

# HOW CAN THE FINANCE INDUSTRY SUPPORT THE CLIMATE TRANSITION

9 September, 2021

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# OW TEAM TODAY



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Head of OW SEA

# INTRODUCTION



# 300 TO 1000 YEARS

Length of time that carbon dioxide molecules remain in Earth's atmosphere

“

*Changes in climate policies, new technologies and growing physical risks will prompt **reassessments of the values of virtually every financial asset.***

*Firms that align their business models to the transition to a net zero world will be rewarded handsomely.*

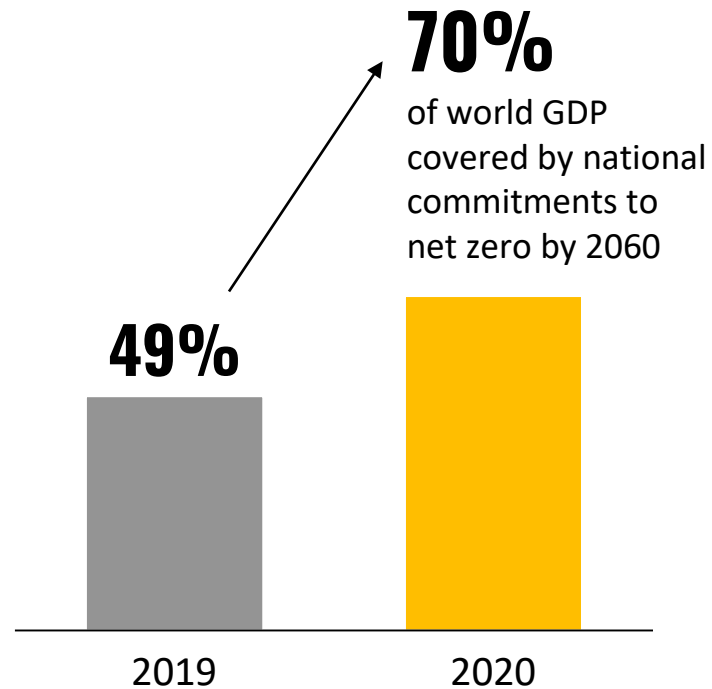
***Those that fail to adapt will cease to exist.***

Mark Carney, Former Governor of the Bank of England

”

# 70% OF THE GLOBAL ECONOMY HAS MADE NET ZERO COMMITMENTS

The last year has seen a rapid GDP increase in net zero commitments



And emissions reduction targets become increasingly ambitious



## EUROPEAN UNION

April 2021

*“Yesterday, we agreed Europe's first ever Climate Law with the European Parliament [...]. With this, we write into stone the goal set out by the European Green Deal – to make Europe climate-neutral by 2050.”*

– Ursula von der Leyen, President of the European Commission



## CHINA

September 2020

*“We aim to have CO<sub>2</sub> emissions peak before 2030 and achieve carbon neutrality by 2060”*

– Xi Jinping, President



## USA

April 2021

*“The United States sets out on the road to cut greenhouse gases in half — in half by the end of this decade. [...] These steps will set America on a path of net-zero emissions economy by no later than 2050”*

– Joe Biden, President



## UNITED KINGDOM

June 2019

*“Today we're leading the world yet again in becoming the first major economy to pass new laws to reduce emissions to net zero by 2050”*

