Recommendation on Starting Line Criteria

Working Group 1: Net Zero Finance & Disclosure of Climate Risks

April 15, 2022

Executive summary on relevant template questions

1. How, if at all, is this topic currently reflected in the Race to Zero starting line criteria, lexicon, and interpretation guide?

Net zero finance is a subsector of the global set of actors in Race to Zero, and therefore does not expressly feature within Race to Zero's "Pledge, Plan, Proceed and Publish" via specific finance criteria. As such, there is also no detail on disclosing climate-related risks nor requirements for financial commitments in particular. Access to finance is expressly mentioned under the leadership practice and interpretation guide, but there is limited additional detail. The lexicon does not include finance-specific definitions. The *Net Zero Finance & Disclosure* working group makes a number of recommendations to the Expert Peer Review Group (EPRG) regarding the starting line criteria.

2. What are the strengths and weaknesses of the current starting line criteria approach? How can Race to Zero best address this topic in its minimum criteria (the floor below which members may not fall)?

The current starting line criteria is broad and general such that it can be applied to various actors. However, it does not reflect the minimum clarity, and in a few instances minimum ambition, needed to halve global emissions by 2030 and limit global warming to 1.5C. We recommend the EPRG to enhance the starting line criteria according to the following recommendations.

Pledge:

- Specify "no/ low overshoot" pathways to achieving net zero;
- Add to pledge: "Make finance consistent with climate resilient development and ending new fossil fuel investment in line with IPCC no/low overshoot scenarios and/or the IEA Net Zero by 2050 scenario";
- Make it clear that 2030 targets should be established;
- Align with the 5 year/ Paris article 4.9 cycle to pre-emptively encourage 2035, 2040 etc., targets; and
- Clarify the minimum standard for RtZ qualification as absolute annual emissions reporting from all partner organisations (in aggregate on their members).

Plan:

- Require the disclosure of an emissions baseline within 1 year of joining R2Z
- Encourage establishments of 'milestone' and reporting toward 2030 (so that targets/progress reporting can be brought forward where possible from 2030)
- Require transition plans, which should:
    - Reference published scenarios;
    - Disclose climate related risks, especially financial;

    - Align with financial statements; and
    - Consider just transition
- Ask members to explain how they are working towards addressing Scope 3 emissions.

Proceed: we recommend the EPRG provides more detail on *how* actors should proceed and *what* to consider, by:

- Require members to proceed in alignment with transition plans (not just achievement of targets)
- Recognize that planning is a dynamic process and suggest a 3-year revision cycle
- Prioritise emissions reduction towards net zero and and limiting residual emissions to those not feasible to eliminate

Publish: we recommend only minor changes to the 'publish' section to clearly align with understood intended practice requiring use of Race to Zero reporting templates.

Specific recommendations shaded in light purple ("Alternative Views") indicate that no clear consensus view was identified.

Detailed recommendations and alternative views are as follows:

Pledge

Current Wording

- *Pledge at the head-of-organization level to reach (net) zero GHGs as soon as possible, and by mid-century at the latest, in line with global efforts to limit warming to 1.5C.*
- *Set an interim target to achieve in the next decade, which reflects maximum effort toward or beyond a fair share of the 50% global reduction in CO2 by 2030 identified in the IPCC Special Report on Global Warming of 1.5C*

Suggested changes / additions:

Starting Line Criteria	
Recommendation	Working Group rationale and discussion
Change "global efforts" to **"no/low overshoot pathways"**	The working group agreed that "global efforts" was too vague and that "no/ low overshoot pathways" aligns with the level of ambition required and the SR 1.5C IPCC report. In the interpretation guide, it is worth clarifying what is meant by "no/ low overshoot pathways". The IPCC pathways should be used as a guide. However, there was some concern within the group around land implications. In particular, illustrative pathway 3 is controversial because of the large quantity of bioenergy with carbon capture and storage (BECCs) and large area of land needed (5x area of France). -
Change "in the next decade" to **"by at least 2030"**	The working group agreed to emphasise 2030, rather than use of the term 'decade'. In the interpretation guide, it may be worth including that as of 2022, there are less than 8 years at current rates remaining to stay within the 1.5C budget.
Add another pledge: **"Pledge to make finance consistent with climate resilient development including ending deforestation and respecting biodiversity as well as ending all new finance for new oil, gas reserves, or coal plants and phase out all financial services for coal companies by 2030 in OECD and Eastern Europe**	Many members of the group believe that a pledge like this should be a minimum criteria. Others felt it should be a finance sector specific criteria within the leadership practice for at least one year. The group noted that GFANZ is also working on a fossil fuel responsible requirement and O&G sector pathways. Others noted that the IEA Net Zero by 2050 Scenario could explain what is meant by "new" i.e., unlicensed fields. There was a suggestion to include in the interpretation guide what is meant by "new" whether this means "new unlicensed fields". As regards "equity", it should be noted that some licensed fields are perhaps high carbon emitters (tar sands, arctic fields), while some unlicensed fields are perhaps more carbon efficient and located in the global south. There are therefore equity considerations in the use of 'new' as 'unlicensed'.

