Annex

Sound practices supporting the transition to carbon neutrality

The Hong Kong Monetary Authority ("HKMA") has held a series of discussions with banks to understand their approach to and readiness for climate risk management. In the course of the discussions with banks, the HKMA observes that some banks have developed comprehensive climate strategies and are implementing them with respect to their Hong Kong operations. Apart from incorporating climate risk considerations into their risk management framework[1], these banks have devoted resources and taken measures beyond risk management to support the goals of the 2015 Paris Agreement[2] and contribute to achieving global net zero emissions.

This note highlights the observed sound practices adopted by leading banks in the space of climate risk management under four areas, namely (i) reducing greenhouse gas ("GHG") emissions of own operations, (ii) reducing financed emissions through portfolio alignment, (iii) assisting clients to transition, and (iv) promoting collective efforts to assist the economy to transition to net zero. The sound practices are of reference value to banks in formulating their own climate strategies.

(1) Reducing GHG emissions of own operations

Leading banks in the space of climate risk management begin their climate-related efforts towards carbon neutrality with reducing emissions through their own operations. GHG emissions reduction targets, or targets to achieve "net zero" emissions from their own operations by 2030 or sooner are set. Sound practices taken by these leading banks include:

- **Adopting energy-saving measures and green office / branch policies.** These banks adopt measures such as electricity and water reduction, use of cleaner fuel mix and reduction of paper use, to generate less waste and promote behavioural change in operations. Specific targets, such as the amount of energy, waste and water reduction, and the target amount of electricity from renewables, are set. Some banks have also moved their operations into green buildings and enhanced the energy efficiency of their data centres to reduce the carbon footprint of their operations. Branch operation has gone "green" by adopting paperless processes.

[1] The HKMA issued a circular in July 2020 to share a range of practices adopted by banks in relation to climate risk management. For details, please see https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2020/20200707e1.pdf.

[2] The Paris Agreement, adopted by 196 countries in 2015, aims to limit the increase in the global average temperature to well below 2°C, preferably to 1.5°C, compared to pre-industrial levels. The other two long-term goals of the Paris Agreement are: (i) to increase the ability to adapt the adverse impacts of climate change and foster climate resilience; and (ii) to make finance flow consistent with a pathway towards low GHG emissions and climate-resilient development.

- **Launching in-house carbon reduction programme and initiatives** to raise awareness and cultivate green and sustainability-centric core value within the bank. One example is the collection of "internal carbon tax" by a bank from its various business units based on their GHG emissions in order to incentivise them to reduce carbon emissions and to launch new green initiatives.

These leading banks have put in place mechanisms to measure the GHG emissions from their own operations against their reduction or net zero targets. Quantitative metrics or key performance indicators ("KPIs") are set to monitor banks' emissions from various sources. Some banks calculate the emissions of their operations (including Scopes 1, 2 and 3 emissions) according to the Greenhouse Gas Protocol framework[3]. Domestically, some banks have made reference to the guidance materials on environmental, social and governance ("ESG") of the Hong Kong Exchanges and Clearing Limited ("HKEX")[4] when they compute the carbon footprint of their Hong Kong operations. Regular disclosure of the performance of these metrics or KPIs helps enhance banks' transparency and accountability, allowing their stakeholders to better gauge the greenness of the banks' operations.

By taking steps to proactively reduce GHG emissions of their own operations, these leading banks help build green and sustainability culture within the organisations. This "green culture" can in turn motivate and drive reduction in GHG emissions related to the banks' financing and investment activities.

(2) Reducing financed emissions through portfolio alignment

Banks, as financial intermediaries, can reduce financed emissions through allocating funds to support low-carbon transition in their lending and investment portfolios. Many leading banks in the space of climate risk management have already set explicit targets to align their portfolios with net zero carbon emissions by 2050, in line with the Paris Agreement. Sound practices adopted by the leading banks to reduce their financed emissions include:

- **Channeling more funds to greener and more sustainable areas and activities**. Some leading banks, which used to have a relatively large exposure to traditional energy sectors, have increased their financing to clean technologies and renewable energy sectors, such as wind, solar, and hydro energy sectors. New markets, particularly in Asia, for renewables as well as clean technologies have also been explored, given the growing awareness of climate change and opportunities in the region.

