Supplementary written evidence submitted by Carbon Tracker Initiative

CTI High-Level Analysis of EAC Letter Responses

Carbon Tracker has undertaken a high-level review of the letters published by the Environmental Audit Committee on 18 October 2022 as part of the Committee's inquiry into *The financial sector and the UK's net zero transition*. This analytical note collates the responses of 39 financial institutions and examines how financial institutions have answered the eight questions - on their policies towards fossil fuel finance and specifically in respect of the International Energy Agency's net-zero climate scenario – contained in the Committee's letter sent to these institutions in August 2022[1].

Against this background, Carbon Tracker is submitting supplementary written evidence – in the form of this document - to the Committee's inquiry following consultation with the EAC's Secretariat. The document identifies the key themes found across the set of replies and reviews the detailed responses to each individual question.

General themes Identified

- **Engaging with fossil fuel companies:** a considerable number of institutions cited engaging with the companies who are not aligned with Paris goals[2], and who continue to invest in fossil fuels, although they didn't specify the purpose of their engagement.
- **Fossil fuel exclusion policies:** the only explicit exclusion of fossil fuel investments is by companies who make e.g., 20% + revenue from coal, or unconventional fossil fuels (arctic or oil sand related activities). Moreover, there is a significant lack of action when it comes to banks underwriting for new projects.
- **The IEA's Net-Zero report's support of no new projects:** very few investors actively support this because they still lend to new projects. The inquiry has raised issues of responsibility here (e.g., "we don't specifically fund oil and gas assets"). In response, many vocally support the principal and undertake Paris alignment. The simple answer from most would be "Yes, we agree it is probably what's needed, but we still lend to companies pursuing new projects".
- **Calling out a lack of political action:** a number of replies called for more policy actions by governments to target net-zero and decarbonisation, in order to incentivise the private sector. It can be summarised in the line: "we are policy takers, not policy makers."
- **Energy security**: some investors would prefer to take refuge in the fact that energy security has risen up the agenda this year because of geo-political concerns, as a means of defending ongoing investment in fossil fuels.
- **Regional variation:** European investors scored more highly than institutions with headquarters in other regions, notably the US and Asia.

Public Position on Fossil Fuel Finance

Question One: Is your institution's position on financing fossil fuels, including the funding of new projects, carried as a public statement on its website? If so, please provide the URL.

Over half of respondents who answered this question confirmed the presence of a policy statement on financing fossil fuels on their websites, although they varied in their coverage of different fossil fuels. Coal and unconventional fossil fuel exclusion policies (Arctic oil and tar sands) were most popular. Fewer financial

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[1] CTI reviewed letter responses received by Friday 21st October 2022.
[2] For CTI, Paris alignment means that the GHG reduction targets and Climate Mitigation Measures of the company help achieve the goals in Articles 2.1(a) and 4.1 of the UNFCCC's Paris Agreement, most notably limiting global temperature increase to 1.5 degrees Celsius above pre-industrial levels.

institutions have statements referencing the funding of new exploration projects, despite expansion being a prominent request right now due to the energy crisis. Several respondents acknowledged the climate impact of the fossil fuel sector, but diverted from the question to discuss broader sustainability/ESG objectives. Moreover, multiple respondents emphasized the need to fund fossil fuel companies in order to help with their decarbonisation strategies, though they did not elaborate on how the continued financing of these companies with assist them in delivering their own net-zero decarbonisation goals. Only 20% of respondents had clear fossil financing statements available publicly on their websites, and therefore scored more highly.

Question Two: Does your institution's overall approach to energy transition include fossil fuel exclusion policies?

Only a minority of financial institutions with fossil exclusion policies cover all fossil fuels and expansion projects. The majority focus on revenue thresholds for thermal coal and unconventional fossil fuels. Nuances also include the absence of firmwide exclusion policies, but the simultaneous presence of restrictions for some of its ESG focused portfolios. Those with poorer ratings focus on company engagement and the need to invest in energy companies' changing business models. Financial institutions which have decided to stop financing companies after failed engagement strategies fared better. Considerable emphasis, again, was placed on supporting energy companies to decarbonise. The strongest reply included a commitment to stop investing in and underwriting new upstream oil and gas projects, as well as ending unconventional fossil fuel financing and coal in the near future. The reference to underwriting practices is significant here as it is the sole reply to do so, which highlights the potential loopholes within other fossil fuel exclusion policies.

Question Three: How does your institution give weight to energy companies which are in transition from reliance on fossil fuels to investment in renewable sources?

Fewer investors answered this question directly, however, many financial institutions emphasized their intention to work with energy companies during the energy transition. The better replies talked of credible transition plans and stated their decision to favour companies committed to aligning their operations and disclosure with net-zero by 2050. Additionally, those that scored better preferred to finance low carbon activities and those transitioning away from fossil fuel operations.

