

2° Investing Initiative

CCCA PACTA Presentation

15 October 2020

Paris Agreement Capital Transition Assessment

Supported by:



Federal Ministry
for the Environment,
Nature Conservation
and Nuclear Safety

based on a decision of the German Bundestag



About our funders: This project is part of the International Climate Initiative (IKI). The Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) supports this initiative on the basis of a decision adopted by the German Bundestag. This project has also received funding from the European Union LIFE program. The views expressed here are the sole responsibility of the authors and do not necessarily reflect the views of the funders.

Agenda

① Intro to 2DII and PACTA for Banks

- 3:00 – 3:15 **Introduction to 2DII**
Sarah Mendelsohn, Project Manager at 2DII
- 3:15 – 3:30 **Introduction to PACTA for Banks**
Maarten Vleeschhouwer, Head of PACTA at 2DII
- 3:30 – 4:00 **Case Study: Katowice Banks' application of PACTA for Banks**
Imène Ben Rejeb-Mzah, Group CSR Methodologies and Data Officer at BNP Paribas
- 4:00 – 4:15 Q&A

② Deep-dive

- 4:15 – 4:35 **PACTA for Banks Methodology Deep Dive**
George Harris, Analyst at 2DII
- 4:35 – 4:55 Q&A
- 4:55 – 5:00 Getting started & next steps

1: Intro to 2° Investing Initiative & PACTA for Banks

Our mission

Aligning financial markets & regulations with
climate goals



Founded in 2012



Working globally, with offices in Paris, New York, Berlin, Brussels, and London



Collaborate with FIs, NGOs, universities, policymakers and supervisors



Non-profit, non-commercial

What we do



Research



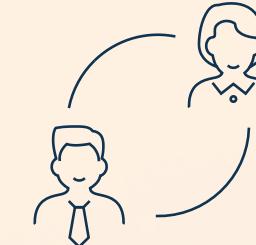
Policy



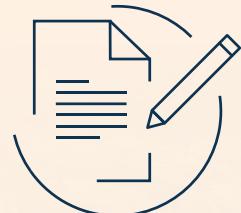
Data & tools



PACTA
Climate scenario
analysis



**Retail
investing**
Supporting retail
investors'
sustainability goals



**Risk
management**
Supporting long-
term risk supervision



**Impact
measurement**
Studying FIs' impact
in the real economy

Introduction to PACTA for Banks

- Free, open-source climate scenario analysis methodology & supporting tool kit
- Designed in collaboration with a wide range of external stakeholders covering banks, NGOs, academia

