TRANSITION OF FINANCIAL ACTIVITIES TOWARDS NET ZERO

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The importance of transparency and transition planning in meeting Net Zero

"Net zero" has become the clarion call of our times. It is a call that is used and understood by schoolchildren, media outlets, politicians and policymakers, and both financial market participants and their supervisors. While climate issues have up until recently not been considered material for the financial sector, it is now acknowledged we do not have the luxury of ignoring this crisis – climate change represents an existential threat to communities and ecosystems - and we are now in the phase of identifying solutions and acting on them. In this context, identifying the need to achieve net zero in a little over 25 years' time is in many ways the easy part.

Long-term damage can only be reduced through rapid and significant changes to technology, processes and behaviours. Decarbonisation cannot occur without strong political will to drive the massive levels of private and public investment needed. In addition, there needs to be clear transition planning to assist all actors in meeting the net zero target.

As a central bank and regulatory authority, we acknowledge that getting from where we are to where we need to be involves significant transition-planning for financial market participants. Policymakers, supervisors and indeed users of the financial system must play a significant role, through their guidance and participation respectively, in ensuring transition plans are successful. While on a macro level, transition planning has the ultimate objective of ensuring the future of our economies and financial systems in the longer term, at the firm level there are basic requirements that are a prerequisite to successful transition planning. Firms should therefore ensure that:

- There is board level ownership of climate risks affecting them;
- There is a willingness to measure, monitor and mitigate, and test their robustness against the climate and transition risks they face;
- There is an embedding of transition planning into the firms' operations and strategic approach; and
- There is a willingness to disclose their transition planning.

Firms must 'walk the talk' on transition plans so planning should be credible, robust and measurable.

Enabling the financial system to work towards an optimal transition is a major challenge and one that requires engagement from all participants within its eco-system. While relevant data and forward-looking assessments and projection are still at early maturity stage, there must be a willingness to move from qualitative to quantitative metrics. There must also be a move to embrace science-based targets. The financial system should seek to capture and analyse data in a way that establishes whether capital is flowing in sufficient quantities to enable the transition to a net zero sustainable future – we need to be transparent in respect of the carbon intensity and carbon footprint of portfolios. This requires leadership: firms need to "walk the talk" on their transition plans, so planning should be credible, robust and measurable.

In this context, we can draw on the progress that has been made in respect of:

- The publication of various target-setting transition plans and frameworks which can identify best practices for financial institutions to achieve net zero;
- Classification tools such as the EU Taxonomy, which comprehensively identifies the economic activities that are sustainable and those that can assist in transitioning to a low carbon economy;
- Net zero portfolio alignment tools, as well as climate investment strategies such as the Paris Aligned Benchmark and the Climate Transition Benchmarks, which provide for strict annual decarbonisation objectives, as well as consideration of products like the newly agreed new EU Green Bond Standard;
- Transition pathways for sectors, which set out credible plans and targets to decarbonise over the medium to longer term; and
- Assurance and certification assessments – in order to ensure that what is being reported is accurate and can be trusted.

It should also be noted that that the transition to a sustainable future will not occur without the necessary participation by private investment in green and transition finance. Trust in the system is of fundamental importance in order to ensure this participation. There is an onus on all participants to ensure that the framework in which we operate is fit for purpose and eliminates greenwashing.

The need to achieve net zero is stark – the challenge lies in combining our efforts to successfully meet that end-point. In recognising the evolving nature of the tools at our disposal there is a clear need for both policymakers and the financial system to require transparency in how we aim to meet net zero, to embrace transition planning, and to continue to develop frameworks which can help guide efforts to achieve net zero.

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Transition of financial activities towards net zero in the global context

The transition of our economies towards climate neutrality is in full swing. And yet, to achieve our net zero goals, we need to accelerate our efforts and help to mobilize private capital. While many tools exist to define what makes an economic activity sustainable, companies are largely left alone on their journey from "brown" or "yellow" to "green". In this context, the concept of transition finance has rapidly gained traction. At the center of the discussion are transition plans, which are increasingly viewed as a cornerstone of transition finance.

