MAJOR CANADIAN BANKS JOIN NET-ZERO BANKING ALLIANCE (NZBA) — UNPACKING THE INITIATIVE AND NET-ZERO COMMITMENTS

Posted on October 21, 2021

Categories: Insights, Publications

On the eve of the 2021 United Nations Climate Change Conference (COP26) in Glasgow, six of Canada's largest banks — BMO, CIBC, National Bank of Canada, RBC, Scotiabank, and TD — announced that they had signed on to the Net-Zero Banking Alliance (the "**NZBA**"), a global sustainability focused banking initiative.

With these announcements, the Big Six join other large international financial institutions such as BNP Paribas, Citi, and HSBC who have already committed to the NZBA. Earlier this year, Vancouver-based Vancity Credit Union became the first Canadian institution to join NZBA as one of the founding signatories.

Background

On April 21, 2021, the United Nations convened an international alliance that brought together several net-zero initiatives across the financial system into one strategic forum called the Glasgow Financial Alliance for Net Zero ("**GFANZ**"). Chaired by former Bank of Canada Governor and UN Special Envoy for Climate Action and Finance Mark Carney, the GFANZ has four primary initiatives — Net Zero Asset Owner Alliance (NZAOA), Net Zero Asset Managers Initiative (NZAMI), Net-Zero Insurance Alliance (NZIA) in addition to NZBA. While there are specific guidelines for each initiative, broadly speaking, the GFANZ requires signatories to set science-based interim and long-term goals to reach net-zero emissions by 2050 or earlier.

The Alliance

Facilitated by the UN Environment Programme - Finance Initiative ("**UNEP-FI**"), which also acts as its secretariat, the NZBA is the banking arm of the GFANZ. In April 2021, an initial group of 43 banks from 23 countries joined NZBA as the founding signatories and committed to transitioning their lending and investment portfolios to reach carbon emissions neutrality by 2050 or sooner, in line with the 1.5°C temperature targets of the Paris Agreement.

Commitments

As a condition of joining the NZBA, the member banks have to sign the alliance's Commitment Statement and agree to the UNEP-FI's Guidelines for Climate Target Setting for Banks. At a high level each of the institutions have committed to the following:

- **Long-Term and Intermediate Targets:** Within 18 months of joining, signatories are required to set and publicly disclose long-term and intermediate targets for their greenhouse gas ("**GHG**") emissions that support the goals of the Paris Agreement. The long-term targets must include a 2050 target and the intermediate targets must include a target for 2030 (or sooner). The intermediate targets are to be reviewed every 5 years.
- **Sectoral Targets:** For the 2030 targets, the signatories will set targets that cover a significant majority of their financed emissions within 18 months of signing, including at least one of the carbon-intensive sectors where they can have the most impact. After a further 18 months (within 36 months of signing), banks will set a further round of sector-level targets for all or a significant majority of specified carbon-intensive sectors. Agriculture, aluminum, cement, coal, commercial and residential real estate, iron and steel, oil and gas, power generation, and transport have initially been identified as some of the carbon-intensive sectors.
- **Scope of Emissions:** Banks' targets will include their clients' Scope 1, Scope 2 and Scope 3 emissions, where significant, and where data allows. Scope coverage is expected to increase between each review period.
- **Activities Covered:** Targets will cover lending and investment activities. Initially, only on-balance sheet investment and lending activities will be included and securities held for client facilitation and market-making purposes are excluded. Off-balance sheet activities, including facilitated capital markets activities (such as underwriting), are expected to be considered in the next version of the guidelines.
- **Scenarios:** The targets must be based on decarbonisation scenarios from credible and well-recognised sources that rely conservatively on negative emissions technologies and to the extent possible, minimise misalignment with other Sustainable Development Goals.
- **Disclosures:** Each bank has also committed to annually publish absolute emissions and emissions intensity in line with best practices and within a year of setting targets, disclose progress against a board-level reviewed transition strategy setting out proposed actions and climate-related sectoral policies.

Business and Legal Considerations

Scenarios

The achievement of the NZBA targets can vary depending on underlying approaches that are utilised to generate data. As a result, significant attention is paid to which models are used for reference. The UNEP-FI guidelines note two approaches — the first is based on research from the Intergovernmental Panel on Climate Change ("**IPCC**") and the second is derived from a recent pathways report published by the International Energy Agency ("**IEA**"). As some have noted, although IPCC and IEA scenarios provide largely similar outcomes in terms of climate scenarios, an important issue for the banks is that IEA lays out a road map that assumes no new oil and gas projects are developed from this year, while the IPCC does not. Given the capital-intensive needs of the energy industry, the choice of models will have an impact on the business strategy.

Transition Finance

The reallocation of credit from carbon-intensive sectors towards less intensive ones will create political headwinds and banks will need to skillfully navigate associated tensions. One likely consequence will be the increasing focus on transition finance instruments such as sustainability-linked loans and bonds. Deal makers will need to demonstrate dexterity and recognise unique circumstances of each industry, particularly in economies with significant natural resource sectors such as Canada, while ensuring that transition finance can drive tangible climate progress.

Legal and Governance

Although based on a comply or explain model, the NZBA commitments require that targets be approved at the highest executive level at each signatory. Executives and directors will need to strike a balance between overly prescriptive policies on the one hand that may affect their decision-making flexibility and insufficiently ambitious goals on the other that may not meet the NZBA standards. While these voluntary commitments are not necessarily binding on the banks, the board of directors and officers will have to fine-tune their governance frameworks and corporate strategy so that they are living up to their public pronouncements and reduce the possibility of secondary market liability for misrepresentations.

Offsets

The Commitment Statement also asks the NZBA banks to commit to taking a robust approach to offsets. After frequent reports of questionable usage of offsets by entities to reach their targets, the alliance has given a cautious nod. Signatories are allowed to use offsets to help fulfill their net-zero goals, though these "should be restricted to carbon removals to balance residual emissions where there are limited technologically or financially viable alternatives to eliminate emissions. Offsets should always be additional and certified." Banks are also asked to "conduct appropriate due diligence on client offset claims in line with other internal processes."

Road Ahead

All told, there is considerable pressure on financial institutions to display prompt action on their climate commitments. Earlier this month, over twenty Quebec based financial institutions with $900 billion in assets under management also signed onto the Quebec Financial Center's Declaration on Sustainable Finance and committed themselves investment and capital allocation decision-making based on the principles of responsible investment.

While each institution will tailor its policies, targets, and disclosures according to its business needs, the increasing granularity required by the NZBA provides a timely fillip to the banking sector's overall approach to climate alignment.

by Ravipal S. Bains, Bruno Caron, Eric Friedman, Don M.E. Waters and Isabelle Guevera (Articling Student)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.