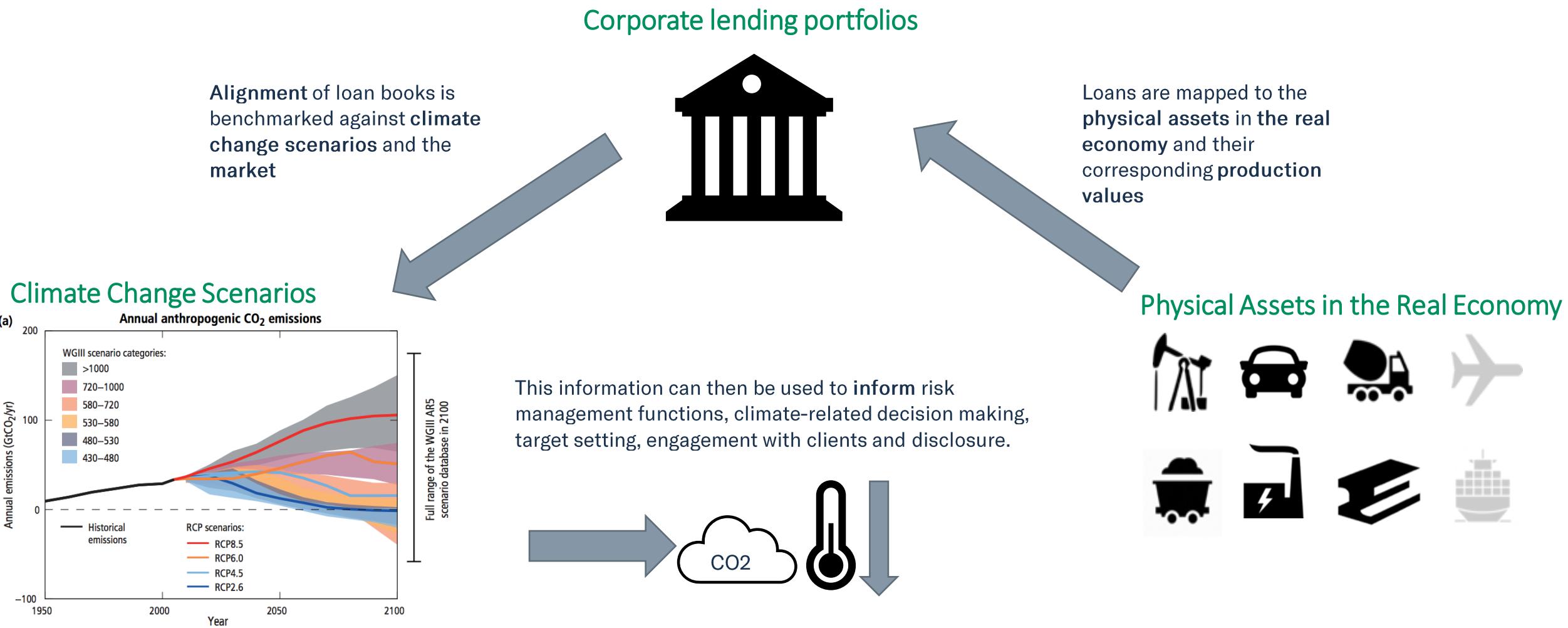
The PACTA for Banks pilot group



2DII's other partners in the academic and NGO sectors



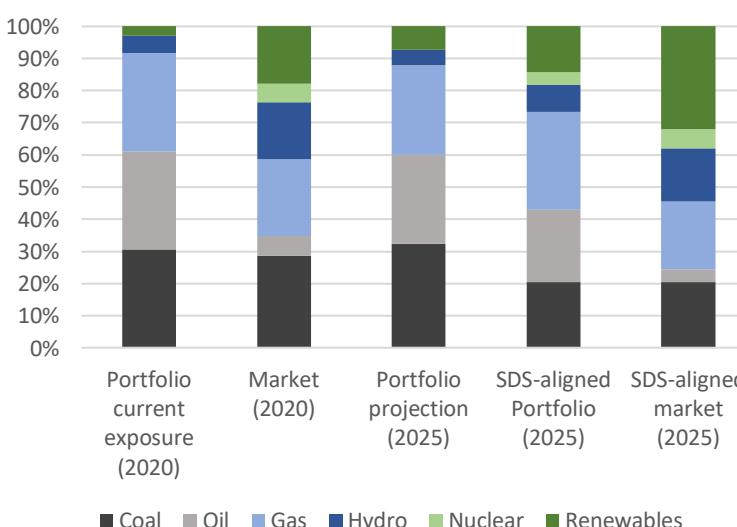
Introduction to PACTA for Banks



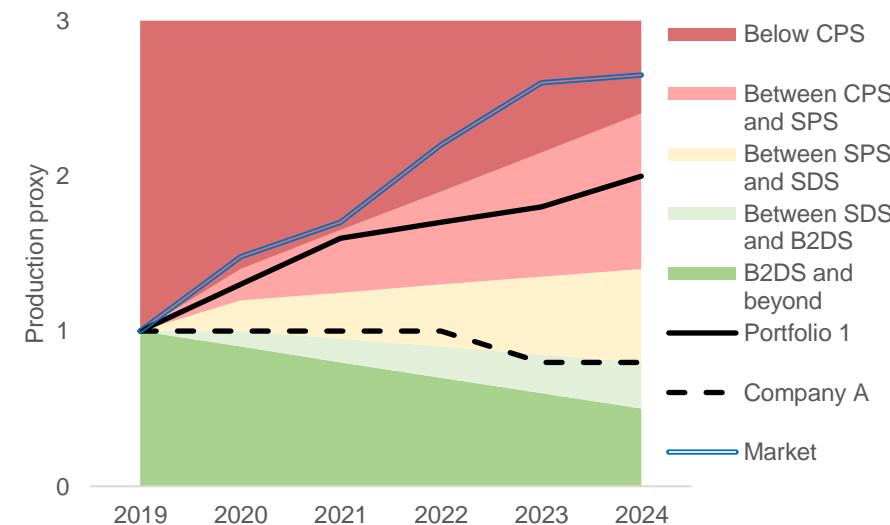
PACTA Metrics

- PACTA for Banks metrics allow for multiple benchmarks and are projected up to 5 years in the future

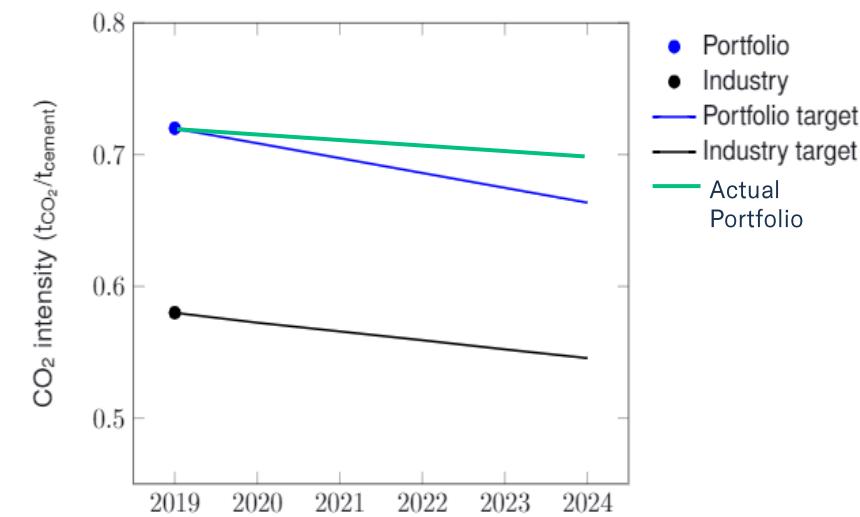
Technology / Fuel Mix



Production Volume Trajectory



Emission Intensity



PACTA for Banks Toolkit

- PACTA for Banks is **free** and **open-source**
- The methodology is **data**, **software** and **scenario-agnostic**
- Free data, software, and preformatted scenarios are accessible at www.transitionmonitor.com

Methodology / Supporting Documents



PACTA for Banks
Methodology
Document

Climate scenario analysis for corporate lending portfolios

Date: 18 September 2020
Version: 1.1.0*

Software



Free Data Set



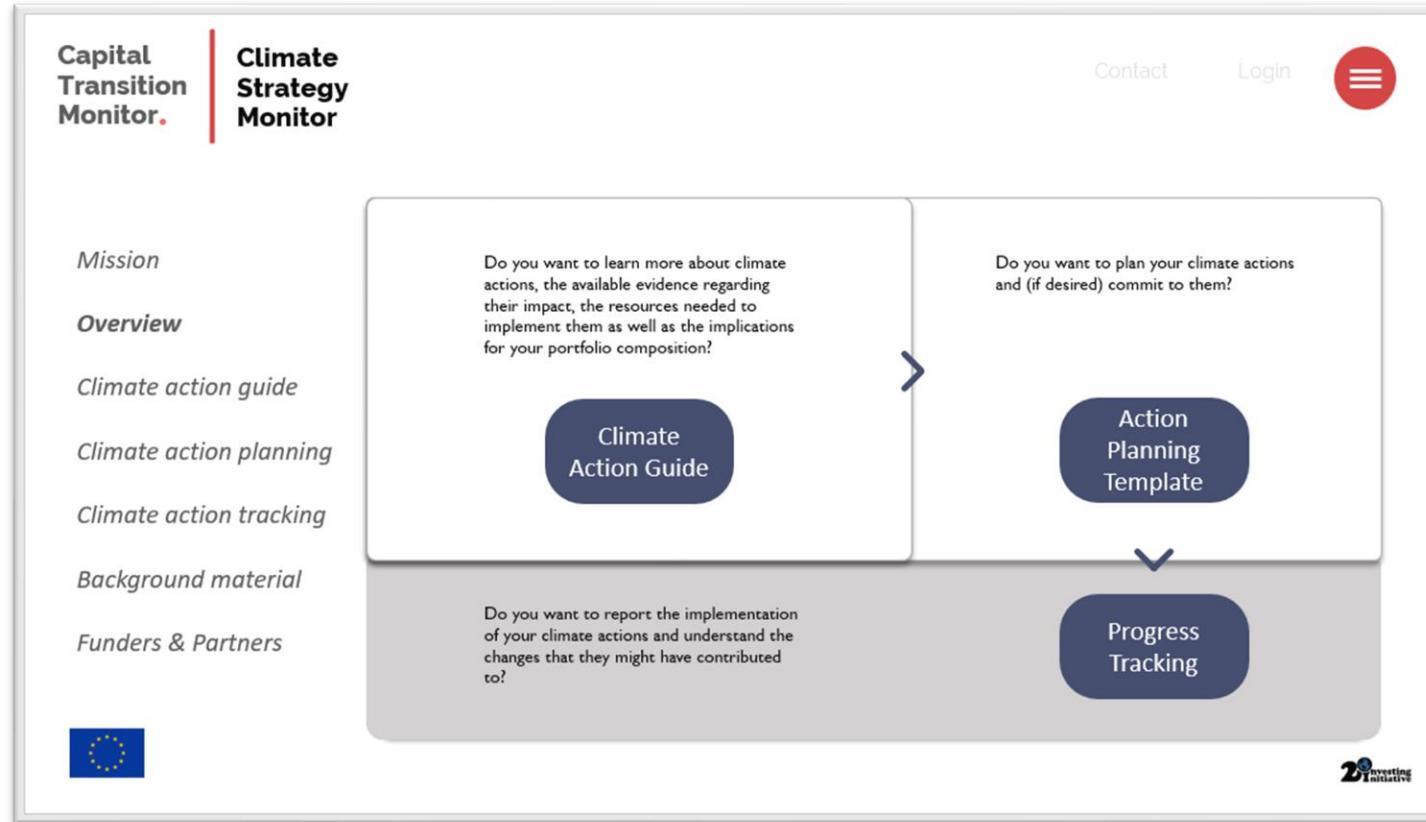
Training Materials

Practical User
Guide

Part 1:
Planning your Resources

Date: 18/09/2020
Version: 1

Evidence for Impact



The outcome of the **Evidence for Impact** project will be a tool allowing FIs to:

- Access the most up-to-date scientific information regarding the effectiveness of climate actions & understand the various implications of implementing these actions
- Record their implemented actions in a standardized fashion
- Track the impact of their actions

As FIs use this tool, **data will be collected to inform evidence building.**



CREDIT PORTFOLIO ALIGNMENT

AN APPLICATION OF THE PACTA METHODOLOGY

BY KATOWICE BANKS

SEPTEMBER 2020

BBVA

ING 

Standard Chartered 



BNP PARIBAS



**SOCIETE
GENERALE**

**2^o
investing
initiative**



1. INTRODUCTION

- 1.1. Who are we
- 1.2. Our journey with the PACTA methodology
- 1.3. Publication of the Katowice application of PACTA
- 1.4. Why did Katowice Banks decide to use PACTA?
- 1.5. Why did Katowice Banks decide to write the KB paper?