At the international level in particular, many actors are already addressing this topic intensively. These include the Financial Stability Board, the OECD, the G20 Sustainable Finance Working Group, the EU-International Platform on Sustainable Finance and standard setters like the ISSB. Additionally, work in the EU is progressing and several non-EU initiatives on national levels like the UK-Transition Plan Taskforce are also advancing rapidly. Transition plans can be important sources of information for both corporates and financial institutions to make business decisions. For supervisors, it can be a tool to assess financial stability risks, as environmental, social and governance (ESG) risks can have far-reaching implications on the stability of both individual financial institutions and the financial system as a whole.

However, at the moment, the lack of consistency and data in general presents a considerable challenge for transition planning in the financial sector in particular. Many financial market participants have set net zero emissions targets, for example through memberships in alliances such as the Glasgow Alliance for Net Zero (GFANZ). However, to mitigate their financed emissions the financial sector is dependent on the efforts of companies. So, in order to implement net zero targets, financial institutions need information from corporates on whether they are on a credible path towards climate neutrality and sustainability.

Transition Plans can close the gap between the financial sector and the real economy.

Hence, both transition plans of financial institutions and corporate transition plans are needed to holistically address short, medium, and long-term sustainability risks and opportunities. According to the OECD credible transition plans have e.g. the following key characteristics:

- Clear net-zero and interim targets
- Use of sectoral pathways
- Performance measurement and progress through metrics and KPIs
- Clarity on the use of carbon credits and offsets
- Strategy and actions on decarbonization, including on preventing carbon-intensive lock-in
- Integration with financial plans and internal coherence
- Sound governance and accountability
- Transparency and verification

Currently, regulatory requirements for transition plans are being developed separately for the financial and real economy. They should however, be designed in a way to complement one another. At the level of the European Union, it is being discussed to make transition plans mandatory for banks to address climate-related and environmental risks in the course of the revision of the Capital Requirements Directive (CRD) VI. Criteria for transition plans are also developed via the Corporate Sustainability Reporting Directive (CSRD) and its corresponding European Sustainability Reporting Standards (ESRS) which apply to both the financial sector and the real economy. At the international level, the International Sustainability Standards Board (ISSB) addresses transition plans as part of its draft climate disclosure standard.

It is now up to public decision makers to tie together existing works on transition plans and to close the gap between information needs of the financial sector on the one hand and transition finance needs of the real economy on the other. This implies a careful analysis of the right amount of information needed to steer portfolio adjustments. When designing such frameworks, an additional burden on corporates, which are already facing an unprecedented wave of sustainability reporting requirements, should be avoided. Instead, transition plans should fit into existing and upcoming sustainability disclosure frameworks.

In a global context, the standards of the International Sustainability Standards Board (ISSB) will likely be of great importance. Furthermore, they should not simply be a report published for the use of financial market participants. Rather, it should be a tool of great use to corporates themselves which can help them to successfully navigate the transition towards a sustainable economy. If this is achieved, transition plans will be an entry ticket into a bright net-zero future of our economies.

SHINICHI TSUNODA

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Japan's transition initiatives and related challenges

Over the past two years, decarbonization has gained momentum in Japanese industry. In October 2020, the Japanese government released a Carbon Neutral Declaration with an aim to cut overall greenhouse gas (GHG) emissions to zero by 2050. Towards achieving this aim, in June 2021 the government further outlined a Green Growth Strategy, which encompasses an industrial policy to create a virtuous cycle for the economy and the environment as well as an action plan for business areas with growth potential.

