CANDRIAM
A NEW YORK LIFE INVESTMENTS COMPANY

Financial Institutions Climate Change Survey

Active Engagement

FEBRUARY 2021

Marketing communication

The topic.

The impacts of Climate Change on the financial sector are already measured in the billions, just for extreme weather events. Add in other elements such as credit risks for banks, and delays in tackling climate change could cost financial companies up to $1.2 trillion over the next 15 years.[1]

7 ÉNERGIE PROPRE ET D'UN COÛT ABORDABLE

13 MESURES RELATIVES À LA LUTTE CONTRE LES CHANGEMENTS CLIMATIQUES

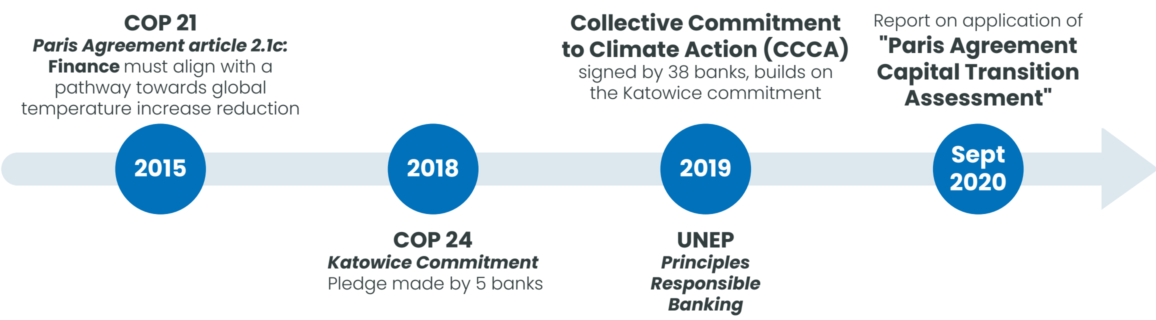
We see two main dimensions of Climate Change risk to financial companies: Transition Risks and Physical Risks. The *Transition* to a lower-carbon economy means entire industries such as power generation, and oil and gas, are susceptible to stricter regulation, disruptive technologies and changes in customer behavior. While banks and insurance companies are a major source of funding for fossil fuel projects, climate change has not historically played a role in their credit analysis of and capital allocation to fossil fuel and extractive industries. *Transition* risks of exposure to these assets is difficult to assess, along with the climate change risks to the financial firms. *Physical* risks include increased weather-related insurance claims and payouts for insurers, and increased premiums for consumers, and stranded assets for banks.

The story thus far

The 2015 Paris Agreement marked a turning point in the relationship between financial firms and ESG regulation.[2] Providers of capital are under increasing pressure, some of it regulatory, to demonstrate both their own sustainability and how they incorporate 'green finance' in their decisions to make capital available to clients.[3]

Initiatives have emerged to improve climate transparency in bank lending portfolios. The most important, the 2019 *UNEP Principles for Responsible Banking*, is a coalition of 130 global financial firms who are developing open-source measurement methods and tools to "*provide the much-needed framework for the sustainable banking system of the future*".[4] Their first follow-up is expected by the end of 2021.

Figure 1: Initiatives for Better Climate Change Practices in the Financial Sector



Promises made: What has been the result on fossil fuels exposure ?

However, since the Paris Agreement came into force in 2015, bank lending for fossil fuels has increased by almost *$2 trillion*, in sharp contrast to the pledges made.[1]

Candriam has engaged with banks and insurance companies to determine whether these public statements of intent have begun to improve disclosure and practices. We also analysed whether those financial firms which were not involved in these initiatives exhibited below-average disclosure, weaker climate policies, and worse fossil fuel exposure.

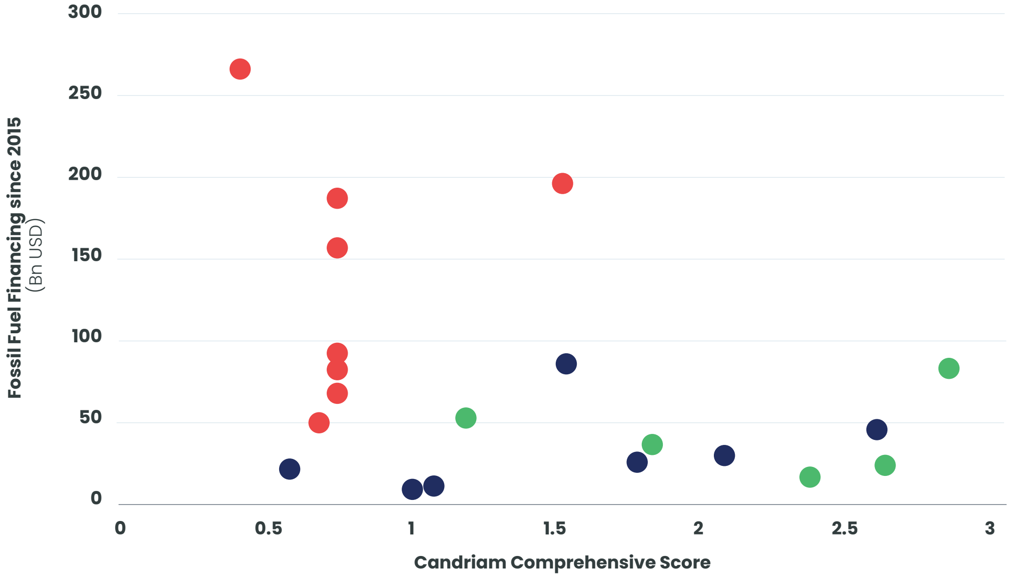
Our climate-oriented engagement campaign, launched in the second half of 2019, yielded responses from 33 financial institutions -– 27 banks and six insurers. We incorporated issues and findings from NGOs such as *Banking on Climate Change*[5] and from collaborative initiatives with other investors, such as CDP's *Climate Change Reports*, and ShareAction's *Banking on a Low-Carbon Future*.