1.1. WHO WE ARE

The Katowice Banks (KB) is a coalition of 5 global banks comprising BBVA, BNP Paribas, ING, Societe Generale and Standard Chartered.

On the occasion of COP24, in December 2018, we committed to:

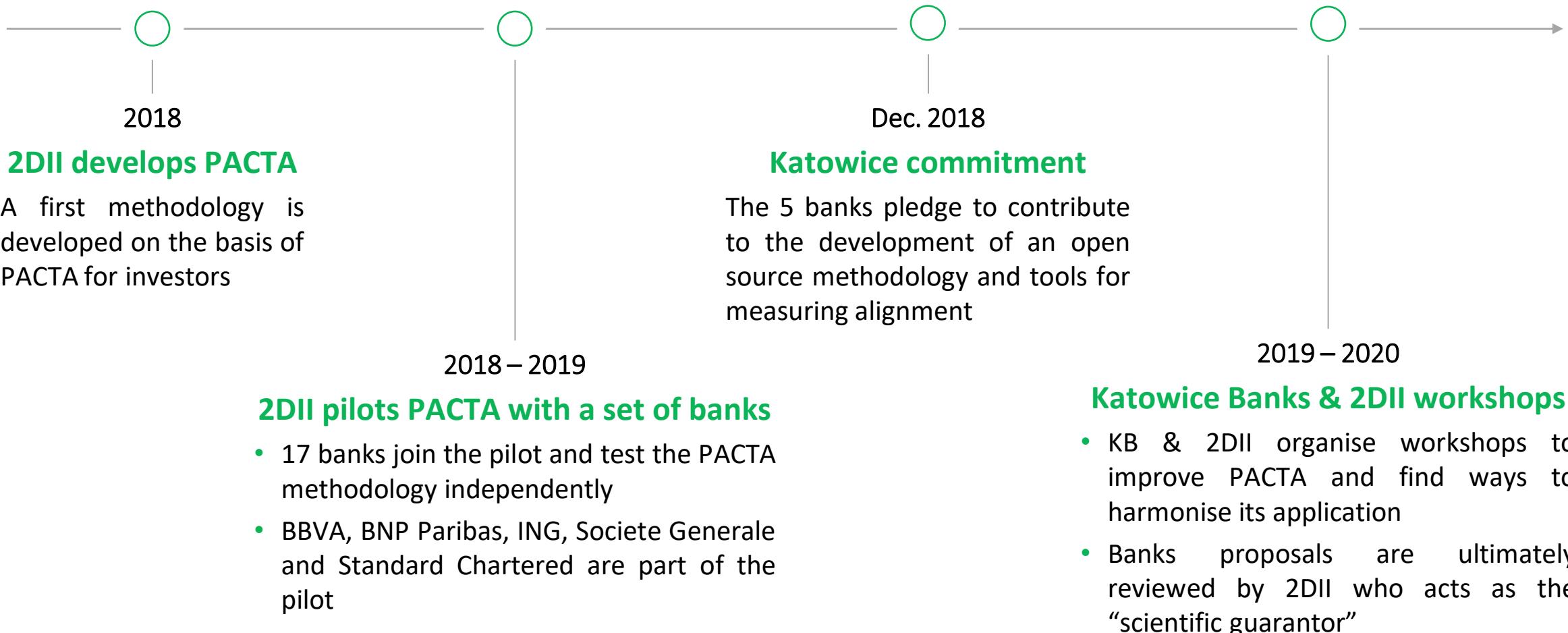
- (1) contribute to the development of an open source methodology and tools for measuring alignment;
- (2) and to steer credit portfolios to be in line with the Paris Agreement.



To meet this objective we joined forces with **the 2°C Investing Initiative (2DII)**, an international, non-profit think tank working to align financial markets and regulations with the Paris Agreement goals.



1.2. OUR JOURNEY WITH THE PACTA METHODOLOGY

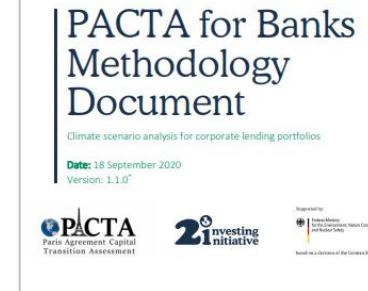


1.3. PUBLICATION OF PACTA

September 2020 Publication of PACTA by 2DII and its application by KB

- 2DII publish the “PACTA methodology” with an online tool.

<https://www.transitionmonitor.com/wp-content/uploads/2020/09/PACTA-for-Banks-Methodology-Document.pdf>



- Katowice Banks to publish their “Application of the PACTA methodology”.
- The aim is to help peers apply the methodology and publish comparable results.

<https://2degrees-investing.org/wp-content/uploads/2020/09/Katowice-Banks-2020-Credit-Portfolio-Alignment.pdf>

1.4. WHY DID KATOWICE BANKS DECIDE TO USE PACTA?

Katowice Banks looked for methodologies that helps:

- Set the right incentives for taking portfolio-reallocation decisions
 - Climate scenarios show there is not one but a set of transitions that vary across sectors, regions and timeframes.
 - PACTA's sector-based approach is most suited for portfolio reallocation because it helps identify indicators that are enablers of the transition.
- Can easily be measured, monitored and steered, and are not volatile or dependent upon changes except for changes in the client's alignment or the bank's portfolio decisions.
 - PACTA offers ways to monitor alignment based solely on counterparties climate materiality and banks' portfolio decision.