Despite these moves, Japan's decarbonization still poses an extreme challenge compared to other geographical regions. The government has set a 46% cut in GHG emissions relative to FY2013 as its mid-term target for FY2030, matching targets set in other regions; however, Mizuho Bank estimates that Japan's cumulative efforts will result in only a 41% reduction, even assuming that the government's Strategic Energy Plan comes to fruition. In the area of renewable energy, which enables local energy self-sufficiency, a number of initiatives are already underway, and additional suitable land is not readily available. Therefore, it is necessary to consider further strategies, taking into account Japan's particular disadvantages in comparison to other countries. There is room to innovate using new technology, but with only seven years remaining until 2030, it will clearly be an uphill battle to make further progress in decarbonization.

Given these challenges, promoting transition finance will be critical for the achievement of Japan's 2050 carbon neutral target. In December 2020, the International Capital Market Association (ICMA) released its Climate Transition Finance Handbook, which recommends the following four elements for transition finance disclosures:

1. Issuer's climate transition strategy and governance;
2. Business model environmental materiality;
3. Climate transition strategy to be 'science-based' including targets and pathways; and
4. Implementation transparency.

Further, in May 2021, the Japanese government formulated its Basic Guidelines on Climate Transition Finance. These guidelines address Japan's unique characteristics, such as by incorporating the government's sector-based roadmaps into the 'science-based' climate transition strategy disclosures. To date, the government has disclosed roadmaps for the electric power, oil, gas, iron and steel, cement, chemical, pulp and paper, shipping, and aviation sectors.

Mizuho taking proactive steps to advance transition finance and support clients' decarbonization.

Since the release of the ICMA handbook, Japanese firms have taken a leading position in fundraising under the transition finance framework, both in the number of deals and amount. One major reason for this is that firms have been provided with some clear benchmarks for deciding their decarbonization plans, due to the government clarifying its technological milestones up to 2050 in its sector-based roadmaps. Also, companies may feel an incentive to gain approval for aligning their decarbonization strategy with that of the government through using the government's transition finance framework.

Even so, the issue remains of how to address various uncertainties that exist in the development of transition finance. For example, the Japanese government estimates hydrogen demand to be 20 million tons in 2050, which is somewhat different from the Mizuho's estimate of 24 million tons. It also goes without saying that 2050 hydrogen demand estimates assume the establishment of new supply-side and demand-side technologies, such as those for hydrogen power generation, and hydrogen steelmaking. However, these technologies' realization is not guaranteed. Because of this, in moving forward transition finance, it is essential to carefully assess long-term business plans with attention to inherent uncertainties, including medium- to long-term policy and market developments and new technology development. In this way, advanced business assessment capabilities continue to be vital for financial institutions.

At the Mizuho, we are taking proactive steps in the area of transition finance, where we have become a global leader. We have already been maintaining a top position in the sustainable finance market, and we are establishing a similar position in the transition finance market as well. Aside from this, we have enhanced our framework for evaluating clients' transition strategies and initiatives, and in December 2022 we publicized our approach to transition support. We have clearly stated that we will allow for short-term increases in financed emissions as long as an appropriate longer-term decarbonization plan is in place.

As a financial institution, Mizuho has supported the development of heavy industries, mainly in Japan, since early times soon after our establishment. We will continue to provide transition support to clients, ranging from financial solutions to non-financial solutions such as consulting.

We will not be held back by short-term increases in financed emissions when they are part of us fulfilling our duties as a financial institution.

HACINA PY

Group Chief Sustainability Officer - Société Générale

Enabling transition to a low-carbon economy is an opportunity we should not miss

Societe Generale has been strongly committed for more than 20 years to the financing of renewable energy and positive impact finance. We are engaged in aligning our most carbon intensive portfolios to trajectories compatible with the Paris Agreement and have launched a transformation plan to accompany this major shift. More than ever, building solutions for the new paradigm requires cooperation with various stakeholders and a global environment facilitating a harmonious and swift move in this crucial decade. The current geopolitical context exacerbates the need to have a clear global plan and to accelerate the transition to a low carbon economy.

Defining and implementing transition pathways, starting with high emitting sectors, is prone to multi-faceted challenges: strategic, economic, geopolitical, social, and operational among others.