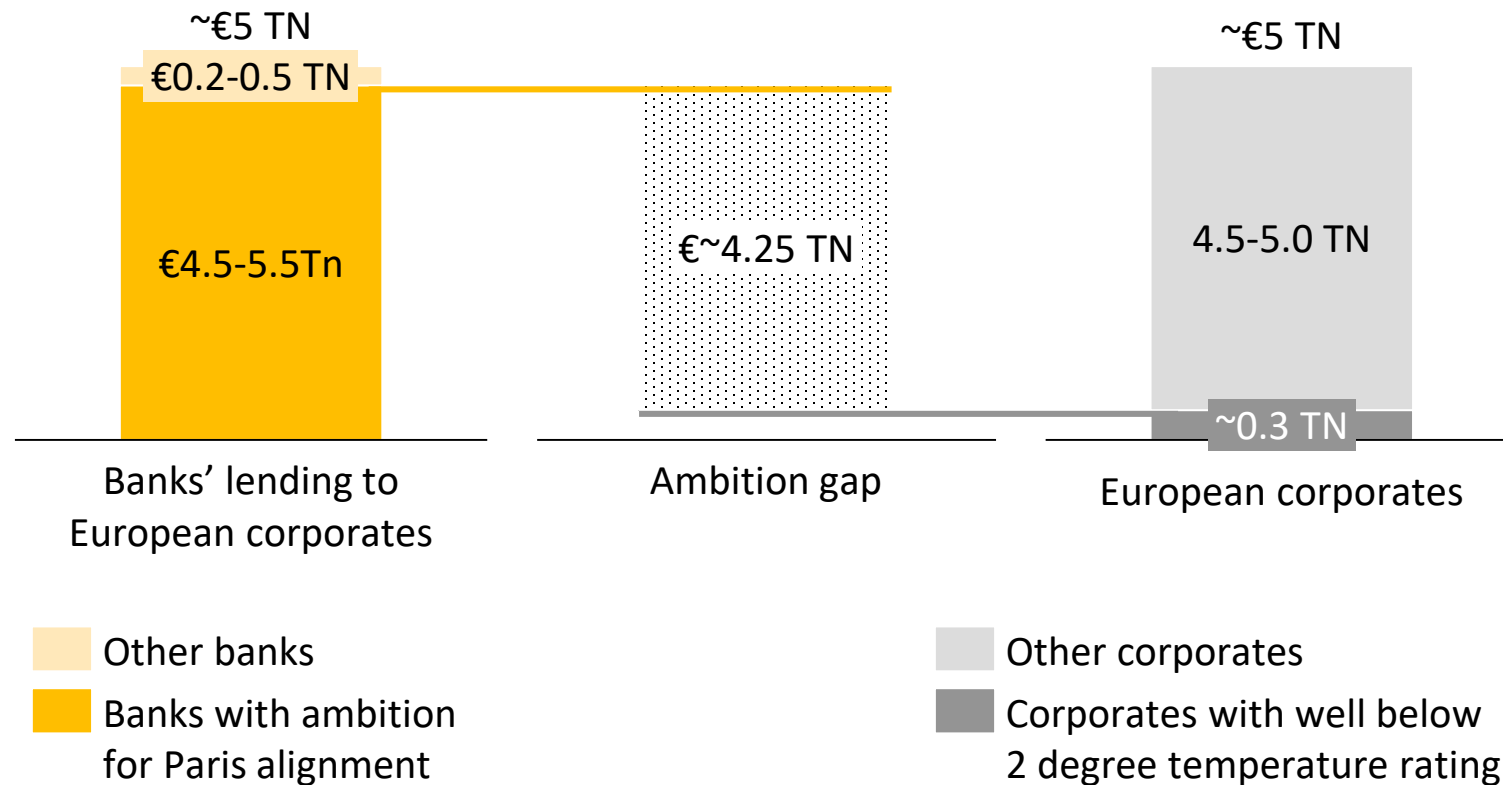
– Chris Skidmore, Energy and Clean Growth Minister

Source: UNFCCC, Oxford Net Zero, Nature Capital Partners, Oliver Wyman analysis



# DEEP DIVE: **BANKS** ARE COMMITTING TO THE PARIS AGREEMENT WHICH MAY REQUIRE A PORTFOLIO REALIGNMENT

## Ambition gap for Paris alignment of the financial services lending activity and European corporate borrowers



## Comments

- In Europe, there is a mismatch of **>€4 trillion** between capital with Paris ambition, and the current available market for Paris-aligned corporate lending
- **95% of lenders** to European corporates have ambitions to be Paris aligned
- But only **10% of European** corporates have transition plan aligned for below-2°C warming

Source: Bloomberg, Dealogic, ECB, Annual reports and investor presentations, Oliver Wyman analysis, <https://sciencebasedtargets.org/companies-taking-action/>



# GLOBALLY, THERE ARE 11 SECTORS – WITH \$2.2 TN DEBT – THAT HAVE ELEVATED ENVIRONMENTAL RISK EXPOSURE

## Breakdown of sectors with “elevated risk<sup>1</sup>” (USD BN)

Elevated Risk – Immediate \$517

Elevated Risk – Emerging \$1,726



Unregulated Utilities & Power companies \$504	Coal Mining & Terminals \$13		Shipping \$24		Building Materials \$91	O&G – Independent Exploration & Production \$370
	O&G Refining & Marketing \$68	Steel \$88	Chemicals Commodity \$119			
	Surface Transportation & Logistics \$241		Mining, Metals & Other Materials (excluding coal) \$261		Automobile Manufacturers \$466	

