Written evidence submitted by ShareAction

EAC Inquiry: The financial sector and the UK's net zero transition

Executive Summary

- **The Glasgow Alliance for Net Zero (GFANZ) is currently failing to align the financial sector with net-zero at the pace required to reach a climate-safe world (1.5C)**. Many of its alliances are compounding climate risks by continuing to invest in and/or underwrite fossil fuels beyond what is required to contain global warming within safe planetary boundaries according to the IEA and IPCC. This is allowing fossil fuel firms to grow their exploration and extraction activities.
  - **Only 60 out of 240 of the largest GFANZ members have any policy excluding support for companies developing new coal projects**. Of these 60, just 11 have adopted robust policies to end financial services for all companies building new coal mines, plants and related infrastructure.
  - Out of 74 of the largest members of GFANZ, **only five have policies with any mention of restricting some support for oil and gas supply expanders**.
  - In 2021, the 44 largest members of the Net-Zero Banking Alliance (NZBA) provided $143.6 billion in lending and underwriting for the 75 companies doing the most to **expand** oil and gas.

➔ **Financial institutions cannot make credible net-zero commitments unless:**
  - they implement **financing restrictions** in relation to **coal and oil & gas expansion**;
  - they **phase down fossil fuels** on timelines aligned with **1.5C pathways**;
  - their finance sector transition plans lead to **absolute emissions reductions** (rather than emissions intensity reductions).

- **GFANZ has weak accountability structures which undermines the alliance's objectives.** GFANZ consists of *voluntary* initiatives in which members commit to a set of *guidelines.* Whilst GFANZ members are technically bound by the criteria set by Race to Zero (RTZ), the threat of being forced to leave the alliance in the case of incompliance is a weak accountability mechanism and one that to date has not been enforced (even where guidelines have been clearly breached).

- **Latest GFANZ guidance, published on the same day as RTZ's updated guidance (15th June 2022), is far less ambitious than RTZ's when it comes to financing restrictions on fossil fuel assets**. This raises questions about if and how GFANZ plans to follow the lead of RTZ. RTZ guidance also contains notable exclusions from a human rights perspective, which we address below.

- **The financial sector will not transition at the pace required to limit warming to 1.5°C without new laws and regulations, that are properly enforced.** We provide detail of how policymakers and regulators can create laws that will transition the financial sector to a 1.5C pathway more effectively than voluntary-led alliances.

Introduction to ShareAction

ShareAction is a registered charity established to promote transparency and responsible investment practices by banks, insurers, pension funds and other institutional investors. We are a member organisation and count amongst our members well-known NGOs and charitable foundations, as well as over 26,000 individual supporters. Among other activities, we work with the financial services sector to promote integration of sustainability factors in investment decisions, long-term stewardship of assets and the consideration of the views of clients, beneficiaries and pension scheme members. This has included much engagement with many GFANZ members over the years.

Overview

Our written evidence submission will cover four key themes and suggested questions for GFANZ:

1. **Current rates of fossil fuel financing and underwriting by GFANZ members**
   - GFANZ members are still financing fossil fuel expansion which is very clearly incompatible with 1.5C as well as RTZ criteria, and science-based guidance from the IEA and IPCC. What is GFANZ going to do to stop this?
2. **GFANZ' Accountability Gap**
   - When does GFANZ intend to introduce accountability mechanisms in cases where members are in clear breach of the spirit of RTZ / GFANZ aims?
3. **Disconnect between recent update to RTZ guidance and GFANZ guidance (both published 15th June 2022)**
   - GFANZ guidance/recommendations issued 15 June are far less ambitious than new RTZ criteria. How will GFANZ bring the alliances' guidelines up to RTZ levels and enforce compliance?
4. **The need for regulation: aligning GFANZ with the UK Government's ambition**

Written evidence in full

1. **Current rates of fossil fuel financing and underwriting by GFANZ members**

If the City of London were a country, its emissions financed by banks and asset managers would make it the ninth largest polluter in the world. The emissions it funds makes the UK financial sector a bigger polluter than Germany or Canada. GFANZ has huge potential to affect change considering its size and geographic footprint spanning the UK and beyond. It convenes 450 financial institutions across banks, investors and insurance companies, representing over $130 trillion assets under management.

