Returns
- Mobilisation

Under the third category 'Returns' is the following call to action for banks, asset managers and asset owners to:

Commit to align portfolios and lending with Net Zero, disclose accordingly, and publish credible transition plans.

Supporting this work, the **Race to Zero** is a global campaign to rally leadership and support

from businesses, cities, regions, investors for a healthy, resilient, zero carbon recovery that prevents future threats, creates decent jobs, and unlocks inclusive, sustainable growth.

The campaign, coordinated by the UN, brings together Net Zero commitments from a range of leading networks and initiatives across the climate action community.

Within **Race to Zero**, the Glasgow Finance Alliance for Net-Zero (GFANZ), launched in April 2021, is led by Mark Carney's COP26 Private Finance Hub. It will house the various net-zero commitments of the financial sector that have been accredited by **Race to Zero**.

Four well established initiatives¹³ are:

- The UN-convened Net Zero Asset Owner Alliance (NZAOA)
- The Net Zero Asset Managers initiative (NZAMI)
- The Net Zero Banking Alliance (NZBA)
- The Paris Aligned Investment Initiative (PAII)

THE UN-CONVENED NET ZERO ASSET OWNER ALLIANCE (NZAOA)

Host/Secretariat: PRI / UNEP FI

Target Audience: Asset Owners

The UN-convened **Net Zero Asset Owner Alliance** is an international group of 37 institutional investors (as of May 2021) representing \$5.7tn assets under management who have committed to transition their investment portfolios to net-zero GHG emissions by 2050.

The group collectively published in late 2020 a Target Setting Protocol highlighted technical principles and requirements which should be abided by when developing interim targets and

associated actions plans, covering Portfolio-level targets, sector-level targets, engagement targets and 'financial transition' tracking targets. All Asset Owners should set targets for at least 3 of these areas, with Engagement targets being mandatory.

The group has 6 main working tracks for its members which reflect the ambition and objectives of the commitment: Monitoring, Reporting and Verification; Engagement; Policy; Communication; Financing Transition; and Recruiting.

Further information can be found at: <https://www.unepfi.org/net-zero-alliance/>

¹³ As of May 2021, only the NZAOA, NZAMI and NZBA are GFANZ members.