1.5. WHY DID KATOWICE BANKS DECIDE TO WRITE THE KB PAPER

This document provides an overview of the application of the PACTA methodology and the options viewed as most useful by the Katowice Banks

- As far as possible, we have sought to align our application of PACTA to make results comparable across banks for the benefit of our stakeholders.
- Sometimes, we have suggested improvements to the PACTA methodology to ensure that the indicators developed are enablers of the transition
- The aim of this document is also to help banks get started by making use of the countless hours we have spent applying and refining this methodology with internal sector experts, clients and stakeholders.
- We shared our operational feedback to help other banks with the methodology implementation





2. PACTA USE CASES

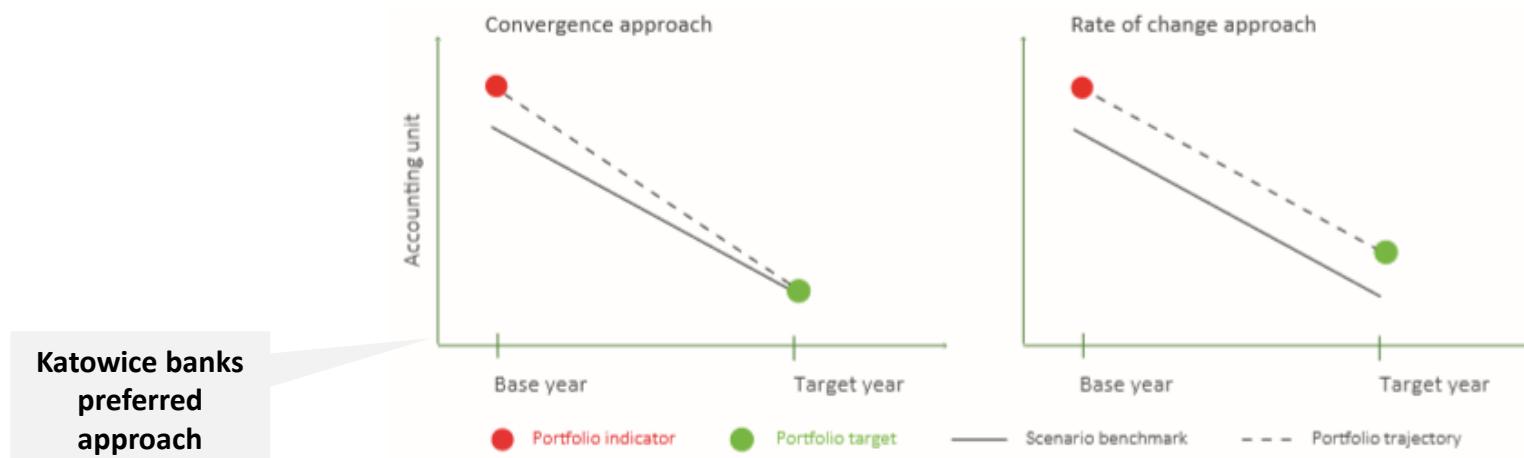
- 2.1. Scenario selection and target setting
- 2.2. Monitoring and Reporting
- 2.3. Steering and engagement with clients

2.1. SCENARIO SELECTION AND TARGET SETTING

PACTA is Scenario agnostic: the PACTA methodology can accept different climate scenarios (benchmarks), assuming they are scientifically defined and Paris-aligned and that the desired indicators are provided

The PACTA methodology proposes two approaches to define the trajectory the portfolio should follow to meet the end target:

- The '**convergence approach**' (SDA approach is a type of application of the convergence approach), which specifies that the portfolio indicator needs to adjust at the same level as the scenario benchmark, independent of the indicator level at baseline => **Katowice banks preferred option** as it is easier to communicate and is connected directly with the level of the benchmark
- The '**rate of change approach** (**trajectory Approach**), where the level of the indicator is not compared with the benchmark, but rather the portfolio indicator needs to adjust at the same rate of change as the scenario benchmark.



2.2. MONITORING AND REPORTING

Forward-looking approach

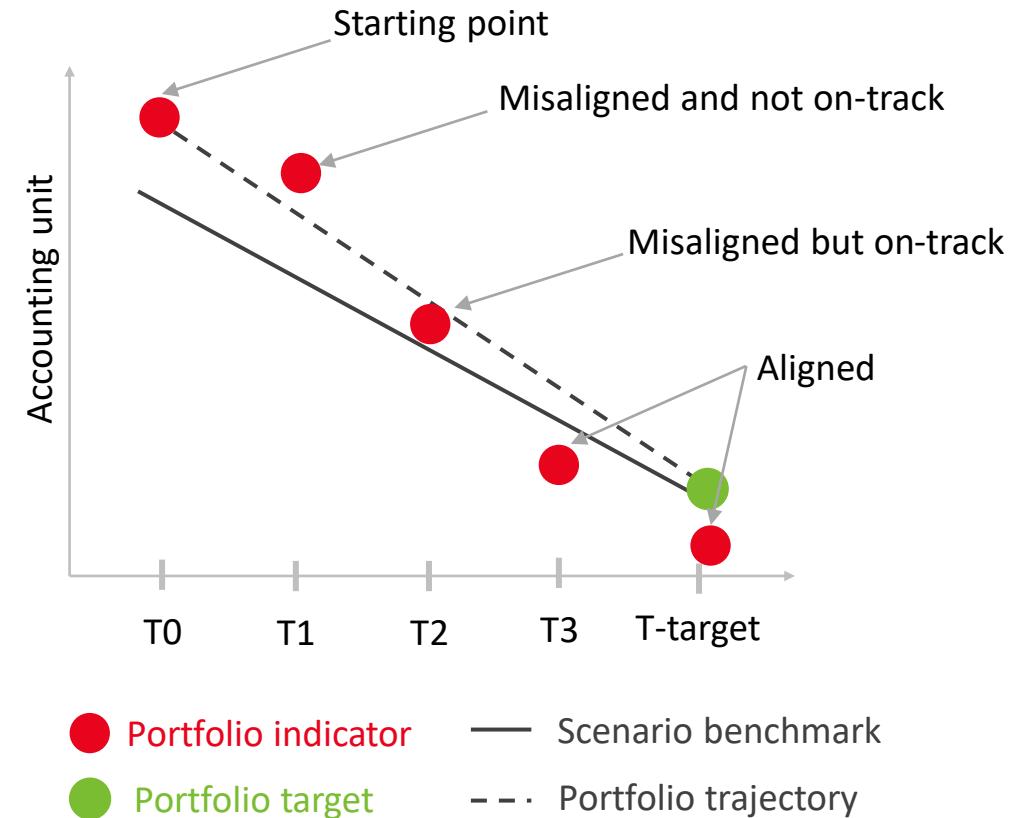
As much as possible, forward-looking data related to clients and assets financed will be integrated to the alignment analysis.

Monitoring

Year on year the degree of alignment could be monitored to ensure that the portfolio is on track with its target trajectory

Reporting

Banks can report their 'degree of alignment' and 'track the trajectory of their alignment', by specifying whether their degree of misalignment is 'on track' or 'off track' with the pathway



