New best practice guidance for global finance on aligning lending and investment with Paris agreement

Portfolio Alignment Team releases best practice framework for financial sector use of net-zero alignment metrics (14 October)

The Portfolio Alignment Team (PAT), an independent expert team comprised of major financial institutions including HSBC, BlackRock and HM Treasury's COP26 Private Finance Hub, has published new guidance on portfolio alignment metrics.

Portfolio alignment metrics help evaluate whether investing or lending is in line with a pathway to a net zero world in 2050. They benchmark not only present-day emissions of assets but also their forecasted future emissions, which take into account a variety of parameters such as company transition plans. They therefore help financial institutions measure how well the counterparties they finance are transitioning against net-zero scenarios, and in turn to what extent their portfolios are aligned with the objective of the Paris Agreement to limit global temperature rise to 1.5°C. They identify the leaders and laggards of the low carbon transition and thus help investors and banks back their net zero commitments with their capital.

At present there are many portfolio alignment metrics available, often divergent and sometimes opaque. The PAT report, while explicitly not a definitive guide to portfolio alignment, aims to foster convergence of approaches around 26 best practice recommendations, and increase the transparency of methodological choices.

The new guidance comes in a technical report requested by the Task Force on Climate-related Disclosures (TCFD), a private sector body set up in 2015 by the Financial Stability Board to enhance and increase reporting of climate-related financial information.

The TCFD today published an amendment to its supplemental guidance for the financial sector, recommending that all financial institutions disclose the alignment of their activities with a well-below 2°C scenario.

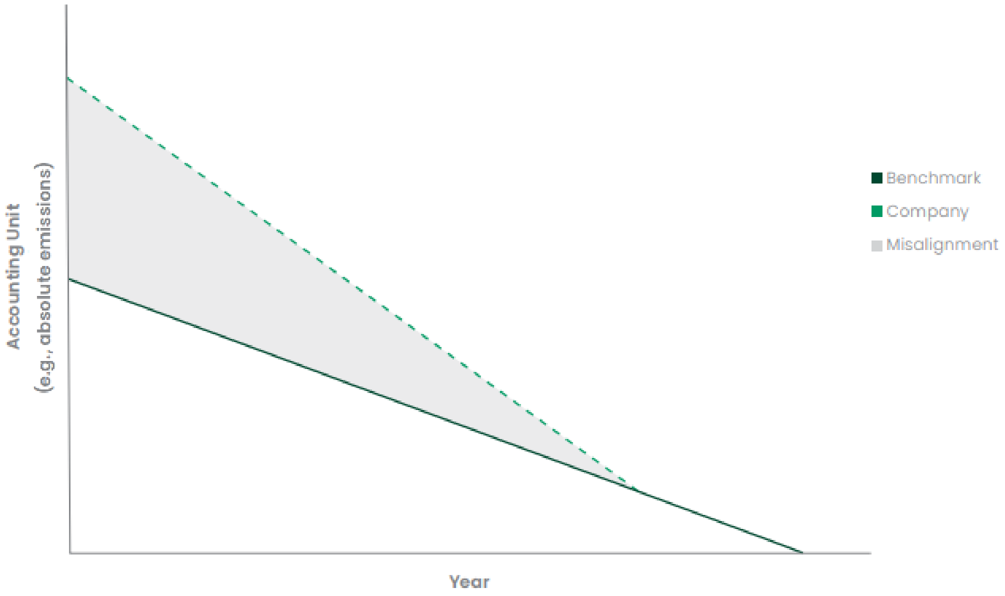
The PAT report may help financial institutions apply this TCFD guidance. It sets out emerging best practice in building portfolio alignment metrics with the aim to make these more robust, transparent and consistent.

The PAT report found that that portfolio alignment metrics add value by *contextualizing* financed emissions. First, they assess not only counterparties' present-day emissions, but also projected future emissions and whether these reduce fast enough to be aligned with a science-based net zero pathway (eg through low carbon transition planning). Secondly, well-designed metrics reflect sectoral and geographical abilities to decarbonise – a portfolio focused on advanced economies should be assessed against more demanding benchmarks than one focused on developing countries. The PAT report also highlights the need for continued improvement in emissions data and scenarios – the two key ingredients for advanced portfolio alignment metrics.