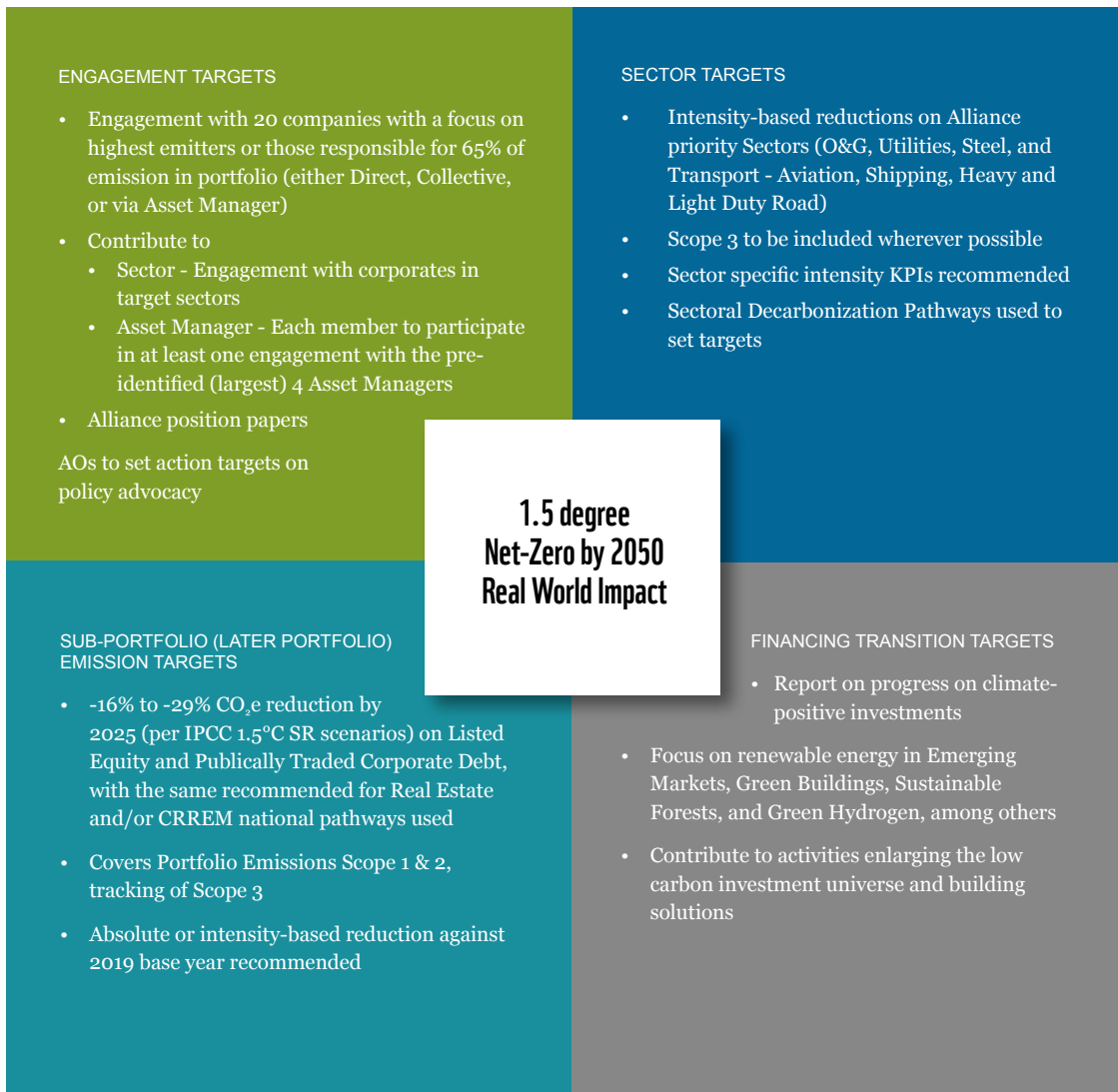


Figure 6: NZAOA criteria for setting Net Zero targets by asset owners. Source: NZAOA Target Setting Protocol

THE NET ZERO ASSET MANAGERS INITIATIVE (NZAMI)

Host/Secretariat: AIGCC, CDP, Ceres, IIGCC, and PRI

Target Audience: Asset Managers

The **Net Zero Asset Managers initiative** is an international group of asset managers committed to supporting the goal of Net Zero greenhouse gas emissions by 2050 or sooner, in line with global efforts to limit warming to 1.5 degrees Celsius; and to supporting investing aligned with Net Zero emissions by 2050 or sooner.

As of May 2021, it is made up of 87 signatories with \$37tn in assets under management.

The asset manager signatories have committed to set interim targets for 2030, within a year of joining the initiative, for the proportion of assets to be managed in line with reaching Net Zero emissions by 2050 or sooner.

Asset managers joining the initiative commit to transparent and rigorous accountability. Signatories will annually report progress against the Task Force for Climate-related Financial Disclosures (TCFD) recommendations, including setting out a climate action plan and submitted this for external.

Further information can be found at: <https://www.netzeroassetmanagers.org/>

THE NET ZERO BANKING ALLIANCE (NZBA)

Host/Secretariat: UNEP FI

Target Audience: Banks

The *Net Zero Banking Alliance* was launched in April 2021. It is a global alliance of banks that have committed to align their loan books and portfolios with net-zero greenhouse gas emissions by 2050, consistent with a maximum temperature rise of 1.5°C above pre-industrial levels.

This commitment requires banks to set an intermediate target of 2030 or sooner, using robust, science-based guidelines developed by the UNEP FI's Collective Commitment to Climate Action (CCCA) leadership group of banks.

The Alliance brings together 43 banks with \$28.5tn in assets, which will transition the operational and attributable GHG emissions from their lending and investment portfolios to align with pathways to net-zero by 2050 or sooner. They will prioritise efforts where they have or can have the most significant impact, i.e. the most GHG-intensive sectors within their portfolios.

Further information is available at:
<https://www.unepfi.org/net-zero-banking/>

THE PARIS ALIGNED INVESTMENT INITIATIVE (PAII)

Host/Secretariat: IIGCC , Ceres, AIGCC and IGCC

Target Audience: Asset Owners and Asset Managers

The *Paris Aligned Investment Initiative* (PAII) was established in May 2019 by the IIGCC in order to support investors in aligning their portfolios to the goals of the Paris Agreement.

The The Net Zero Investment Framework of the PAII, published in March 2021, provides a common set of recommended actions, metrics and methodologies through which investors can maximise their contribution to achieving global Net Zero global emissions by 2050 or sooner. It currently covers 4 asset classes: sovereign bonds, listed equities, corporate fixed income and real estate.

Its primary objective is to ensure investors can decarbonise investment portfolios and increase investment in climate solutions, in a way that is consistent with a 1.5°C Net Zero emissions future.

Further information is available at:
https://www.parisalignedinvestment.org/media/2021/03/PAII-Net-Zero-Investment-Framework_Implementation-Guide.pdf

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