## Global perspectives

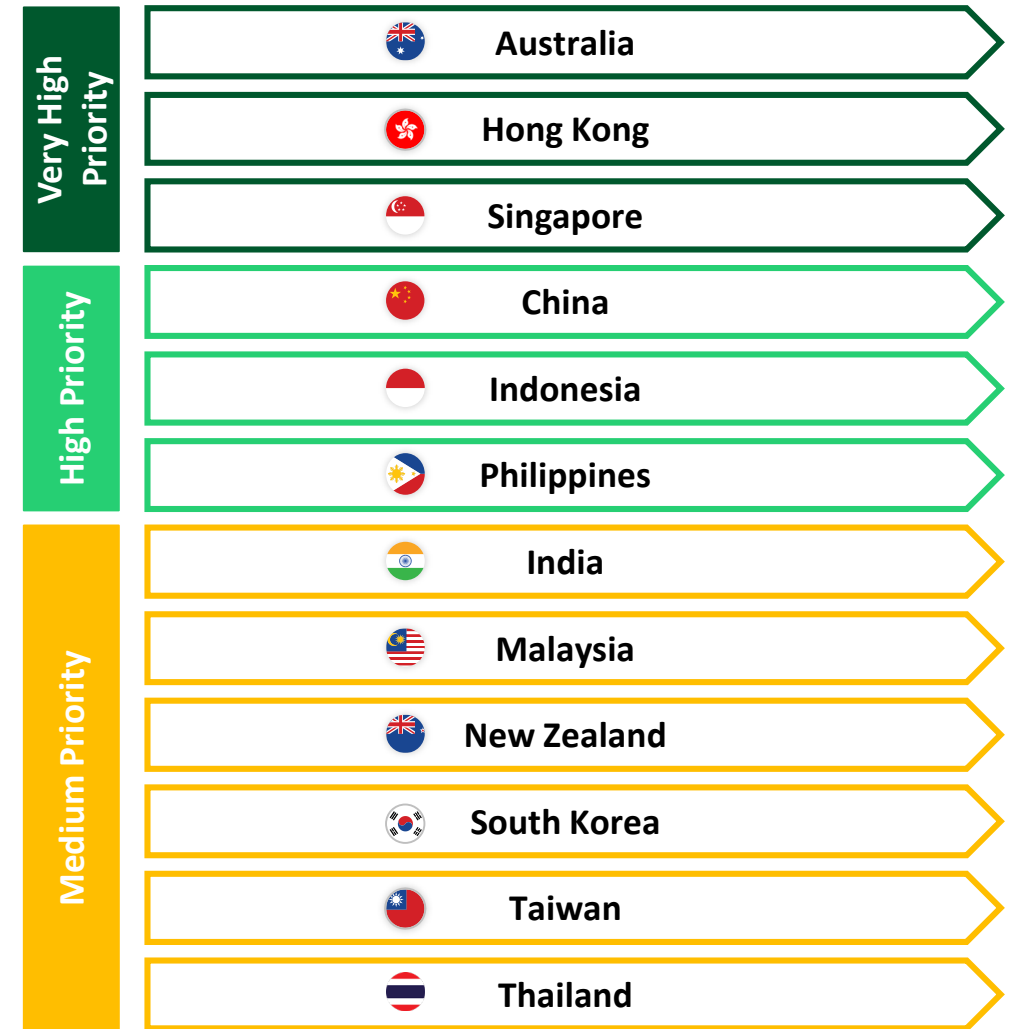
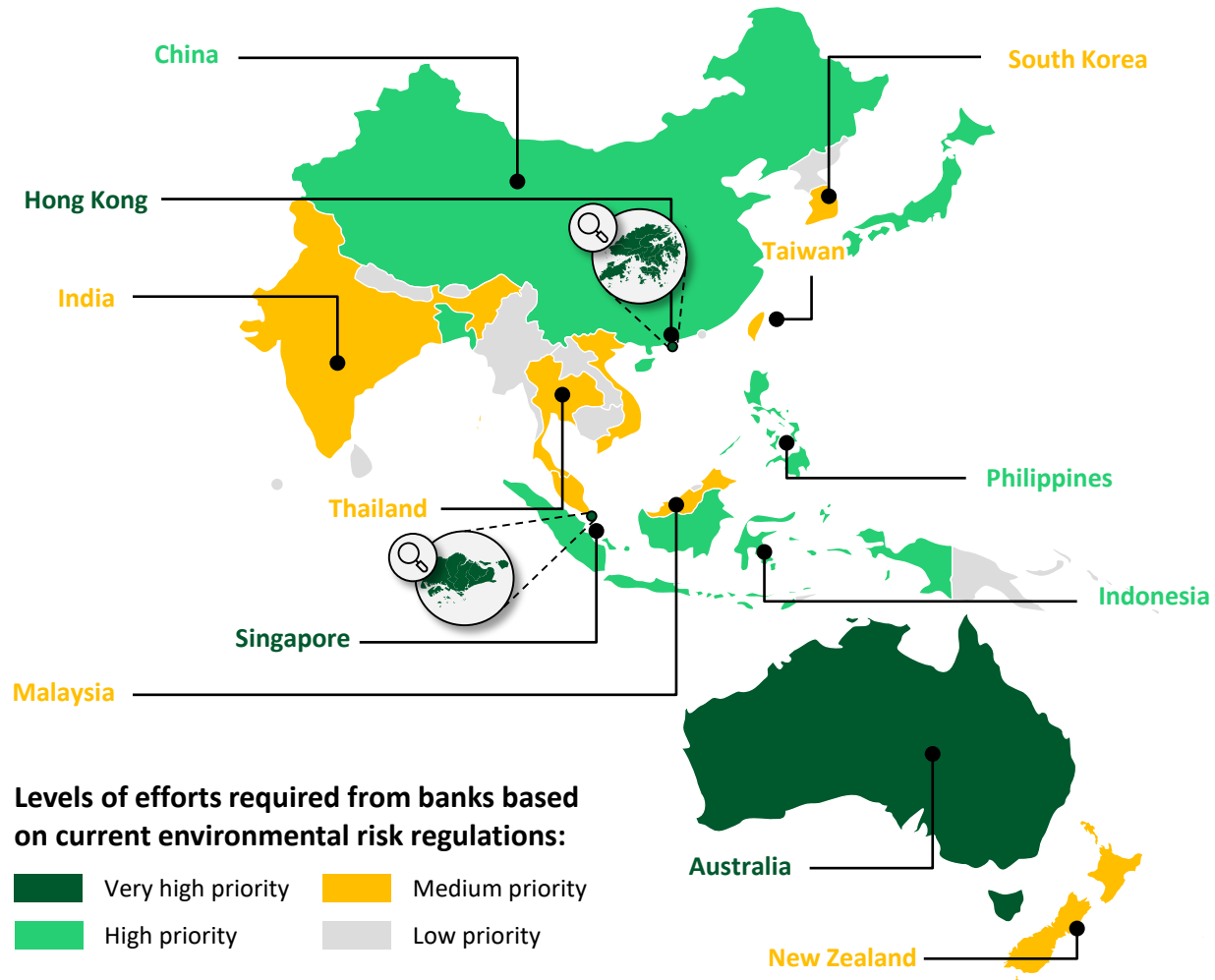
- **Two sectors** have experienced material credit pressure due to environmental risks:
  - Coal mining & coal terminals
  - Unregulated utilities & power
- **Remaining 9 sectors** are expected to be exposed to material impact from credit pressure in the next 3-5 years
- **2 sectors** have been recently classified under “elevated risk,” reflecting a gradual tightening of environmental regulations:
  - Surface transportation & logistics
  - Shipping
- Greater regulatory regimes governing carbon emissions will have a tangible impact on these elevated risk sectors