Our topics included two main categories -- the methodology used to assess exposure to activities contributing to GHG emissions, and the corresponding risk mitigation approach used for their portfolios.

Most investors agree on the need for improved extra-financial disclosure. With TCFD[3] recommendations in mind, we reviewed coal and fossil fuel exposure and dialogued with issuers on their exposure to Physical risks such as unanticipated payouts for fires, floods, etc. We discussed their approaches to project financing, environmental performance-conditioned lending and insurance, and client support for Transition to a low carbon economy (particularly for their clients in the agricultural and extractive industries).

We developed a Comprehensive Scoring System encompassing each company's transparency and the policy put in place. Where available (20 of the companies), we compared our Comprehensive Score to their level of risk exposure based on the *Banking on Climate Change Report 2020.*[5] While some companies were critical of the NGO's methodology, none chose to provide any adjusted data.

Figure 2: Comprehensive score compared to fossil fuel financing since 2015



Source: Candriam, and Rainforest Action Network.

Several issuers increased funding for fossil fuels by more than $50 billion each since Paris Agreement. Within this group, eight also scored poorly in our Comprehensive Score. Of these eight High-Risk issuers, shown in **red**, five declined to respond to our questions. This shows a strong correlation between declining to join the most advanced finance industry initiatives, and suffering from poor environmental policies and practices.

Only one of the issuers judged High Risk by our Candriam Comprehensive score was a signatory of the finance industry climate initiatives. This demonstrates that the companies which make strong public commitment are at least heading in a more positive direction.

Further evidence of the benefit of these initiatives is that the five banks in one of the early initiatives, the 2018 Katowice Commitment, shown in **green**, have reduced their financing of fossil fuels since the 2015 Paris Agreement. All five score quite well in our Candriam Comprehensive Score engagement results.

This reinforces our conviction that specific and individual engagement should be undertaken with selected issuers to raise awareness of the role that lending practices have on climate. In addition, we acknowledge that involvement in these leading initiatives is correlated with improved practices. With respect to reporting of lending and exposure to fossil fuel financing, there is also need for targeted actions including collaborative initiatives and direct engagement. Extra-financial reporting in general remains first hurdle to overcome, as demonstrated by several non-answers to questions we considered to be fundamental. The detailed picture of the symptoms is not yet available, even though we should already be in the 'treatment phase' of this disease.

On the insurance side, it is worth mentioning AXA, who we believe demonstrates 'best practice'. The insurer was not contacted because its public disclosure offered all the necessary information for our analysis.

Next steps?

One year after the launch of our study and engagement program, many financial industry participants have moved forward in both their reporting and their practices in extending capital to fossil fuel companies.

Yet much remains to be done, and the pace of climate change does permit the luxury of time. By providing funding today, financial firms determine the world of tomorrow.

Candriam continues to commit to greater data transparency, to the effective financing of the energy transition, and the gradual ending of financing for fossil fuels. Following the successes by Investor groups such as IIGCC and CA100+ in effecting change at the largest GHG emitters -- notably at AGMs – we have no doubt that the financial sector is next in the spotlight.

The constantly increasing scrutiny is evidenced by the 2020 shareholder resolutions received by financial companies such as Barclays, JPMorgan Chase, Toronto-Dominion Bank, Danske Bank, Topdanmark, National Australia Bank and Australia New Zealand Bank.

We expect this trend to accelerate, and Candriam intends to play an active role.

1 - Share Action. *Banking on a Low-Carbon Future: Finance in a Time of Climate Crisis*, 2019. https://www.euractiv.com/wp-content/uploads/sites/2/2019/11/Full-Report-Finance-in-a-time-of-climate-crisis-FV.pdf, accessed 4 February, 2021. See also -- Share Action. *Banking on a Low-Carbon Future: Finance in a Time of Climate Crisis*, 2020. https://shareaction.org/wp-content/uploads/2020/04/ShareAction-Banking-Report-2020.pdf
2 - Compared to the IEA's central scenario (which incorporates the Paris INDCs, but is associated with 2.7°C warming), 2019-2030 capex on new oil projects is 83% lower in a 1.6°C scenario and 60% lower in a 1.7-1.8°C scenario. Carbon Tracker Initiative. *Breaking the Habit – Why non of the large oil companies are "Paris aligned", and what they need to do to get there.* September, 2019. https://carbontracker.org/reports/breaking-the-habit/, accessed 4 February, 2021.
3 - ESG regulation pertaining to the financial sector includes the Financial Stability Board (FSB) – with the creation of the Task Force on Climate-related Financial Disclosures (TCFD) – the Prudential Regulatory Authority (PRA) and the Financial Conduct Authority (FCA).
4 - https://www.unepfi.org/publications/principles-for-responsible-banking/, accessed 4 February, 2021.
5 - Rainforest Action Network. *Banking on Climate Change, Fossil Fuel Finance Report*. 2020. https://www.ran.org/bankingonclimatechange2020, accessed 4 February, 2021. See also 2019 edition.

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