Several high-profile institutions have begun disclosing the alignment of their portfolios, for example, the Bank of England, insurer Axa and Japan's Government Pension Investment Fund (GPIF). They used Implied Temperature Rise (ITR) metrics, one type of portfolio alignment metrics that translate the alignment assessment as a temperature score that describes the most likely global warming outcome if the global economy was to exhibit the same level of alignment or misalignment as the company/portfolio in question.

The PAT will now transition its work to the Glasgow Financial Alliance for Net Zero (GFANZ), the largest financial sector coalition for aligning finance with the Paris Agreement. GFANZ now represents nearly 300 financial institutions and over $90 trillion in assets and has set up a workstream to develop portfolio alignment guidance and support adoption. Building on the PAT's framework, GFANZ is the natural place to take the guidance on portfolio alignment metrics to the next level - where the financial sector meets to define industry standards.

Chart - Typical portfolio alignment approach to assess a counterparty against a decarbonization pathway



Explaining the significance of the PAT report publication

Mark Carney, Finance Advisor to the UK Prime Minister for COP 26 and UN Special Envoy for Climate Action Finance:
To limit global warming to 1.5°C, countries, companies and projects that are on the path to net zero need capital. Portfolio alignment metrics equips financial institutions, and their stakeholders, with a forward-looking view of how well aligned lending and investments are with science-based pathways to net zero.

David Blood, Head of the Portfolio Alignment Team and Senior Partner at Generation Investment Management
The PAT report is the result of collaboration across the financial sector, and incorporates the thinking of leading method developers and users who we engaged with in extended outreach. The framework we have created together provides a consistent way to measure net-zero alignment. We hope our work will drive convergence of portfolio alignment construction across the financial service industry and increase adoption and disclosure of portfolio alignment metrics.

Mary Schapiro, Head of the Task Force on Climate-related Financial Disclosures
As countries and companies are increasingly making net-zero commitments in order to meet the goals of the Paris Agreement, investors need tools to better measure portfolio alignment. We welcome the release of the PAT's report on portfolio alignment metrics, which is complementary to the TCFD's own work on metrics, targets, and transition plans.

Pascal Christory, Group Chief Investment Officer, AXA Group
AXA strives to align its investments and insurance business with the goals of the Paris Agreement. This is evidenced by our Net Zero Asset Owner Alliance and Net Zero Insurance Alliance memberships. As an investor, we promote a 'portfolio alignment' approach based on the concept of 'Implied Temperature Rise' because this forward-looking metric enables us to identify transition models, and to evaluate their impact on climate change. But ITR requires methodology convergence. This is why we support the TCFD-commissioned work on portfolio alignment tools, presented in the Portfolio Alignment Team's report published today. It provides useful technical hints to help asset owners think how to measure investment-related climate neutrality, and will reduce the risks of greenwashing associated with loosely defined ITR models.

Hubert Keller, Co-Senior Managing Partner at Lombard Odier Investment Managers
As an industry, more forward-looking approaches are needed to help us navigate the climate transition. Implied Temperature Rise (ITR) metrics draw on existing climate science to assess alignment of investments and portfolios to that transition. Whereas most other backward-looking approaches at best help us understand the scale of the problem, ITR metrics can help us define the potential for real reductions in emissions across sectors and industries. The use of these metrics offers a common frame of reference, and will be vital in encouraging the deployment of capital to transitioning leaders in climate-relevant sectors, as opposed to merely allocating capital away from these vital industries.

At Lombard Odier, we have been early adopters of ITR metrics, having been the first asset and wealth manager to develop an in-house capability in this area, combining the latest in data science with our insights as an investor and user of these metrics. Our metric is closely aligned to the PAT team's findings and we are developing products that specifically leverage these new capabilities as part of broader efforts to assess financial exposure to the climate transition. The PAT report provides a thorough and invaluable reference for the proper design and construction of alignment methodologies and will accelerate the mainstream adoption of ITR metrics by the market at large.

Jakob Thomae, Managing Director (Germany) at 2 Degrees Investing Initiative
Portfolio Alignment will be a crucial tool in helping financial institutions meet their net-zero commitments. We welcome this report as an important contribution to the technical debate on how to measure alignment, and we hope the next phase of the work will focus on connecting alignment methodologies to real world emission reductions.