/ Former Soviet Union, and 2040 globally in line with IPCC no/low overshoot or IEA's Net Zero by 2050 pathway"	The working group suggests RtZ provide guidance as to what 'respecting biodiversity' means. RtZ should also provide more guidance on what it means to phase out fossil fuels in line with these scenarios, and further provide guidance on 'financial services'. (The working group did not have time, or ability to reach consensus on these items).
Add reference to **"5 year target cycle /Paris Article 4.9"** to future proof interim targets	Shorter dated targets are required among some R2Z partners (e.g., Asset Owners Alliance) and allows for progression towards the high expectation of 50% reductions by 2030. Multiple members wanted to introduce the expectation of a "5 year/ Paris Article 4.9" cycle, in which 2035, 2040, etc., targets are preemptively planned for. We recommend this change is introduced by 2025.
Scope 3 ***Alternative viewpoints***	Targets must cover all greenhouse gas emissions: 1. Including Scope 3 for businesses and investors where they are material to total emissions and where data availability allows them to be measured sufficiently [some colleagues suggested to add: and if they do not cover scope 3 emissions explain why they have not done so] Financial institutions with coal, oil and gas companies in their portfolio should include the Scope 3 emissions of these investees.

Add absolute target reporting requirement ***Alternative viewpoints***	Members discussed whether to mandate absolute targets. They noted that in financial institutions, there have been lots of targets based on intensity, rather than absolute measures. And there was overall consensus that absolute reductions are what is needed environmentally. Absolute targets for the hard to abate emissions sectors e.g. oil and gas, steel, aviation, etc. seem most important, intensity based targets per unit produced can be as useful given an absolute target could be achieved through a sell-off of a business line to another operator not influenced by RtZ. Whether absolute targets appropriately incentivise real world emission reduction for financials is not certain as it may incentivise divestment, and then there is no pressure on real economy companies where shares are picked up by less environmentally minded investors. If the financial institution has an overall absolute reduction target (which it should have given existing RtZ criteria), then within that overall 50% cut, it could have productivity / intensity-based targets for different sectors and it is up to the financial institution to determine this. But the important thing is that overall, it is going for a 50% absolute cut. There was an acknowledgement that in the banking alliance, there are only sectoral targets and they can be intensity targets, so they do not take on overall, absolute emissions targets. Others disagreed with this example, stating that the banking alliance targets are productivity based intensity targets so it is an absolute cut, it's just normalised by sector.) Several alternative views on absolute vs. intensity included: 1) Reporting absolute emissions reductions is required as minimum criteria, while 2) Setting absolute targets should be leadership practice. 3) Setting sector specific targets (on a productivity basis) should be leadership practice. OR 4) Absolute target setting is required but the actor can explain why it is necessary to use intensity metrics for the present time. OR 5) Absolute target setting is required for certain sectors while intensity targets are permitted for others. All actors would be required to move towards an absolute target over time. - There is concern from the working group that this may result in challenges in data comparability.

Interpretation guide	
Organisational head	Some members of the working group felt it would be useful to specify in the interpretation guide what is meant by "head of organisation" and to ensure that the entire organisation is on board/ included. For example, the auditing requirement may need to be included and the right skills in the board may be required.
Comply or explain approach	A comply or explain approach was discussed at numerous points by our working group. While the starting line criteria should be met, compliance or explanation should be encouraged.
IPCC report reference	The pledge wording is complicated compared to the other 3 Ps. We recommend the "IPCC Special Report on Global Warming of 1.5C" (or new report in April 2022) should be referenced in the interpretation guide, rather than the pledge.
Residual emissions clarification	We recommend that in the transition to (net) zero, we should prioritize reducing emissions and limiting any residual emissions, which are those that are not feasible to eliminate per IPCC 1.5C pathways.
Materiality	EPRG should define materiality based on the latest guidelines by regulatory frameworks. For double materiality there are several existing definitions in national/jurisdictional regulation.
Coal company	We recommend the EPRG to use the Global Coal Exit List (GCEL) to define coal companies. This public database is devised to help financial institutions navigate the complicated landscape of coal-based business models and is already being used by investors representing over US$ 16 trillion in assets.
Oil and gas company	We recommend the EPRG to use the Global Oil & Gas Exit List (GOGEL) is the world's first extensive public database on oil & gas companies. It covers 887 oil and gas companies, which account for almost 95% of global oil and gas production. GOGEL provides detailed information that enables users, particularly from the financial industry, but also policy makers/regulators, NGOs/civil society and the media to readily identify the largest oil and gas expansionists as well as the companies.