The challenge for banks to align their portfolios on 1.5°C scenarios is huge, as they finance an economy heading closer to 2.7°C. We are convinced that cancelling financed emissions through immediate withdrawals of high-emitting assets or termination of clients' relationships would be inefficient from the global decarbonization perspective. Banks should not only gradually reduce their financed emissions, but crucially "finance emissions reduction", to quote the GFANZ. The best path is to support clients across sectors by financing their investments towards activities consistent with the Paris Agreement and improving the carbon intensity of sectorial portfolios.

Economic incentives and enabling infrastructures are also needed. For the energy sector alone, the International Energy Agency's Net Zero Emission scenario estimates $3.6tn annual needs, a five-fold increase in investments by 2040 against 2021. The situation is comparable for other high-emitting sectors. Yet, financial institutions' offers and capacities are abundant, but we observe that low carbon projects, that can be financed, are missing. This starts with the need to change demand, to progress to an economy of usage, to switch to more electrification, which implies new public infrastructures, capacity building and skills development.

Public policies have a role to play to facilitate corporates' preference for investing in low-carbon solutions over existing technologies. Public support can take different forms such as public private financing, public risk-sharing, subsidies, or fiscal measures. The recently announced Net-Zero Industry Act in the EU is a step in the right direction.

Defining and implementing transition pathways is prone to multi-faceted challenges.

Geopolitically, current tensions are making common approaches more difficult and risk increasing disparities amongst jurisdictions. As an international player, while having in mind the global goal of the Paris Agreement, we must take particular care to support the transition of the economy globally, to leave no-one behind in the transition journey. To do so, the transition pace should be appropriate in developed as well as emerging economies, considering their specific needs.

At a social level, the shift to a carbon-neutral economy by 2050 is conditioned by its social acceptance. This is an area for public policies: seek just transition, address the social consequences of climate change mitigation measures, and ultimately avoid social crises. New collective narratives are also needed, starting with education and adapting marketing messages to ensure the adoption of sustainable consumption habits.

Operationally, the lack of comparable and audited data on companies' decarbonization pathways is problematic. Although we remain optimistic that disclosure obligations under the Corporate Sustainability Reporting Directive (in the EU) and under the International Sustainability Standard Board (ISSB) standard on climate financial risks (outside of the EU) will bring positive outcomes in that space, reconciliation of different and evolving requirements at the global level is critical to the operability of banks' transition pathways.

Challenges ahead of us create opportunities for the EU economy to rise stronger while following an ambitious transition path. Huge opportunities exist for banks and companies investing in future-proof business models, consistent with their purpose. EU banks' clients, both people and companies, employees and their other stakeholders are at the forefront of the decarbonization movement. Banks increasingly need to engage in a meaningful dialogue with them to build common standards and create new products, processes, and services.

At Societe Generale, ESG is at the heart of our strategy, in line with our corporate purpose guiding our actions, and leads us to accompany our clients in building a more sustainable world. We have taken public commitments both on the reduction of our own carbon footprint and on the adaptation of our portfolios, with a strong push on adapting our models to finance the transition.

With the support of policymakers to help us shift the economy with the relevant pathways and make them socially acceptable, we can achieve a lot.

THOMAS BÉHAR
Chief Financial Officer - CNP Assurances

Biodiversity preservation and transition to net zero are both needed

Climate change mitigation and adaptation are the core focus of the global risks' perceptions. It is a clear challenge for the next decades. Therefore, the burdens on ecosystems will grow up given their undervalued role in our planet's health. In January 2023, the World Economic Forum's Global Risks Report ranked biodiversity loss and ecosystem collapse as one of the top five threats facing humanity over the next ten years.

Scientific reports have been warning about the acceleration of biodiversity loss, which is reflected in the destruction of ecosystems, the disappearance of species and reduced genetic diversity within species. The IUCN (International Union for Conservation of Nature) red list is a leading benchmark used to monitor the state of biodiversity in the world. This red list has showed us that now one in four species of mammals, one in seven birds, and one-third of conifer species are threatened with global extinction. In the coming decades, one million species are at risk of extinction, i.e. an extinction rate 10 to 100 times higher than the average for the last 10 million years. Much like climate change, biodiversity loss is thus a major environmental challenge for current and future generations. It is also an economic challenge.