1. Defined as immediate & emerging risks  
 Source: Moody’s Investors Service (2018)  
 © Oliver Wyman

<span style="display:inline-block; width:15px; height:15px; background-color:darkred; border:1px solid black;"></span> Elevated risk – Immediate	<span style="display:inline-block; width:15px; height:15px; background-color:orange; border:1px solid black;"></span> Elevated risk – Emerging
<span style="display:inline-block; width:15px; height:15px; background-color:yellow; border:1px solid black;"></span> Moderate risk	<span style="display:inline-block; width:15px; height:15px; background-color:lightblue; border:1px solid black;"></span> Low risk

# REGULATORS ACROSS ASIA ARE MOVING AT DIFFERENT SPEEDS – VARIED LEVELS OF EFFORT WILL BE REQUIRED TO MEET ENVIRONMENTAL RISK REGULATIONS

Environmental risk regulations across select countries in Asia



Source: Regulatory guidance, Oliver Wyman analysis  
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# WE BELIEVE THAT GREEN IS THE NEW DIGITAL

There is an opportunity for banks that can get ahead of the market now



We expect Green to be a key investment theme in the next 20-30 years



Four forces will drive growth in Green investment

- Government policy
- Investor activism
- Consumer activism
- Financial sector ambition



Just as there was with Digital, there is an opportunity now for financial institutions that can get ahead of the market for Green investment

# 99% CAGR

2014-2019 GROWTH IN GREEN  
BOND ISSUANCE IN ASIA PACIFIC<sup>1</sup>

# 88%

OF PEOPLE IN SINGAPORE ARE  
ALARMED OR CONCERNED ABOUT  
CLIMATE CHANGE<sup>2</sup>

1. Climate Bonds Initiative | 2. Oliver Wyman Consumer Survey on Sustainable Lifestyle, July 2020, n=302 (Climate Change Alarmed, Concerned, and Cautious represents the respective segment as defined by the Yale Program on Climate Change Communications based on 4 climate change questions)

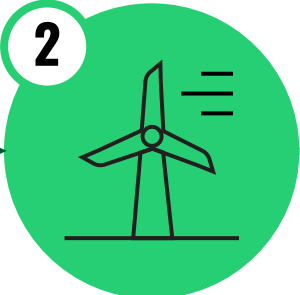
# ROLE OF FINANCE

An aerial photograph of a coastline. The water is a vibrant turquoise color, transitioning to a darker blue further out. A sandy beach runs along the right side of the frame. To the right of the beach, there is a residential area with several houses and a parking lot. The land is a mix of green grass and brown earth. The overall scene is bright and clear, suggesting a sunny day.

# FINANCIAL INSTITUTIONS HAVE AN IMPORTANT ROLE TO CATALYSE RESPONSES TO CLIMATE CHANGE

Carbon<sup>1</sup> emissions from human activities are causing **climate change**

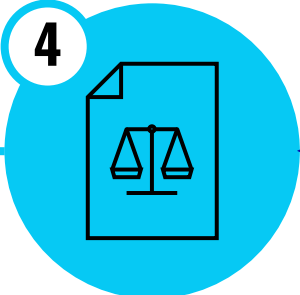
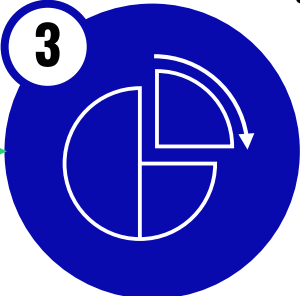
Climate change is increasing the frequency and severity of **Physical Risk** events and losses for Financial Institutions



In the coming years, the **real economy will shift** towards activities that emit less Carbon

There will be winners and losers, resulting in **Transition Risk** for Financial Institutions

The shift in the real economy will result in a **natural shift** in the **composition of Financial Institutions' portfolios** towards clients that emit less Carbon...



... Financial Institutions can **catalyse** the real economy shift by **rapidly realigning their portfolios** to climate goals

Many stakeholders will pressure them to do this  
Lowering emissions will help **abate climate change**, creating a symbiotic relationship between **Climate Risk Management** and **Climate Portfolio Alignment**

1. Note – we use the term “Carbon” to denote all greenhouse gases including NO<sub>x</sub>, CFCs, methane, etc., not only Carbon Dioxide

**FINANCIAL INSTITUTIONS' CATALYST ROLE LEADS TO A TWO FACETED RELATIONSHIP WITH THE CLIMATE:  
THE CHANGING CLIMATE WILL IMPACT FIS' BUSINESSES, WHILE FIS' ACTIVITIES WILL IMPACT THE CLIMATE**