Whilst progress has been made over the years, with members setting net-zero targets and publishing transition plans, GFANZ still has a long way to go if it wishes to reach net-zero by 2050. This is due, in part, to targets and plans not being ambitious enough.

Financial institutions cannot make credible net-zero commitments unless:

- they implement **financing restrictions** in relation to **coal and oil & gas expansion**;
- they **phase down fossil fuels** on timelines aligned with **1.5C pathways**;
- their finance sector transition plans lead to **absolute emissions reductions** (rather than emissions intensity reductions)[1].

And yet, many GFANZ members choose to set targets using emissions intensity and fail to set financing restrictions in relation to fossil fuel expansion. The IEA and IPCC have made it clear that, as of July 2021, new fossil fuel projects are incompatible with a net-zero future. However, despite this:

- According to Reclaim Finance, only 60 out of 240 of the largest GFANZ members have any policy excluding support for companies developing new coal projects. Of these 60, **just 11 have adopted robust policies** to end financial services for all companies building new coal mines, plants and related infrastructure.
- Six of the eight top holders of stocks and bonds in the global coal industry as of November 2021 were GFANZ members. The biggest coal investor, BlackRock — a member of GFANZ's Steering Group — held over $34 billion in companies developing new coal infrastructure, including mines and power plants.
- Out of 74 of the largest members of GFANZ, **only five** have policies with any mention of restricting some support for oil and gas supply expanders.
- In 2021, the 44 largest members of the Net-Zero Banking Alliance (NZBA) provided $143.6 billion in lending and underwriting for the 75 companies doing the most to expand oil and gas. In October 2021, JPMorgan Chase, Mizuho and Unicredit joined the NZBA. The following month they participated in a syndicate that underwrote the sale of $580 million in bonds for Gazprom (the company with the second biggest oil and gas expansion plans globally).
- NZBA member HSBC led 11 banks to lobby to weaken the requirements of the alliance before joining: in particular, they asked to ditch the need for science-based targets, and to have three years from signing the NZBA commitment – rather than 18 months – before setting their 2030 target.

Question 1: GFANZ members are still financing fossil fuel expansion which is very clearly incompatible with 1.5C as well as RTZ criteria, and science-based guidance from the IEA and IPCC. What is GFANZ going to do to stop this?

2. GFANZ' Accountability Gap

GFANZ has a huge opportunity to accelerate members' progress by being more assertive than it is currently. GFANZ consists of *voluntary* initiatives – members commit to follow a set of *guidelines*, determined by the UN's Race to Zero (RTZ) campaign. However, there are limited accountability mechanisms in place in the case of inaction.

For example, Barclays – one of the founding members of GFANZ's Net Zero Banking Alliance – put forward a Say on Climate plan to its investors at its 2022 AGM and it passed. However, ShareAction found that this plan is not net-zero aligned and urged investors to vote against it, not least because it

[1] Emission intensity targets do not necessarily lead to reductions in absolute emissions. This is because companies can reduce intensity in two ways – through decarbonising or by increasing market share. For example, if a bank or a company increased its investments in low-carbon assets at a faster rate than it is investing in high-carbon assets, it would reduce its emission intensity. Yet it would not necessarily reduce its absolute emissions – as it might still grow the size of its high-carbon assets and/or keep it constant. In addition, an emission intensity metric does not capture the climate impact of large emitters.

flouted RTZ guidelines at the time. Notably, Barclays did not set a high-level interim target to halve its financed emissions by 2030 as opposed to some of its peers (e.g. Natwest). The need to set a 2030 target was part of former criteria set by RTZ, which as today has only been implemented by a handful of NZBA members. This casts doubt over whether GFANZ members truly need to comply with these criteria in practice.