In March 2022, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) acknowledged that "nature-related risks, including those associated with biodiversity loss, could have significant macroeconomic implications, and that failure to account for, mitigate, and adapt to these implications are a source of risks relevant for financial stability".

In our corporate mission that designs our strategy, CNP Assurances defines the Planet as one of our stakeholder (like customers or staff). Our commitment is double: to combat climate change and protect natural world. In 2023, CNP published for the first time our overall performance covering both financial and non-financial indicators including biodiversity and climate change:

- CNP Assurances, a responsible investor with €347 billion in investments managed with ESG screening, has been a member of the Net-Zero Asset Owner Alliance since 2019 and is committed to making its investment portfolio carbon-neutral by 2050. As such, the Group is strengthening its sector-based policy on thermal coal by excluding, as from 2023, any new direct investment in companies deriving more than 5% of their revenue from thermal coal-related activities (versus 10% previously). This new and more demanding threshold will allow CNP Assurances to exit thermal coal definitively by 2030 in European Union and OECD countries and by 2040 in the rest of the world.

Biodiversity preservation is as important as the decarbonization of the portfolio

- In September 2021, CNP Assurances signed the Finance for Biodiversity Pledge and set new biodiversity protection targets over the next five years. These targets cover all asset classes from equities and corporate bonds to real estate, infrastructure and forests. Furthermore, at end-2021, 26% of our directly held equity and corporate bond portfolio comprised companies that are heavily or very heavily dependent on at least one ecosystem service. In other words, more than a quarter of the value of the securities held in the scope under review would be exposed to a significant risk if an ecosystem service were to disappear in the coming years. Dialogue with the companies and countries that CNP Assurances finances is crucial. It is a joint effort to reverse the deterioration of the environment. In 2020, biodiversity was discussed in 64% of CNP Assurances' direct dialogues with companies in which it is a shareholder.

The management of forestry assets are a concrete example of the link between these two fronts. In France, no fewer than 70 million tonnes are captured each year thanks to the forests. Thus, our forests are playing an active role in the fight against global warming. Reforestation and planting new forests are effective ways of combating global warming, especially when selected species are resistant to this change. In addition to preserving biodiversity, the challenge is to adapt forests and make them more resistant to climate change. With more than 57,000 hectares of woodland, CNP Assurances is France's largest corporate owner of forests. The charter signed with the subsidiary in charge of managing this asset sustainably includes an inventory of potential biodiversity, with the aim of improving it through actions such as the conservation of microhabitats, the creation of ecological corridors, and cessation of forestry work during the reproduction periods.

Assurances is committed to measuring the biodiversity of 100% of its forestry assets and to setting aside 3% of the forest area for ageing plots and areas undergoing natural evolution by the end of 2025.

CNP Assurances makes the choice to do both: helping preserving biodiversity and limiting global warming.

MATTEO
DEL FANTE
Chief Executive Officer -
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The road most travelled – Climate risk is not a construct

A construct is an idea or a theory containing different concepts and elements, that are usually not regarded as empirical but widely influenced by social, political, and biased views. Consequentially, a risk construct is based on the idea that any risk assessment cannot be definitive or absolute – but rather partial, in progress or susceptible to the latest socio or geopolitical view.

The main risks we are exposed to nowadays are real and tangible, like climate change, loss of biodiversity and the associated adaptation risks (of which mass migration is one becoming more and more evident), all the above interpreted within a construct framework and not as events to act upon, because still considered adaptable and mitigable through market-based mechanisms, different risk weights or asset pricing. A construct is interpretable, beyond the event itself, through political or regulatory decisions. Climate change action requires much more robust interventions and a much longer time horizon than our five years plans. So, a potential fallacy lingers over us, just as threateningly as increasing CO_2 emissions.