Plan

Current wording:

Within 12 months of joining, explain what actions will be taken toward achieving both interim and longer-term pledges, especially in the short to medium-term.

Suggested changes:

Recommendations	Working Group rationale and discussion

Starting line criteria	
Add **"Disclose an emissions baseline"** within 12 months of joining RtZ membership	The WG discussed that there should be date flexibility for organisations in setting the baseline, though alignment with the five-year cycle with UNFCCC could be helpful. R2Z could indicate what type of protocol or guidance could be used to set baselines.
Change "both interim and longer-term" to **"the 2030 target"** Change "short to medium term" to **"including milestones toward achieving that"**	Offer clarity that the 2030 target should be set. Members discussed whether to include additional interim targets within the 'Pledge' ahead of 2030 e.g., 2025. Some members in the group felt this wording was too vague and R2Z should be more specific and less redundant. Milestones are considered important to allow R2Z actors a thoughtful approach in the short-term. The group discussed that the 5-year cycle of Paris could be relied on by R2Z for before and after 2030.
Scope 3 Alternative viewpoints	Parties should explain how they are working towards addressing scope three emissions. For fossil fuel companies, the disclosure of Scope 3 emissions should be independent of an assessment of materiality or data availability.
Timing Alternative viewpoints	Some members wanted to change "within 12 months of joining" to 3 or 6 months. Others felt that a change like this to the minimum criteria could be significant for partner organisations, disqualifying many members, especially those representing SMEs, cities or hospitals.
Interpretation guide	
Topic	Recommendation
Transition Plan	The Working Group noticed that the "Plan" is currently silent as to an explicit transition plan or any disclosure requirements within that and recommended EPRG to include the following guideline. Transition plan should: (a) state transparently the choice of scenario; (b) align with no/low overshoot 1.5C pathways and test for physical resilience against higher temperature pathways; (c) disclose climate related risks (especially for financial institutions) that address both transition and physical risks of climate change. (d) be reflected in financial statements; (e) be consistent with governance, stewardship, and lobbying practices; (f) integrate just transition considerations. Since planning is a dynamic process, we believe R2Z could suggest a 3-year revision cycle. In addressing both the transitioning and physical risks of climate change in the transition plan companies should use the following scenarios: :

	a) 1.5C aligned transition scenario where one scenario describes an orderly transition and another one involving disorderly transition b) 3C or more transition scenario to capture the extreme physical risks of climate change when actors fail to meet the 1.5C transition Either in the interpretation guide, or under leadership practice, we encourage the EPRG to consider guidance for what "best practice" is within those transition plans (and we anticipate recommendations from another working group). Some suggestions include: Governance: relevant climate expertise and accountability within governance Remuneration: alignment between individual incentives and delivery of corporate climate goals

Proceed

Current wording:

- *Take immediate action toward achieving (net) zero, consistent with delivering interim targets specified.*

Suggested changes:

Starting line criteria	
Recommendation	Working Group Rationale & Discussion
Change "consistent with delivering interim targets" to **"consistent with delivering the 2030 target and transition plan"**	Most WG members felt that there should be a requirement to act consistently with the outlined transition plan, not just the 2030 target. Members also noted that planning is a dynamic process and should suggest a 3-year revision cycle. R2Z should seek to increase climate disclosure coherence by aligning its transition plan guidance with global best of practice baseline. (E.g. Latest TCFD and/or the ISSB disclosure guidance, expected in Q3 2022).
Change "Take immediate action toward achieving (net) zero" to "**Take immediate action to bring governance, financial reporting, and policy lobbying activities in line with the (net) zero pledge.…"**	Add "Consider: governance, personnel, finance and audit committee" Requirements to proceed should depend on the level/ extent of oversight or resourcing capabilities a R2Z member has in the following areas: *(a) Remuneration* Management and executive remuneration must ensure alignment between individual incentives and the delivery of corporate climate goals. *(b) Governance*

	All relevant corporate governance principles and investment stewardship must align with the net zero target and transition plan. *(c) Lobbying activities* Membership within associations/coalitions, and lobbying activities should be part of the R2Z pledge.
Sinks and credits: limiting the use of offsets Add **"Immediate actions should prioritize emissions reduction in the transition to net-zero and do not allow the use of offsets to meet interim targets with removals only used for residual emissions that are not feasible to eliminate."**	Some members felt that R2Z criteria is problematic in that it allows each company to decide "residual emissions". It is necessary in the starting line criteria to include guidance on limiting the use of offsets, referring to a sectoral or possibly the SBTi approach i.e., there should be no use of offsets to meet interim targets and removals should only be used for residual emissions for that company's respective emission's profile. Other members recommend a more balanced approach in which each actor in a given sector should prioritise abatement and then work to get to sector-specific residual emissions as per IPCC no/low overshoot scenarios.
Interpretation Guide	
Clearly define what "immediate" refers to	Some members felt that "immediate" should be more specific and elaborated in the interpretation guide. E.g. To take action <u>within 6 months of the release of the transition plan</u>, by implementing the sequence of actions included in the plan to deliver the 2030 target (and longer-term pledges).