Furthermore, only one of Barclays' newly announced 2030 targets (Energy) truly aligns with the IEA NZE and 1.5°C. The rest – Power, Cement and Steel – only integrate this level ambition as the upper end of a target range, leaving significant scope for lower emissions reductions in these climate critical sectors. And finally, Barclays' fossil fuel policies are still filled with loopholes. Despite several improvements to its coal policy, the bank is still in a position to support thermal coal expansion. And Barclays' policy on the dirtiest forms of oil & gas (e.g. Arctic oil & gas or oil sands) is one of the weakest among European peers.

Question 2: When does GFANZ intend to introduce accountability mechanisms for GFANZ in cases where members are in clear breach of the spirit of RTZ / GFANZ aims?

Without credible, short-term plans of how to get there, and accountability mechanisms where guidance is disregarded or targets are missed, 2050 net-zero targets risk becoming empty promises. It is time policymakers and regulators step in to mandate financial institutions' compliance with sustainability targets. See Chapter 4.

3. Disconnect between the latest Race to Zero (RTZ) guidance and GFANZ guidance

New RTZ criteria

ShareAction have been encouraged by the UN RTZ campaign's new criteria for members, which include all of the GFANZ alliances, released on 15th June 2022. These new criteria are much more ambitious and explicit on fossil fuels than previous versions, which leaves some GFANZ members in an awkward position.

The new Starting Line criteria reiterate that members must pledge to "reach (net) zero greenhouse gases as soon as possible, and by 2050 at the latest" and must commit to a "fair share" of the 50% cut in global CO2 emissions that the Intergovernmental Panel on Climate Change (IPCC) says is needed by 2030 in order for global warming to stay under 1.5°C.

Among other criteria, the so-called 'Starting Line' requirements include the following:

- "Halting deforestation and **phasing down and out all unabated fossil fuels** as part of a global just transition" *(Starting Line criteria, "Pledge");*
- members "must **restrict the development, financing, and facilitation of new fossil assets**." The criteria stress that "this includes no new coal projects" *(Interpretation Guide, "Pledge", 5.b);*
- financial institutions must include in their targets all the emissions caused by their **investments, lending, underwriting and insurance, including the Scope 3 emissions** of the companies to which they provide these financial services *(Interpretation Guide, "Pledge", 2.b);*

- targets must include "land-based emissions" *(Starting Line criteria, "Pledge")*
- members must develop transition plans to show how they will meet their commitments, **including what actions they will take within the following 12 months, 2-3 years, and by 2030** *(Starting Line criteria, "Plan");*
- members must "align external policy and engagement, including membership in associations, **to the goal of halving emissions by 2030**" *(Starting Line criteria, "Persuade").*

These new Race to Zero criteria pose a major challenge to GFANZ, its seven sectoral net-zero alliances, and all of their more than 450 members. GFANZ is not structured to have its own demands for its members — instead it requires its member alliances to join the Race to Zero and made clear in its 2021 Progress Report that "**all GFANZ members must align with the Race to Zero criteria**".

The Climate Champions state that "all existing [Race to Zero] members and Partner organisations will need to meet the criteria by 15th June 2023 at the latest". GFANZ members should also note that members that fail to comply "risk being removed from the Race". It remains to be seen if this will be enforced in practice.

New GFANZ transition plans guidance

However, on the same day, GFANZ released updated guidance for members regarding transition plans, which is far less ambitious. GFANZ's recommendations are light-touch technical guidance and miss the opportunity to be explicit about the need for a clear end to the financing of fossil fuel expansion, including of coal companies, as highlighted in this Guardian article.

Notable exclusions from GFANZ's updated guidance:

- There is nothing on absolute emissions in target-setting – it is left to each financial institution to decide which metric they use: intensity vs absolute reductions;
- The transition plan guidance on coal, oil and gas policies fail to make explicit that fossil fuel expansion is incompatible with net-zero;
- There is no mention about the need to phase-down financing of coal, oil, and gas financing along science-based timelines.