In 1985, Baruch Fischhoff, one of the founders of risk management as social discipline, wrote that "people disagree more about what risk is than about how large it is". This is where we stand: in presence of clear signs that, whatever definition and classification we propose through different taxonomies, climate change is happening and it is scary, as recently confirmed by the latest UN Intergovernmental Panel on Climate Change (IPCC). The threat is clear, the associated risks are self-evident, and we are not yet making progress. Thanks to data science, we know the paths to mitigate the main risk, being it the Co_2-driven rising temperature (target: 1.5C by early 2030) of our planet. Ad we have more evidence of the associated dislocations of people and resources, and the incremental need of financing for the ambitious, if not unprecedented, transition plans we all have, in Europe and globally.

We are therefore precisely at the point where we need to avoid building another risk construct, a fallacy of interpretation stopping us from seeing the real problems and their magnitude. This is a huge and collective change and here are some ideas from our experience in Poste:

- Build a stronger social purpose of financial services: Our starting point is what we believe is right for the people we serve: we see growing demand towards greener and more sustainable services. So, in Poste, we started greening and transforming our offer, embedding in our proposals, being a financial asset, a service or even a physical service, not a 'green' add-on but making our net zero targets an essential component of the value chain. This, in our experience, begun from transforming our physical platforms. In its 161 years of history, Poste built the widest office network in Italy and one of the largest in Europe (over 12,500 offices around the whole country). We kept our physical footprint, leaving offices open even in the more remote locations, and we are not only greening our fleet and real estate, but we are using digitalization and dissemination of services to foster social cohesion, reducing digital divide but also reducing the implicit Co_2 footprint of our clients and suppliers. Our investment activities and life pension operations are integrating their decisional framework not only to invest in ESG labelled assets, but also to quantify impacts and be more proactive both as equity and bond investors. Getting closer to the society we serve and reinterpreting and making the challenges of net zero a familiar and shared objective will make the difference.
- Be the link between regulatory bodies and the public: We are learning that climate and transition challenges are not akin to any other risk: we are not dealing with regulating financial products, new asset classes or financial offers, but with how climate disruption will have real impact on people's lives. Therefore, we are learning to shift from a defensive approach towards our financial regulators to wanting to be partners with them. We all need to be engaged in a frank and open dialogue, not only among experts and practitioners, but also downstream: we are producing more and more communication with our clients, that is our investors, retail customers and citizens, as represented in our Integrated Annual Report. And this approach needs even more forms of networking, working groups and taskforces where regulators and institutions engage with each other. At Poste Italiane, we have access to vast amount of data via our clients and we believe that there is a role that financial services have in providing real-time feedback to regulators. This capacity to address concerns from the public and use the information to inform our dialogue with regulators and legislative powers will bring over time a sense of trust and common mission.
- Make adaptation matter – The most important challenge in these transition years is to adapt our activities to a new framework and new realities imposed by climate and social events. The recent droughts in Northern Italy and Northern Europe have had an impact on our clients, on their capacity to generate revenues and we are now openly talking about climateflation, meaning that the lack of water or reduced capacity of basins have had an important impact on price levels for agricultural products and reduced hydro energy production. From a financial perspective, we need to keep serving those communities in what is a transforming journey.

The "risk construct" may lead us to believe that being compliant on paper, with all the necessary ESG ratings and awards and with all the required statements and assessments requested by the European regulators, is enough. In fact, compliance should not be an excuse not to think harder about the implications and consequences of these transitions also from a governance point of view. Corporate responsibility transparency and accountability are becoming as important as the development of new financial products. The change of "G-ear" as in governance is even more relevant for new generations of young colleagues and customers, all very aware of social and environmental challenges ahead of us. We do not believe that offering either recyclable credit cards or sustainable finance products is enough, but only part of a more general strategy and a radical change of thinking about how we can work together. Towards, as the Brudntland Report titled in 1987, 'Our Common (n.d.a. and transgenerational…) Future'.