# **CLIMATE RISK MANAGEMENT**

Reduce financial risks stemming  
from climate change

Risks can be reduced without  
meaningful portfolio greening

# **CLIMATE PORTFOLIO ALIGNMENT**

Shift the portfolio to align the Bank's  
activities with its climate goals

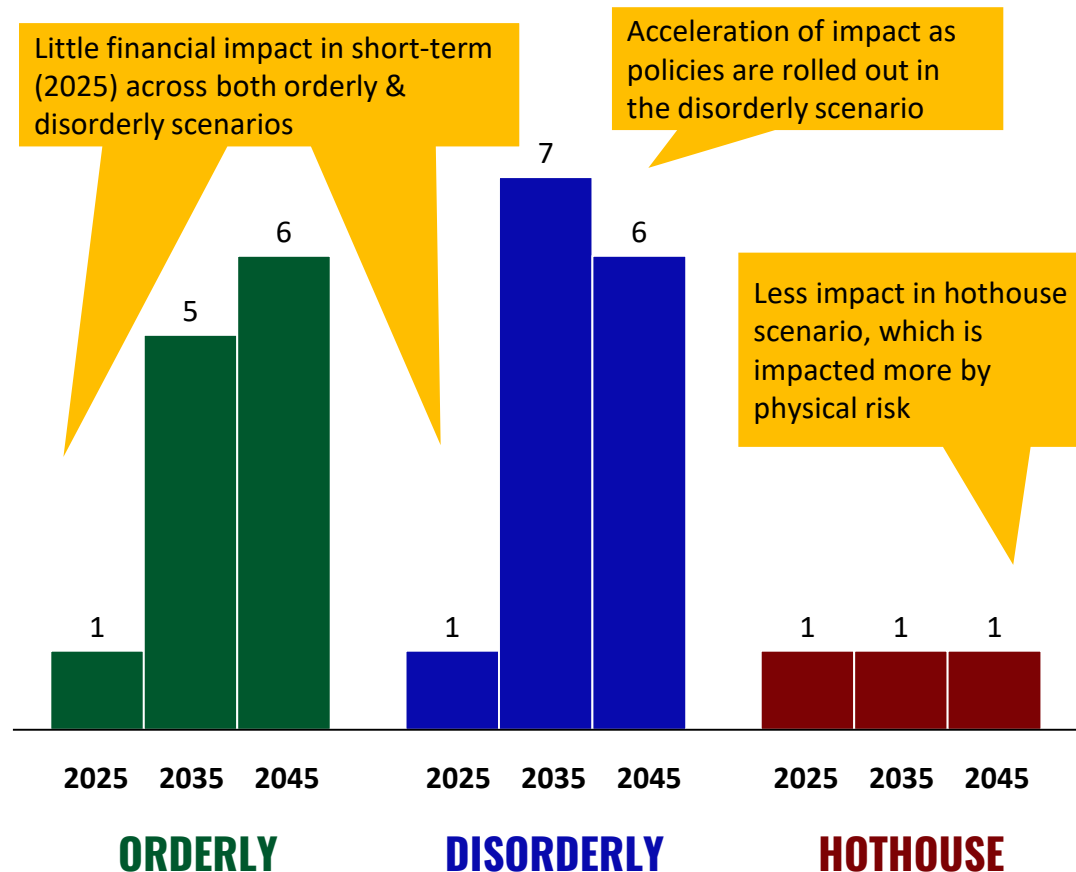
Greening the portfolio will not  
necessarily make it less risky

**Financial Institutions should account for both directions of their relationships with the climate in their strategies**

# THE SCALE OF INDUSTRIAL TRANSFORMATION IMPLIED BY A SHIFT TO NET ZERO WILL CREATE LARGE SCALE RISKS TO BANKS, PARTICULARLY TO OLDER AND LESS EFFICIENT TECHNOLOGIES IN BROWN INDUSTRIES

## Downgrades in ratings based on transition risk<sup>1</sup>

# of companies with at least 2 notch drop in ratings vs. 2019; n = 24



1. Analysis based on OW's proprietary transition risk impact model

Note: N = 24 includes companies from the following sectors – real estate, shipping, aviation, metals & mining, coal, power & utilities, oil & gas, chemicals, manufacturing, and cement,

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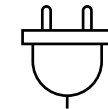
## Commentary: Key sectors & idiosyncrasies within them

Analysis based on OW's transition risk impact model & expertise



**COAL:** Downgraded and under severe pressure where not exited

- Examples of investment pullback from coal projects in Asia
- High risk from firms outside of region divesting from Asia's coal



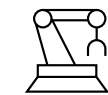
**POWER & UTILITIES:** Impact on rating depend on fuel-type mix

- Pressure to come from regulations, less economics



**METALS & MINING:** Impact on rating depend on metal type

- Limited transition risk, but rising consumer pressures



**MANUFACTURING:** Depend on emission intensity (driven by energy use & raw material); impact on rating mostly localised



**CEMENT:** Most impact on rating under disorderly scenario, with high sensitivity to carbon price; footprint from underlying process