Remy Briand, Head of ESG and Climate at MSCI
MSCI believes transparency and improved climate disclosures are crucial. Forward-looking temperature metrics provide investors with much needed clarity as they sharpen their focus on the financial impact of climate change. Adoption and standardization of temperature metrics is integral to this success and we are proud to work with the PAT and incorporate the recommendations in our Implied Temperature Rise.

Hannah Helmke, co-founder and CEO of right. based on science
Since 2016, right. has been a pioneer of 'implied temperature rise' (ITR) metrics - providing tools to benchmark capital flows as well as business activities against the Paris Agreement goals. The PAT report provides a landmark framework to help mainstream the use of portfolio alignment metrics. This bears enormous potential of moving the transition forward which far outweighs the methodological challenges that remain. We're proud to have contributed.

Notes to editors

About the Portfolio Alignment Team

The PAT was established in 2020 by Mark Carney in his capacity of UN Special Envoy for Climate and Finance and is led by David Blood, Senior Partner of Generation Investment Management. The team's members come from nine institutions (Bank of America, BBVA, BlackRock, COP26 Private Finance Hub, Generation Investment Management, Goldman Sachs, HSBC, McKinsey, and Oliver Wyman).

The PAT is an independent team whose objective has been to catalyse progress in the analysis and use of portfolio alignment metrics as part of the COP26 Private Finance Agenda. The PAT will be disbanded after the publication of its report (14 October 2020). A GFANZ working group on portfolio alignment is taking up its work.

For this report, the PAT has engaged with eleven of the world's foremost portfolio alignment method providers, in addition to multiple expert academics and practitioners, including 2 Degree Investing Initiative, Arabesque, Barclays, Carbone4, CPR Asset Management (Amundi Group), Lombard Odier, London Stock Exchange Group, MSCI, right. based on science, S&P Trucost, and SBTi.

About the COP26 Private Finance strategy

Mark Carney leads the COP26 Private Finance agenda with the objective that every professional financial decision takes climate change into account. This requires the right frameworks so that the financial sector can allocate capital to manage risks and seize opportunities in the transition to net zero. This means in particular:

- improving reporting;
- embedding climate risk management;
- unlocking the opportunities in the transition;
- mobilising flows to emerging economies.

The PAT report is one element of the strategy that enable financial institutions to identify leaders and laggards among the counterparties they finance in a robust and comparable way.

About the Glasgow Financial Alliance for Net Zero (GFANZ)

https://www.gfanzero.com/

The Glasgow Financial Alliance for Net Zero (GFANZ) was launched in April 2021 by Mark Carney, UN Special Envoy for Climate Action and Finance and UK Prime Minister Johnson's Finance Adviser for COP26, and the COP26 Private Finance Hub in partnership with the UNFCCC Climate Action Champions, the Race to Zero campaign and the COP26 Presidency. Bringing together existing and new net-zero finance initiatives in one sector-wide coalition, GFANZ provides a forum for leading financial institutions to accelerate the transition to a net-zero global economy.

Members currently include nearly 300 financial firms responsible for assets in excess of $90 trillion. GFANZ is a whole financial sector umbrella that unites for the first time leading sub-sectoral net-zero initiatives that are in the UN's Race to Zero campaign: the Net-Zero Banking Alliance (NZBA), the Net Zero Asset Managers initiative (NZAM), the Net-Zero Asset Owner Alliance (NZAOA), the Paris Aligned Investment Initiative (PAII), the Net Zero Financial Service Providers Alliance (NZFSPA), and the Net-Zero Insurance Alliance (NZIA).

This coalition is focused on broadening, deepening and raising net-zero ambitions across the financial system and demonstrating firms' collective commitments to supporting companies and countries to achieve the goals of the Paris Agreement. It also supports collaboration on steps firms need to take to align with a net-zero future.

Entry to GFANZ is grounded in the UN's Race to Zero campaign to ensure credibility. Members must use science-based guidelines to reach net-zero emissions, cover all emission scopes, include 2030 interim targets and commit to transparent reporting and accounting.