[3] According to the Greenhouse Gas Protocol, Scope 1 emissions are direct emissions from owned or controlled sources; Scope 2 emissions are indirect emissions from the generation of purchased energy; and Scope 3 emissions are all indirect emissions (not included in Scope 2) that occur in the value chain of the reporting company, including both upstream and downstream emissions, e.g. financed emissions and supply chain emissions. (*Source: https://ghgprotocol.org/*)

[4] https://www.hkex.com.hk/listing/rules-and-guidance/esg-academy?sc_lang=en

- **Expanding the range of green and sustainable financial products** to "green" their portfolios and to meet the increasing market demand of borrowers and investors. Apart from assisting large corporate clients to issue green bonds to raise capital for green projects, some banks offer green or sustainability-linked loans at concessionary rates to small and medium-sized enterprises, which form a major part of their client base. Green deposits and mortgages as well as investment products such as green or sustainability funds and related derivative products have been offered to the market.

- **Adopting limiting policies** to reduce exposures to sectors with high carbon emissions. Many banks set intermediate exposure targets and time-based targets for reducing their exposures to high-emitting sectors to avoid disorderly transition. For instance, some leading banks have committed to reducing their thermal coal financing in phases. Some European banks have particularly scheduled to phase-out coal-related financing by 2030 for the EU and OECD countries and by 2040 for the rest of the world to align with the government climate-related goals and commitments of their respective countries.

Some leading banks have used science-based tools and methodologies to assess their portfolio alignment against pre-set targets under benchmark scenarios, develop transition pathways to achieve the targets in line with the Paris Agreement, and keep track of their financed emissions against their targets. For instance, some banks have joined the Science Based Targets Initiative ("SBTi")[5], under which banks must follow a rigorous process to develop science-based GHG or carbon emissions reduction targets to align their lending and investment portfolios with the goals of the Paris Agreement and submit their targets for validation. Some commonly used methodologies are also adopted such as the Paris Agreement Capital Transition Assessment ("PACTA"), which is an open source methodology for assessing the alignment of banks' portfolios on a sectoral basis[6] and setting clear and measurable pathways to net zero.

It is observed that some leading banks have made efforts to include quantitative information about their financed emissions in their climate-related disclosures. For example, a few banks have disclosed information about their Scope 3 emissions including carbon intensity for specific portfolios. A bank has also disclosed the percentage of its commercial loan exposures in high transition risk sectors and the impacts of climate scenarios on these sectors. These disclosures on financed emissions help meet investors' increasing demand for information on banks' delivery of ESG and sustainability policies.

[5] SBTi, launched in 2015 by CDP (an international non-profit organisation), the United Nations Global Compact ("UNGC"), the World Resources Institute ("WRI") and the World Wide Fund for Nature ("WWF"), defines and promotes best practices in emissions reductions and net-zero targets in line with climate science. (*Source: https://sciencebasedtargets.org/*)

[6] The climate-relevant sectors currently covered by PACTA include: power, coal mining, oil and gas upstream sectors, auto-manufacturing, cement, steel, and aviation, with the shipping industry to be added. These sectors collectively account for about 75% of global GHG emissions. (*Source: 2degress-investing.org/*)

(3) Assisting clients to transition

Banks can also catalyse decarbonisation efforts through working closely with their clients and assisting them to transition to low-carbon activities.

- **Offering transition financing** to fund transition activities and projects of clients particularly those from "brown" sectors. While lacking a single definition, "transition finance" is generally industry inclusive (spanning green to brown), including activities which are not yet consistent with net-zero pathway. It helps to bridge the gap between traditional and sustainable financing through which companies can obtain financing to adopt new technology and implement long-term changes to reduce carbon emissions as well as to progressively transform their businesses into greener and more sustainable models. Leading banks offer transition loans with pricing linked to the achievement of some pre-set sustainability objectives to incentivise their clients to transition towards carbon neutrality. This is an important supportive approach that would help avoid disruptive financial exclusion of some of the traditional industries, while proactively encouraging operators in these industries to transition to low carbon and reduce the risk of disorderly transition.

- **Facilitating clients to obtain green certification and assessment.** Through partnership with green certification agencies, some banks facilitate their clients to obtain third party green certification and independent assessment of the greenness of their clients' projects or usage of the proceeds prior to green financing applications. This helps to streamline the green loan application process and enable clients to access green financing more efficiently. A leading bank has also partnered with consultancy firms which provide complimentary advisory services on green building certification to their green financing clients, with a view to promoting decarbonisation and shaping a more sustainable economy.