**SHIPPING:** Impact on rating depend on emissions intensity

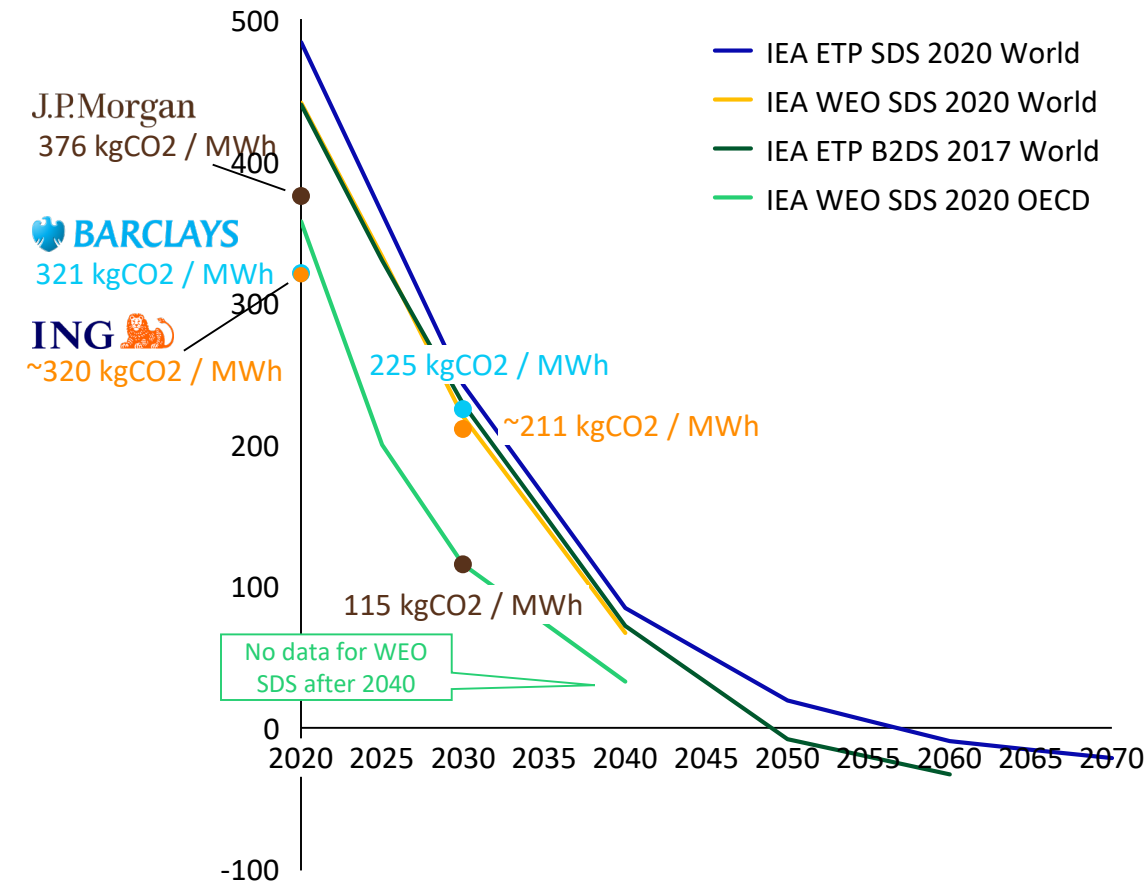
- Driven by variables such as fuel type & fleet age
- Limited immediate transition risk, but rising policy pressures

# MANY BANKS HAVE, OR ARE PLANNING TO, SET NET-ZERO TARGETS, THOUGH THERE IS A WIDE RANGE OF APPROACHES AND AMBITION IN TARGETS