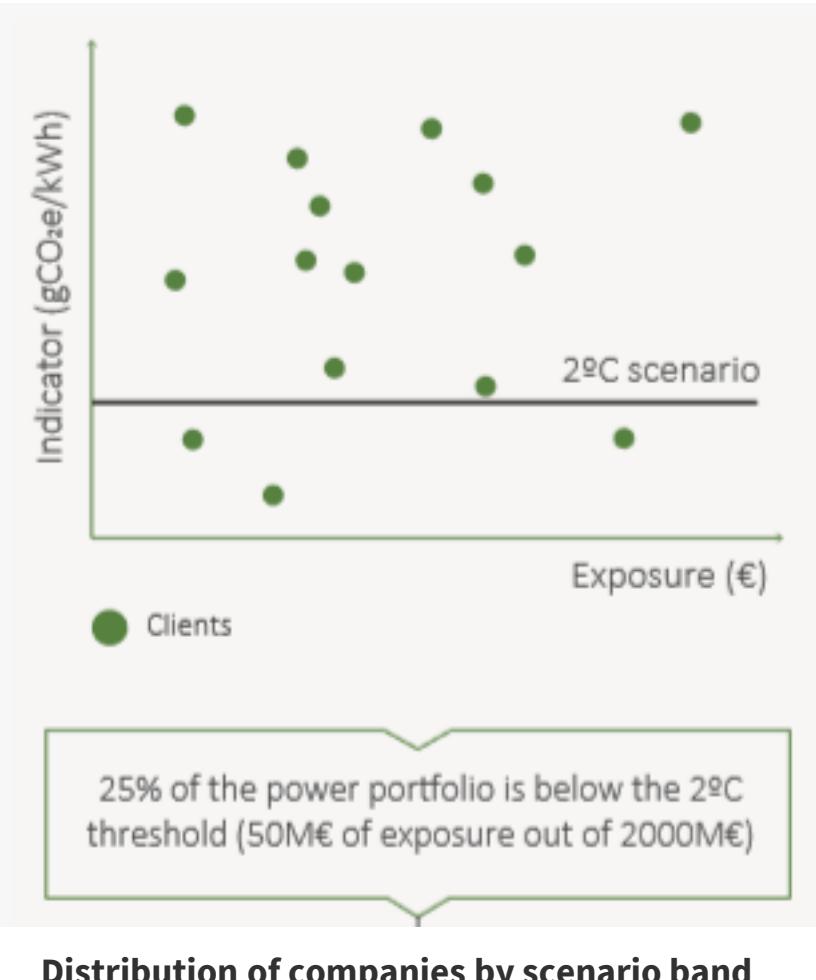
2.3. STEERING AND ENGAGEMENT WITH CLIENTS

Principle of engagement over divestment

Portfolio alignment, or steering, can be achieved either by accompanying existing clients to align their activities, or through shifting our client base.

As a principle, KB believe it is more productive from a climate and business standpoint to work with existing clients and accompany them towards lower carbon practices.

Therefore, an approach of engagement over divestment is favoured, as previously mentioned, although divestment is not ruled out in some circumstances.



A photograph of a modern building's exterior featuring a large-scale vertical green wall. The wall is covered in a variety of green plants, including leafy greens and small flowers, growing in rectangular planters attached to a light-colored metal frame. The perspective is from a low angle, looking up at the building's corner.

3. MAIN LESSONS AND NEXT STEPS

3.1 MAIN LESSONS FROM PORTFOLIO PACTA ANALYSIS

- **It is possible to build and to co-create together with 4 other banks and to share it**
- **Financial flows must be consistent with a low-carbon strategy to keep global warming at a level well below 2°C and ideally 1.5°C.**
- **This calls for engagement with customers to**
 - re-orient their investment plans towards low-carbon technologies and activities,
 - to divert the investment flows from activities not compatible with this objective and/or
 - to bolster the financing of green activities.

3.2. NEXT STEPS

- **Data quality and availability:** Availability of climate data to measure alignment is the main limit to the development of methodologies.
 - As of today, companies that report information related to their emissions are listed companies or sectors subject to specific regulations (e.g. automotive).
 - Lack of standardized reporting framework for carbon intensity
 - Revenue segmentation: Should be considered as a proxy of the distribution of activities.
- **Current available climate scenarios mainly focus on physical variables** (energy demand, energy production, vehicles quantity ...). Indeed, financial variables scenarios (energy capex ...) that may seem to be the most intuitive benchmarks to the portfolio mixes indicators [since they are expressed in the same unit (% euro invested)] are poorly documented
- The study has been focused on the most climate relevant sectors. It will subsequently be **expanded to other major GHG emitting sectors.**

⇒ **Further research is needed**



ANNEX

SUMMARY OF CHOICES MADE BY KATOWICE BANKS

METHODOLOGY STEPS	OPTIONS IN PACTA	KATOWICE BANKS CHOICE
Scoping		
Financial products & services	In principle, the methodology is applicable to all financial products. But for some products (e.g. derivatives), the link with the real economy can be more tenuous and requires more thought about its application at this stage.	– Corporate loans to start with
Exposure type	– Capital exposure – Client relationship	– Capital exposure
Financial indicators	– Net commitment/nominal amount – Gross commitment, including guarantees – Gross commitment – Drawn amount – Exposure at Default (EAD) – Credit limit	– Gross commitment (Drawn + undrawn) – Drawn amount – Exposure at Default
Sector segmentation	– Primary activity – Revenue weighted (not automatic)	– Primary activity – <u>Revenue weighted for the energy sector if data is available</u>
Measuring indicators		
Types of indicator	– Volume – Technology mix – Emission intensity	– All used + – <u>Financing indicator (trend and mix)</u>
Allocation rule	– Unweighted approach – Portfolio weight approach – Ownership approach	– Portfolio weight approach
Benchmarking		
Alignment approach	– Convergence approach – Rate of change approach	– Convergence approach for physical indicators and <u>rate of change approach for financial indicators</u>
Choice of benchmark	– Economy as a whole – Regional subset – Institutional subset	– Economy as a whole – Regional subset – Institutional subset
Aggregate result across several portfolios	– PACTA does not propose any aggregated result	– <u>Proposal to express result using the "share of exposure below a temperature threshold"</u>

Q&A

2: Deep-dive into the PACTA for Banks Methodology

Introduction to PACTA for Banks

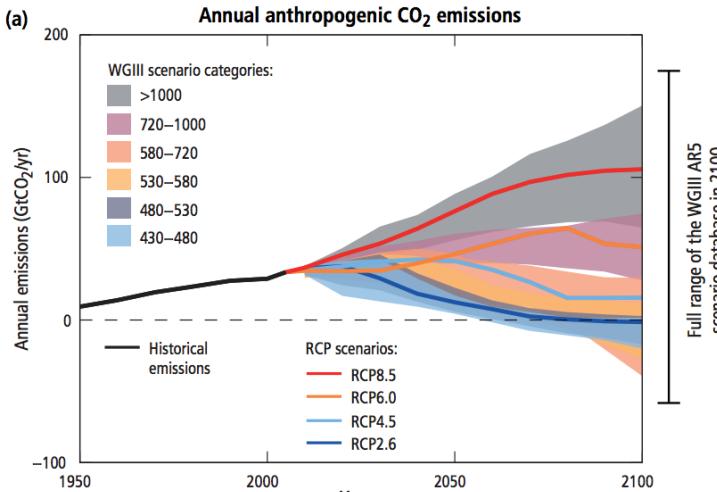
Corporate lending Portfolios

Alignment of Loan Books is benchmarked against climate change scenarios and the market

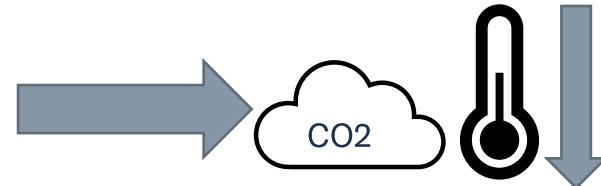


Loans are mapped to the physical assets in the real economy and their corresponding production values

Climate Change Scenarios



This information can then be used to inform risk management functions, climate related decision making, target setting, engagement with clients and disclosure.