Publish

<u>Current wording:</u>

- *Commit to report publicly both progress against interim and long-term targets, as well as the actions being taken, at least annually.*
- *To the extent possible, report via platforms that feed into the UNFCCC Global Climate Action Portal.*

<u>Suggested changes:</u>

Recommendation	WG Rationale & Discussion
Starting line criteria	
Change to: **"Report via the Race to Zero**	This is more reflective of current practice. R2Z should ensure there is compliance with this practice. There was also a suggestion that reporting could be done in an iXBRL.

reporting template which feeds platforms such as UNFCCC Global Climate Action Portal"	
Change "progress against interim and long-term targets, as well as the actions being taken," to **"progress against 2030 target and 2050 pledge, transition plan, and immediate actions being taken"**	Consistent with previous feedback, we believe R2Z should be more explicit and consistent with terminology in the starting line criteria e.g., 2030 target and 2050 pledge. In line with previous comments, progress should be reported "against the transition plan and [targets]". The baseline requirement we suggest above will also ensure that progress is being reported against a certain year.

"Policy"

The group is aware that there is discussion around a fifth "P" to encourage policy engagement for climate action.

- Align direct and indirect policy engagement activities with the Race to Zero commitments and disclose its progress annually.
- Publicly withdraw from trade associations whose lobbying activities are not 1.5C aligned.

Lexicon definitions

Term	Definition
General comments on the lexicon	Below are initial definitions for the EPRG to consider in relation to net zero finance and disclosure. Our working group has not had the opportunity to discuss these definitions. The lexicon is an important offering of Race to Zero. As such, we recommend R2Z partners with the Chancery Lane Project, or similar initiatives, to finalise a comprehensive list of climate-related terms, that takes into account the suggestions below.
Financial/ disclosure definitions	

Net zero finance	Making existing and new finance flows consistent with the pathway toward low greenhouse gas emissions and climate-resilient development (Paris Agreement, art 2.1(c)). *For the financial sector*, finance flows should be in line with IPCC no/ low overshoot 1.5C pathways per sector in the real economy in which the financial institution is invested.
Climate finance access	Climate finance access occurs on two main fronts: ● Delivering on climate finance commitments to support developing countries. ● Providing capital where capital is required for the global net zero economy transition on a sector specific basis.
Financing green	Increasing public/ private/ blended investment for net zero activities e.g., infrastructure, technology and renewable energy.
Greening finance	Incorporating climate and environmental factors into the financial system and processes, improving the identification and management of financial risks related to the climate and the environment, in order to mobilise private capital flows in green investments.
Climate-related disclosure	Disclosing the potential financial effects of climate change on organisations. *For the financial sector,* accurate and timely disclosure of metrics and targets, risk management, strategy and governance in a separate report or part of the annual report. Disclosure should include financial effects on asset valuations, lives, provisions, taxes or other related items in the financial statements. It should be in both the narrative and quantitative form and rely on complete and relevant data. TCFD guidance should be considered.
Climate related risks	Climate-related risks (TCFD) ● Risks related to the transition to a lower-carbon economy: policy, legal, technology, demand, market and reputation ● Risks related to the physical impacts of climate change: acute (event-driven) and chronic (longer-term) *Consider* ● Climate risks means transition/ physical risks to the entity plus the risks the entity poses to the climate (double materiality)
Financial statement audits	Providing evidence in audit reports that assess the impacts of a company's targets (and relevant risks) on current financial reporting and identifying inconsistencies.
General definitions	
Pledge	A pledge is a broad commitment to act on a certain topic e.g. *"Our organisation will become net-zero by 2050 we will develop plans and actions to this effect"*
Target	A target is a concrete, quantitative goal, with clear timelines, and deliverables e.g. *"Reduce by X% Co2/CO2e/GHG in our [Scope of target: operations, investments] by 20XX"*

Transition plan	A time-bound action plan that clearly outlines how an organisation will pivot its existing assets, value chain, operations and model to align with net zero targets and reduce emissions in all scopes from all sources.
Milestones	Milestones are significant stages or achievements on the way to achieving 1.5°C aligned targets by 2030, that are devised in transition plans.
Residual Emissions	Any greenhouse gas emissions which remain after a project or organisation has implemented all technically and economically feasible opportunities, as determined by a climate professional as part of a carbon footprint assessment, to reduce emissions in all scopes and from all sources (Chancery Lane Project).