On engagement, these responses outlined strategies which align with the existing PAII Net-Zero investment framework, TPI and CA100+ methodologies, and their intention to exit companies that fall short of science- based standards or vote against company management. Weaker replies noted that restricting finance could be harmful to the pace of transition. Furthermore, engagement was favoured on the basis that divesting from the company will not reduce real world emissions, though this collection of investors did not elaborate on their engagement methods.

International Energy Agency (IEA) Roadmap to Net-Zero

Question Four: Does your institution support the IEA's net-zero scenario which calls for 'no new investment is needed in coal, oil and gas'?

Most financial institutions gave no specific position on the IEA's net-zero scenario, yet a number of investors were supportive of its strong messaging. A number of letters received noted that the IEA scenario- published in May 2021 - was not representative of the current economic environment and that calls for no new expansion are hard to justify, given how security of supply has risen up the geo-political agenda. Weaker replies basically favour passivity: it is policy makers who should do more on net-zero, which will in turn stimulate the private sector into action. The need to finance fossil fuels to support an

equitable transition for developing countries, and the use of fossil gas as a transition fuel were also mentioned. Majority of financial

institutions therefore find that there is a pathway to net-zero that allows for new fossil expansion. Only a few investors agreed with the IEA's net-zero roadmap and non-expansionary approach.

Question Five: What is your institution's policy on the responsible retirement of the fossil fuel assets you hold in ways which are compatible with maintaining energy security in the UK's national interest during the transition to renewable energy generation?

Responses to this question highlighted a significant gap in the approach investors are taking in relation to climate risk as there was only one letter we assessed as acceptable. There is basically a drastic lack of investor action to address the responsible retirement of fossil fuel assets. Many of the letters didn't answer the question properly and switched back to fossil fuel exclusion policies or engagement practices. Poorer replies noted that it was impractical for investors to try and impose restrictions on financing specific activities and showed support for remaining long-term investors in carbon-intensive sectors, pointing to the need for gas to ensure energy security. Other replies pointed to the importance of ensuring a just transition, or cited the CA100+ benchmark as the tool needed to ensure any divestment is done responsibly. Better responses noted that they were working with TPI and NZE when engaging with companies on transition and retirement.

Question Six: Please identify the proportion of the assets you manage which are (a) actively and (b) passively managed (for example in index tracking portfolios) and the extent to which differential policy mandates between the two investment approaches apply in relation to investment in fossil fuels.

Almost half of respondents did not answer this question, and most fail to distinguish between active and passive assets and how they differ in relation to fossil fuel investments. Those that scored well oversee the active assessment of sustainability capabilities through proprietary manager research; passive mandates are managed in relation to the selection of the index, and include exclusion policies to oversee Paris-alignment and transition objectives. More limited replies call for greater government support for green investment or investing differently for various clients. The weaker replies note that engagement is a more powerful tool than divestment.

Question Seven: Where you continue to hold investments in fossil fuel-producing companies, has your institution communicated to that company's management your position on the IEA's Net-Zero scenario and its conclusion on the need for no new investment in future new production? If not, does your company plan to do so?

Many investors did not respond to this question, and many of the answers provided details on how financial institutions directly communicate their position on the IEA's net-zero scenario with clients, not the IEA Net-Zero finding of no new fossil fuel investment. Better respondents highlighted their status as active stakeholders, advocating for companies to take on board net-zero strategies through a science-based approach and benchmarks (including CA100+).

Question Eight: Has your institution's credit committee been instructed to reduce or decline to make new capital available for new fossil fuel projects?

The majority of respondents did not answer the question and no investor scored well for question 8. There appears to be a disconnect between credit committees within financial institutions and science-based requirement to wind down fossil fuel production. Respondents commonly referenced their existing fossil fuel exclusion policies or the need for continued investment given the current security of supply crisis.

Annex 1: Glossary of Terms

CA100+: Climate Action 100+ is an investor-led initiative launched in December 2017 to ensure the world's largest corporate greenhouse gas emitters take necessary action on climate change.

PAII Net-Zero investment framework: The Paris Aligned Investment Initiative was established by the Institutional Investors Group on Climate Change (IIGCC) in May 2019 and the Net-Zero framework was launched in March 2021 to provide a common set of recommended actions, metrics and methodologies for investors to use to decarbonise investment portfolios and increase investment in climate solutions in a way that is consistent with a 1.5C temperature pathway.

TPI: The Transition Pathway Initiative was created in 2017 to assess the progress of large corporations on the transition to a low-carbon economy, supporting efforts by investors to address climate change.

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