Question 3: GFANZ guidance issued on 15 June 2022 is far less ambitious than new RTZ criteria released on the same day. How will you bring the alliances' guidelines up to RTZ levels and enforce compliance?

Also of note is that both RTZ and GFANZ ignore the financial sector's responsibilities under international human rights law. RTZ criteria makes no commitment to international human rights law and the rights of Indigenous Peoples to Free, Prior and Informed Consent (FPIC). As a result, RTZ – as a high-profile UN-backed initiative – is effectively ignoring well-established soft and hard law including the UN Guiding Principles on Business and Human Rights (UNGP) which clarify that companies and financial institutions have the responsibility to respect human rights. A 'just transition' cannot be achieved without respect for human rights obligations.

4. The need for regulation: aligning GFANZ with the UK Government's ambition

The financial sector will not transition at the pace required to limit global heating to 1.5°C without new laws and regulations, that are properly enforced. We make the following recommendations for policymakers and regulators, which we consider critical to encourage private finance to play its necessary role in decarbonising the economy, that the EAC should consider through the inquiry process:

1. **Give regulators appropriate objectives to enable them to support the transition** (noting that HM Treasury's recommendation that the regulators support the British Energy Security Strategy is concerning, given the strategy supports new domestic oil and gas production) by using the upcoming **Financial Services and Markets Bill** to ensure the statutory framework enables regulators to support UK environmental goals by including an objective in relation to climate change and a regulatory principle in relation to the conservation and restoration of nature and protection of biodiversity. GFANZ members should also be obligated to integrate core principles of the **Green Finance Strategy.** The Government should oversee the degree to which financial institutions are disclosing their climate and biodiversity impacts. All institutions should be required to implement the same disclosure frameworks (e.g. TCFD and TNFD) and disclosure should be mandatory with no exceptions. The government should measure progress by sector, ensuring that financial institutions integrate nature and climate goals and targets into sector-specific strategies and investment screening processes, with goals and targets based on those set forth by the Conference on Biodiversity and the Science-Based Targets Network. **The Government must also pursue accountability measures.** To ensure that transition and mobilisation are progressing, the Government should define short-term, medium-term and long-term goals and should include these time horizons in any and all biodiversity and climate regulation. The government must also measure progress by building oversight capacity to track goal-oriented action by financial institutions and establishing consequences for institutions that fail to take sufficient action.

2. **Introduce increased capital requirements for assets that carry particularly high physical and transition risks**, to safeguard against rising risks and incentivise investments aligned with a low-carbon transition. Encourage banks and insurers to implement new policies to exclude financing and insurance for activities that are incompatible with limiting warming to 1.5°C and for companies without a credible Paris-aligned transition plan through new rules requiring them to hold 100% capital against exposures to new fossil fuel activities.

3. **Produce a robust UK Green Taxonomy** to facilitate the direction of financial flows towards sustainable activities. It must be science-based and reflect the precautionary principle, and must not include gas. GFANZ members must be taxonomy-aligned.

4. **Mandate publication – and frequent regulatory scrutiny – of net zero transition plans** as soon as possible for all financial services firms, listed companies and large companies. Transition plans should be aligned with limiting warming to 1.5°C; financial services firms' transition plans must include strategies relating to financing of carbon-intensive sectors that

reflect science-based pathways (including the IEA NZE); and companies should disclose concrete plans of action and evidence their actual implementation and progress. Regulators must call out instances of non-compliance. Policymakers must regularly publicly scrutinise these plans. GFANZ members should be brought before Ministers or Select Committees in the UK annually to explain why their transition plans are adequate and to evidence the progress they've made.

5. **Require investors to participate in active stewardship** to encourage their investee companies to transition. Evidence shows that one of the most impactful tools available to investors is engagement.

Thank you for taking the time to read through this evidence submission.

Yours sincerely,

Isabella Salkeld

Senior UK Policy Officer, ShareAction

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