- **Promoting clients' awareness of climate change-related issues and opportunities.** Some leading banks have engaged their clients in regular dialogues to increase their awareness of climate change, as well as the associated challenges and opportunities. A few of them have also set up dedicated teams to provide bespoke advisory services to their clients, such as sharing updates on climate change-related issues, benchmarking clients' risk profile against peers and expectations from stakeholders such as regulators, auditors and rating agencies, and assisting with the integration of climate change-related considerations into clients' business and financing strategies. Capacity building is also offered by some banks to their clients through seminars to share their experience and information on latest developments relating to climate change.

(4) Promoting collective efforts to assist the economy to net zero transition

To contribute to global transition towards net zero, leading banks in the space of climate risk management have actively participated in international or regional initiatives and

coalitions to drive collective climate change actions in the banking industry and to shape relevant policies.

- **Participating in global and regional banking sector initiatives**, such as the Collective Commitment to Climate Action ("CCCA")[7] and the Net Zero Banking Alliance ("NZBA")[8]. Participating banks are committed to aligning their business strategies and portfolios with a pathway to net zero economy by 2050 or sooner. Through delivering concrete progress on their commitments to climate change goals under these initiatives, participating banks seek to demonstrate their ambition to and responsibility for achieving net zero globally. The Alliance for Green Commercial Banks is a new global initiative co-launched by the HKMA and the International Finance Corporation of the World Bank Group, which brings together financial institutions across Asia to develop, build, and boost the capacity for green finance and promote climate investments. Banks are encouraged to participate in global and regional initiatives which allow banks to build their capacity through exchanging expertise and experience.

- **Collaborating with governments and policymakers** to proactively provide suggestions and advice to help shape climate-related policies at the jurisdictional level. Domestically, some banks have been actively engaging with the HKSAR Government and the HKMA to share views on climate change matters via their participation in the Centre for Green and Sustainable Finance of the Cross-Agency Steering Group, the Working Group on Green and Sustainable Banking, the HKMA's industry consultation on Supervisory Policy Manual module on Climate Risk Management and the pilot climate risk stress test.

- **Adhering to widely recognised principles and recommendations** of standard-setting bodies and industry associations. Leading banks have made their climate-related financial disclosures by adhering to the recommendations of the Financial Stability Board's Task Force on Climate-Related Financial Disclosures ("TCFD")[9]. They have also adopted other industry guidance and principles, such as the Green

[7] The CCCA is a global banking sector initiative that supports transition to a net zero economy by 2050. The 38 participating banks, which are also signatories of United Nations ("UN") Principles for Responsible Banking, commit to aligning their portfolios with the climate change goal of the Paris Agreement. (*Source: https://www.unepfi.org/wordpress/wp-content/uploads/2019/12/PRB-Collective-Commitment-to-Climate-Action.pdf*)

[8] The NZBA is an industry-led, UN-convened alliance launched in April 2021, of which members are committed to aligning their corporate and institutional lending and investment portfolios with transition strategies to help the world to reach net zero carbon emissions by 2050 or earlier. Signatory banks also need to set an intermediate target for 2030 or sooner, using robust, science-based guidelines. As of 7 December 2021, the NZBA has 95 member banks from 39 countries with 43% of global banking assets. (*Source: https://www.unepfi.org/net-zero-banking/*)

[9] The TCFD's recommendations on climate-related financial disclosures set out a disclosure framework for climate and sustainability-related issues around four areas, namely, governance, strategy, risk management, and metrics and targets. (*Source: https://www.fsb-tcfd.org/*)

Bond Principles[10], Green Loan Principles[11], and Principles for Responsible Banking[12] in their business operations. The adherence to these principles and recommendations helps promote more consistent, comparable and decision-useful information and approaches for green and sustainable banking.

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[10] The Green Bond Principles, issued by International Capital Market Association ("ICMA"), provide voluntary guidelines regarding transparency, disclosure and reporting for issuing green bonds with a view to promoting integrity in the green bond market. (*Source: https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/green-bond-principles-gbp/*)

[11] The Green Loan Principles, issued by the Loan Syndication and Trading Association, the Loan Market Association, and the Asia Pacific Loan Market Association, provide voluntary recommended guidelines for assessing whether a loan can be considered as "green". (*Source: https://www.lma.eu.com/application/files/9115/4452/5458/741_LM_Green_Loan_Principles_Booklet_V8.pdf*)

[12] The Principles for Responsible Banking provide a framework that enables banks to put sustainability at the heart of their businesses. Signatory banks commit to aligning their business strategies and practices with the UN's Sustainable Development Goals and the goals of the Paris Agreement. *(Source: https://www.unepfi.org/banking/bankingprinciples/more-about-the-principles/)*