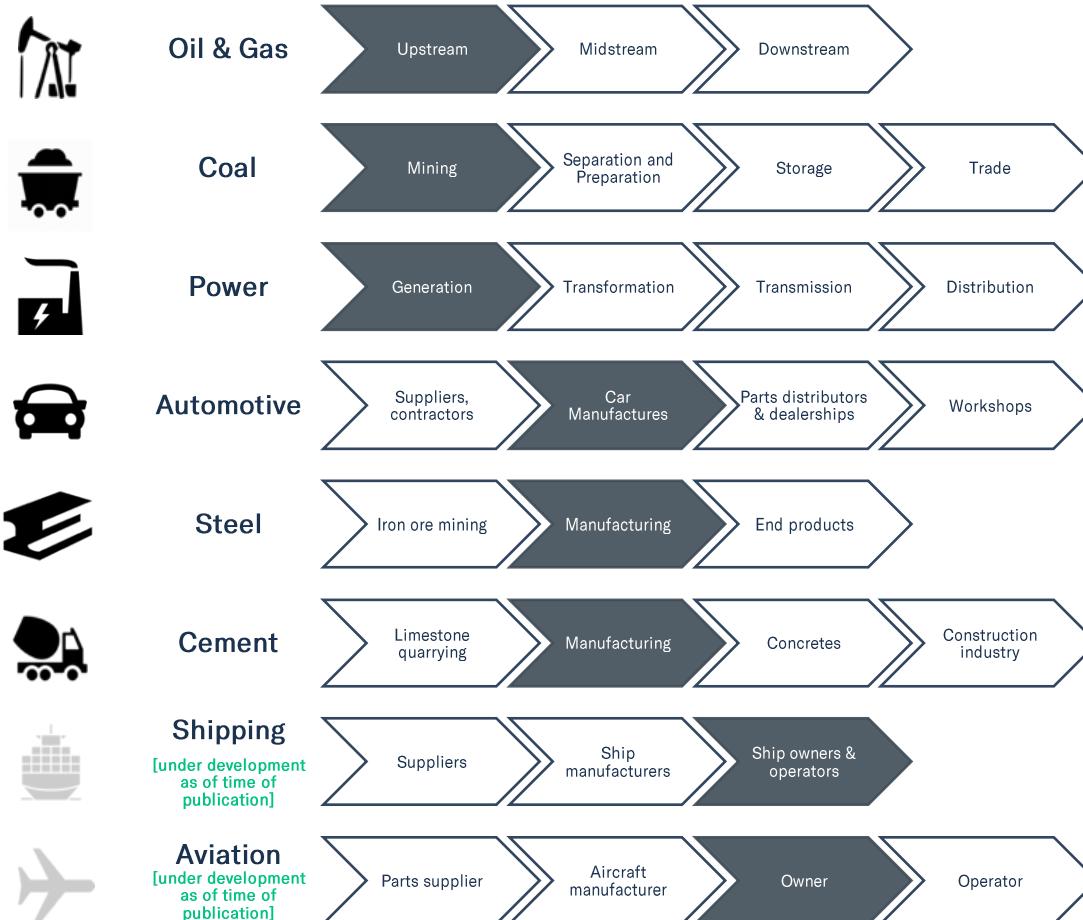


Physical Assets in the Real Economy



PACTA for Banks Methodology

Sectors Scope



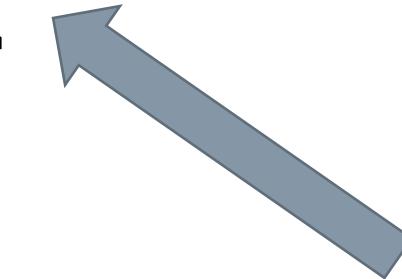
- Only the most climate-relevant segment of the value chain is covered
- Rationale is that if steering efforts align this segment of the value chain then the rest will become aligned
- Results are given at the sector and technology level

PACTA for Banks Methodology

Method of allocating physical economic assets to financial instruments

- **Portfolio-Weight Approach**
- If the loan to coal company A represents 10% of your coal portfolio, then you are allocated 10% of company A's coal production
- This represent the capital allocation decision of the relationship manager behind the portfolio

Corporate lending Portfolios



Physical Assets in the Real Economy

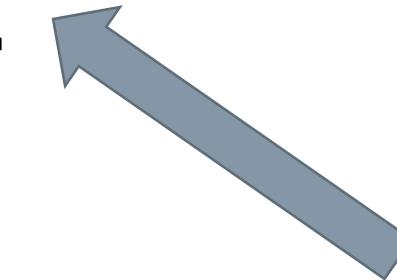


PACTA for Banks Methodology

Method of allocating physical economic assets to financial instruments

- **Unweighted approach**
- This approach allocates the absolute values of the companies that a portfolio is exposed to the portfolio's alignment score
- Used for company-level results

Corporate lending Portfolios



Physical Assets in the Real Economy



PACTA for Banks Methodology

For distributing macro carbon budgets to micro-economic actors

- **Market share approach**
- The decarbonization efforts required by a company is proportionate to their share of the market
- Market share is calculated as the companies' share of the sector's total production in a given technology
- If company A makes up 10% of the market share in a given technology, it is required to make 10% of the sector's decarbonization efforts in that technology

Corporate lending Portfolios



Climate Change Scenarios

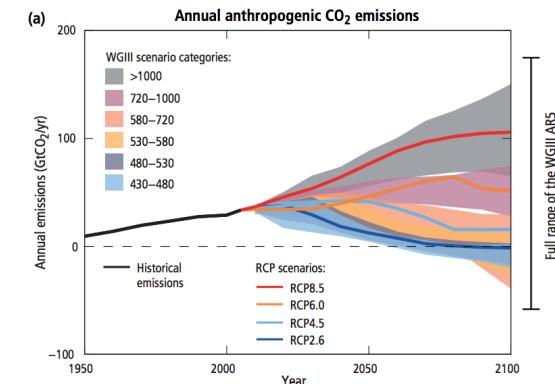
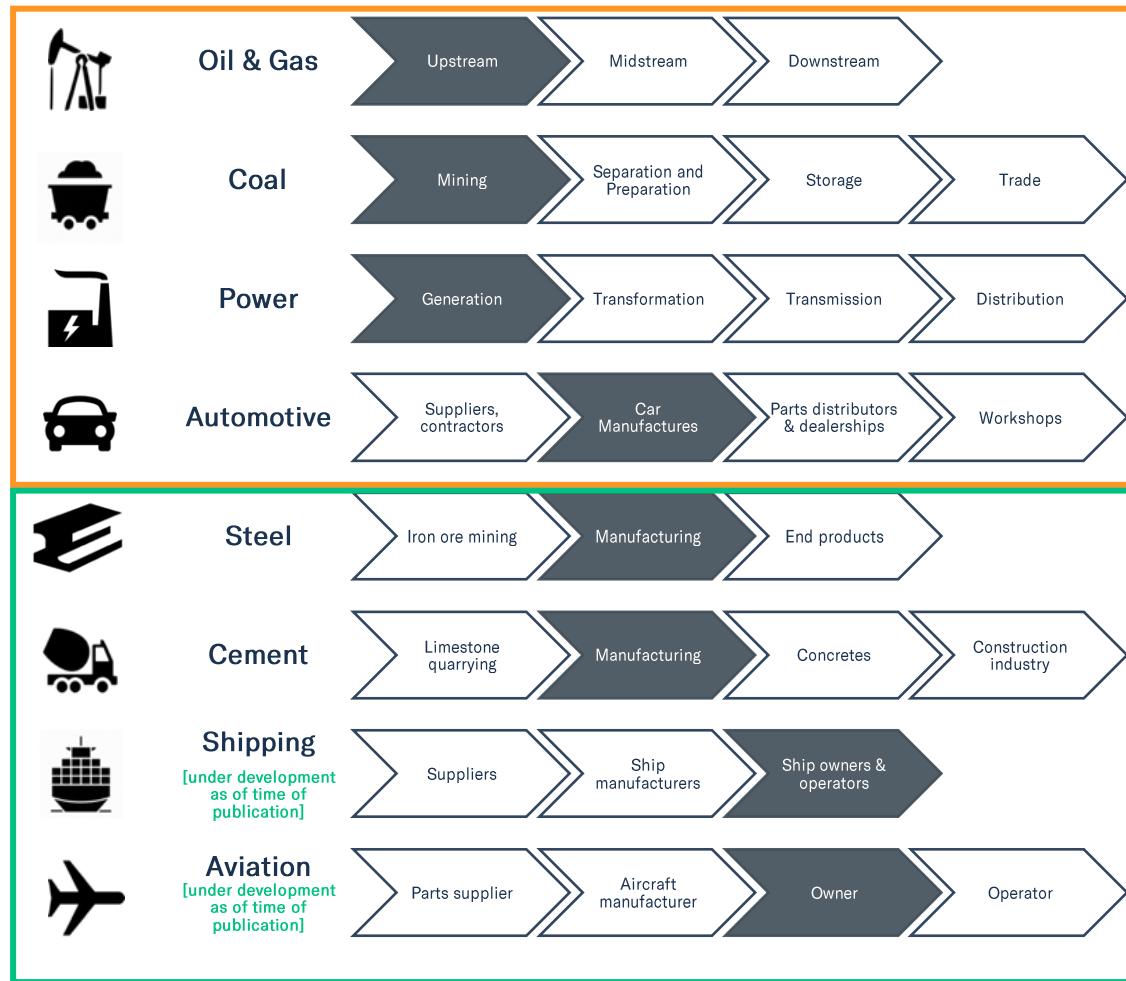


