Science-based targets for banks – towards harmonized guidelines in 2024?

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In November 2023, a report published by Reuters[1] announced that the commitments to set science-based targets of several European banks were removed from the Science-Based Target Initiative (SBTi)[2] website. According to the report, this was the result of decisions by the banks to withdraw their commitment following SBTi's June 2023 publications[3]. However, in the absence of an official communication from the stakeholders, the exact rationale behind the deletion of the banks' names from the website remains unclear.

This development puts the emphasis on the challenges faced by the banking industry to agree on harmonized guidelines, including precise criteria, in order to align their activities with ambitious science-based targets. Year after year, the number of banks that commit to support a net zero economy is growing. For example, the Net Zero Banking Alliance (NZBA)[4] gathers 141 members as of January 2024 (vs. 29 members when it was launched almost three years ago[5]). Thus, such guidelines are becoming even more essential to support the banking industry's transition from commitment to action (e.g., setting ambitious science-based targets with an appropriate coverage, develop appropriate exclusion policies)

Too many cooks spoiling the broth?

Several initiatives provide guidelines for climate target setting specifically for banks, such as the Institutional Investors Group on Climate Change (IIGCC) Net Zero Standard for Banks[6], the NZBA Guidelines for Climate Target Setting for Banks[7], SBTi Financial Institutions Net Zero Standard Draft, ACT Finance draft[8], etc. As an asset management firm, we acknowledge that the initiatives play distinct roles but their lack of alignment on key topics, such as the criteria defining the concept of science-based targets in line with a net zero pathway, is concerning.

A concrete example of that misalignment is the status of fossil fuel criteria, which are explicitly mentioned in the SBTi Net Zero Draft Standard but not in the NZBA guidelines. The latter suffered criticisms from both external and internal stakeholders claiming that its approach to fossil fuel financing was too lenient, and members left the initiative or warned that they would leave without stricter rules on the topic[9].

While a variety of initiatives to set and assess climate transition plans (and associated science-based targets) might be beneficial, the lack of harmonization on key requirements could favour more flexible initiatives, when the climate emergency requires just the opposite. A closer look at the top 60 fossil fuel financiers[10] reveals that as of January 2024, c. 70% are members of the NZBA, while less than 20% commit to the SBTi or have established SBTi validated targets,.

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[1] *Reuters, Exclusive: Four banks quit initiative assessing climate targets, November 2023.*
[2] *SBTi objectives are to (i) define "best practices" in emissions reductions and NZ targets in line with climate science, (ii) provide target setting methods to set science-based targets and (iii) include a team of experts to provide companies with independent assessment and validation of targets.*
[3] *In June 2023, SBTi published the "The SBTi Financial Institutions Net-Zero Standard Consultation Draft" and the "SBTi Fossil Fuel Finance Position Paper") where the organization included fossil fuel criteria that were deemed stringent by Banks (according to Reuters). SBTi states that Financial Institutions shall establish targets for all financial flows to existing fossil fuel activities at the company level and shall also establish targets at the portfolio level. At company level, to engage fossil fuel companies to transition along 1.5°C pathways by establishing 2030 quantitative public targets […] and set clear commitments for no new expansion and the phasing down/out of production along approved 1.5°C pathways with low/no overshoot.*
[4] *NZBA, Frequently Asked Questions, October 2022.*
[5] *NZBA, Our Members – United Nations Environment – Finance Initiative (unepfi.org), January 2024.*
[6] *IIGCC, Net Zero Standard for Banks, June 2023*
[7] *NZBA, Guidelines for Climate Target Setting for Banks, April 2021*
[8] *ADEME, ACT Finance Draft, April 2023*
[9] *Reuters, Comment: The world cannot afford banks to step back from their net zero commitments, April 2023.*
[10] *The Banking on climate chaos report covers the world's 60 biggest banks by assets, according to the S&P Global Market Intelligence ranking from April 2022. Banks with little-to-no league credit for economy-wide financing were excluded from the analysis. Top fossil fuel financiers poured $1.546 trillion into fossil fuel expansion over the 2016 -2022 period.*

Taking the road less travelled …

When designing climate action guidelines, collaboration between the different initiatives in place and systematic alignment with science-based targets are crucial. It would be extremely concerning if independent initiatives were to go against science in order to fit industries' expectations. For example, the most updated version of the SBTi *Near-Term Financial sector science-based targets guidance* no longer mentions that financial institutions (Fis) should expect fossil fuel companies to ''set clear commitments for no new expansion and the phasing down/out of production along approved 1.5°C pathways with low/no overshoot''[11], while this condition was explicit in the previous draft version of the standard. In response to those concerns, the SBTi stated, ''the assertion that a change was made because of lobbying by Banks is simply not the case''[12].

There are certainly several elements which could explain the difficulty of the Banking industry to agree on harmonized guidelines and one might be linked to the lack of international support. Indeed, while the Banking industry is largely responsible for funding the transition to a net zero economy, stakeholders' efforts (e.g., governments, regulators) should support the implementation of such a transition by providing clear guidance. A good example is what transpired at COP28: the official global consensus which advocated for a fossil fuel phase away approach (opposed to a phase out) meaning that ''countries are free to follow their own paths to net zero, and that there is unlikely to be much action from oil and gas companies in the short term''. Thus, by aligning themselves with more flexible initiatives, Banks follows the UN climate conference consensus and are likely to design net zero transition plans with several gaps. For a more stringent approach, a change in tone at future COP meetings and additional support from all stakeholders would be needed.

An independent audit of the transition plan/targets is equally important and should be emphasized. As already observed in the market, the absence of strict requirements and independent reviews may lead to a lack of accountability and ambition. This is clearly illustrated in the recent NZBA progress report which states, for example, that ''for various reasons, some members have based targets on scenarios targeting higher temperature outcomes (than 1.5°C), which are not consistent with the NZBA commitment''[13].

2024 could be a pivotal year with the emergence of more harmonised guidelines for the Banking industry. To reach this milestone, several initiatives expected to announce key developments would need to favour collaborative action:

(i) the SBTi is likely to publish a final version of its short-term and net zero target standards whereby FIs and Banks committed to the SBTi would be expected to submit their targets a few months after the publication of those standards,
(ii) the NZBA is expected to review its criteria and reinforce members' accountability,
(iii) new initiatives, such as the ACT Finance methodology, developed by the French Environmental Agency (ADEME), are expected to be launched and
(iv) Central Banks and banking authorities (specifically in Europe) are expected to increase the scrutiny of transition risks[14] associated with banks and propose new guidelines on minimum standards and reference methodologies for the identification, measurement, management and monitoring by financial institutions of Environmental, Social and Governance (ESG) risks which could enhance ambitious target setting[15].

[11] *This was mentioned on p. 35 of the Near-Term-Financial-Sector-Science-Based-Targets-Guidance-V2-Consultation-Draft.pdf (sciencebasedtargets.org)*
[12] *The Banker, The battle of the standards for net-zero targets and emissions, December 2023.*
[13] *NZBA, 2023 Progress Update, December 2023*
[14] *ECB, Risks from misalignment of banks' financing with the EU climate objectives, January 2024*
[15] *EBA, Draft Guidelines on the management of ESG risks, January 2024*

For sustainability-focused investors, the development of credible tools is key to assess the ambition of transition plans within the banking sector, to identify areas of improvement and to engage with financial institutions, encouraging the implementation of best market practices.