Figure SPM.5 from page 9 of the [IPCC AR5 Summary for Policymakers](#):

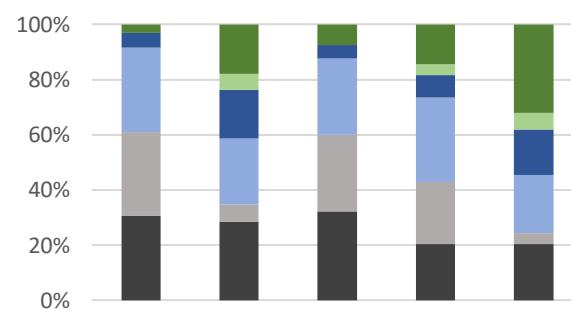
PACTA for Banks Methodology

Sectors Approach

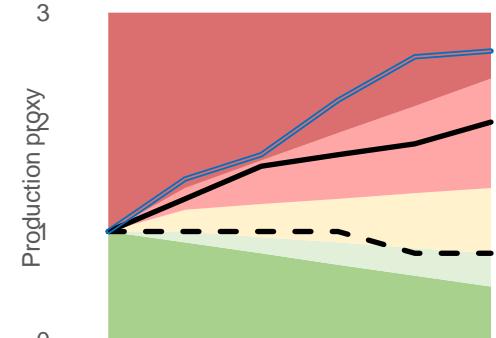


Sectors with Technology Road Maps

Technology / Fuel Mix

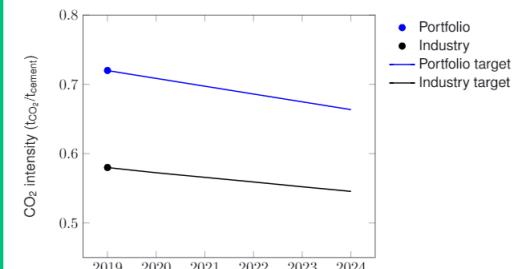


Production Volume Trajectory



Sectors without Technology Road Maps

Emission Intensity

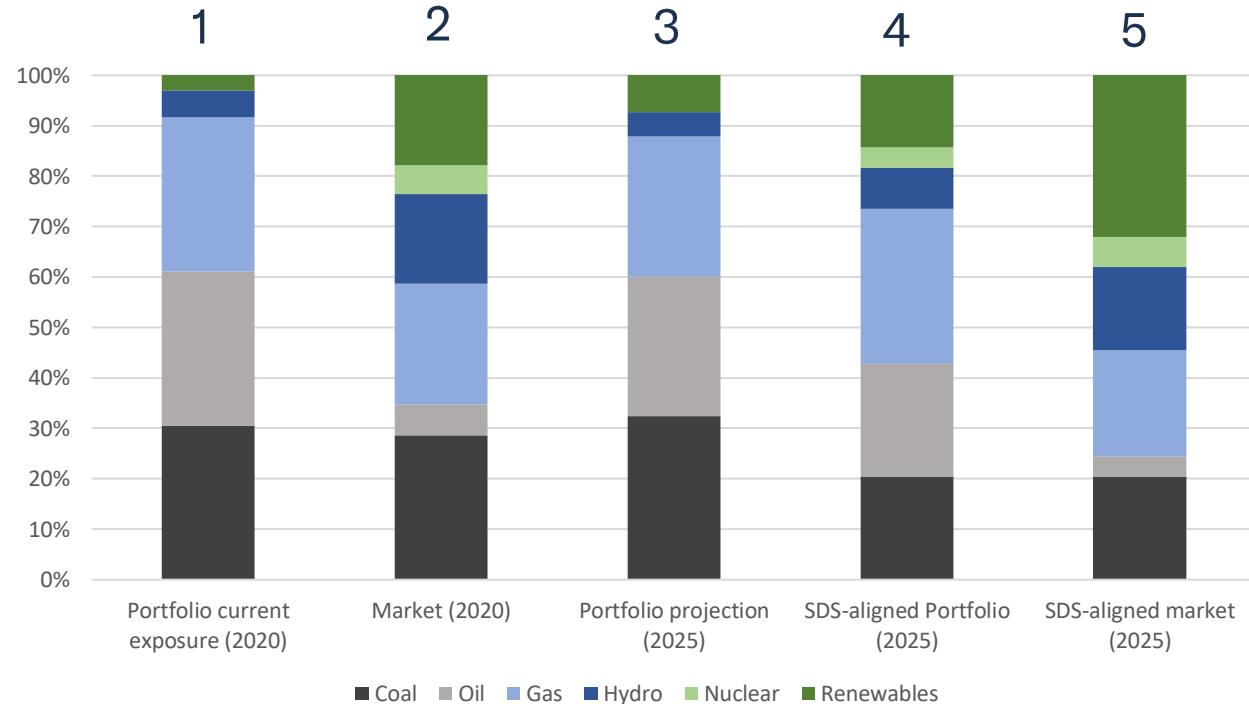


Technology / Fuel Mix

- **Approximates the bank's relative exposure to the economic activities that are impacted by the transition to a low-carbon economy**
- It is a function of **how dispersed the portfolio is across counterparties, and how dispersed these companies' activities are across technologies**



Power Sector Fuel Mix – a comparison of the portfolio to a market benchmark and the SDS scenario

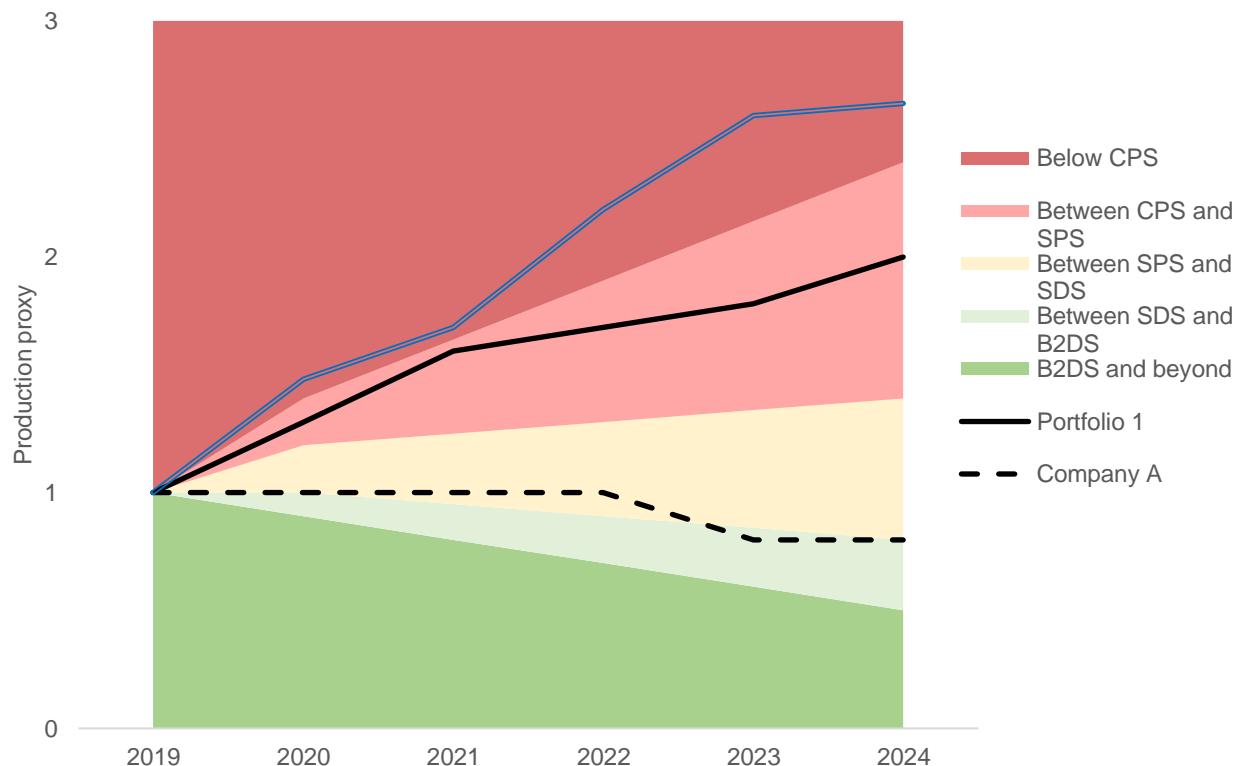


Production Volume Trajectory

- Compares the **portfolio's volume production trend** against the trends set as targets from climate scenarios
- It is also **benchmarked** against the **trend in the industry as whole**
- Company-level results can be given

Sectors:    

Trajectory of the portfolio volume proxy compared to market and scenario trajectories (coal-fired power generation – installed capacity)

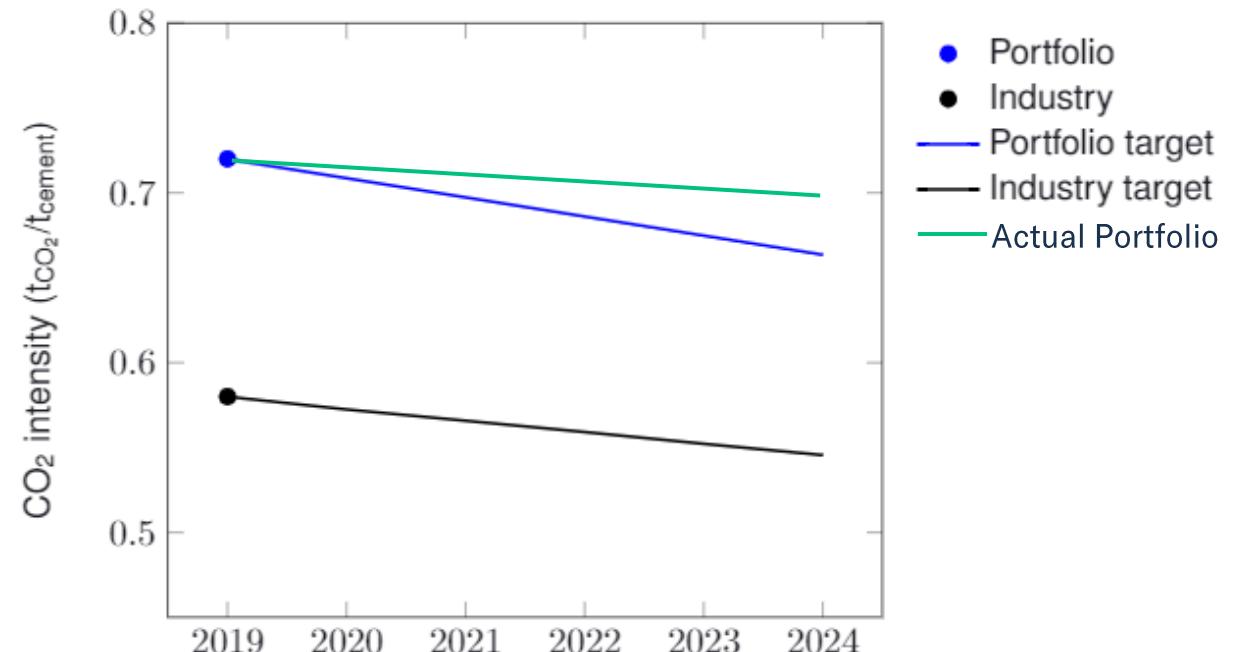


Emission Intensity Metric

- Targets set using the SBTi's Sectoral Decarbonization Approach (SDA)
- Absolute carbon budgets are set for each sector (taken from climate scenarios). This is then converted to **intensity targets** per year for the market (black line)
- The **portfolio's loan weighted average emission intensity** is calculated at present – then, a yearly target is set. (blue line)
- The green line represents the **portfolio's projected intensity**
- **This is a convergence approach.** So, all portfolios' targets will equal the market's target (scenario) at the end point of the scenario



Cement CO₂ intensity metric – The portfolio's projected intensity is compared to its target and the markets target



Q&A

Getting started – next steps

- Planning your resources – **User Guide 1. Resource Planner**
- Preparing your loan book & installing the software - **User Guide 2. Prerequisites and Preparing your Loan Book**
- Accessing the free data – submit a request to Asset Resolution
- All the above are accessible at www.transitionmonitor.com
- Matching webinar (date TBC) – register your interest via www.2degrees-investing.org/events

Contacts

- PACTA for Banks related queries: banks@2degrees-investing.org
- General 2DII queries: contact@2degrees-investing.org
- www.2degrees-investing.org
- www.transitionmonitor.com

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Federal Ministry
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based on a decision of the German Bundestag



About our funders: This project is part of the International Climate Initiative (IKI). The Federal Ministry for the Environment, Nature Conservation and Nuclear Safety (BMU) supports this initiative on the basis of a decision adopted by the German Bundestag. This project has also received funding from the European Union LIFE program. The views expressed here are the sole responsibility of the authors and do not necessarily reflect the views of the funders.