Power sector example

## Power sector: CO<sub>2</sub> emissions intensity across IEA scenarios

Kg CO<sub>2</sub> / MWh



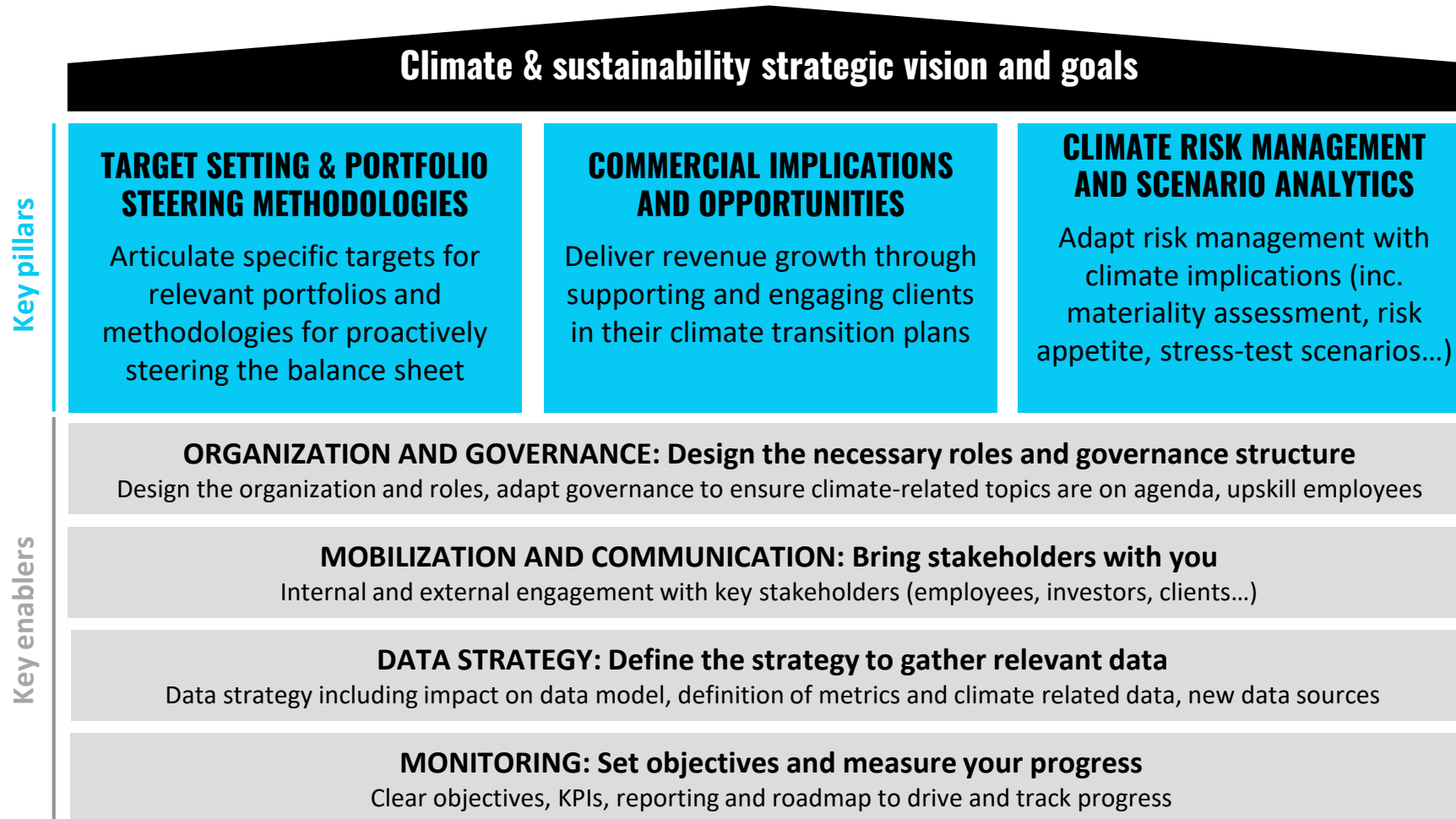
## Perspectives

- Emissions intensity (absolute emissions per unit of production) is a commonly used metric for target-setting as it is required by the Net-Zero Banking Alliance at a sector-level and prevents outsized changes in the target from growth in the business
- However there are many discrepancies in approaches, such as:
  - Scopes of emissions that are measured – coverage ranges from scope 1 emissions only to scopes 1-3, with choices varying by bank and by sector
  - Baseline scenarios that banks are comparing to – IEA scenarios are commonly used, though there are a number of different IEA options, while other providers also exist
  - Etc.
- For instance, in power:
  - ING and Barclays both reported Power sectors intensities below IEA world benchmarks; their 34% and 30% reduction targets for 2030, respectively, bring them in line with benchmark pathways
  - JPM derived its target from the IEA SDS OECD scenario to reflect the current geographic distribution of its Power portfolio and set a high bar for overall reduction by using a more stringent pathway






# MAKING THIS HAPPEN WILL TOUCH ON ALL ASPECTS OF THE BANK

## OW Climate & Sustainability strategy framework





# THERE ARE OPPORTUNITIES RELATED TO GREEN AND TRANSITION SECTORS SPANNING BOTH TRADITIONAL AND NEW PRODUCTS & SERVICES


## Asset-side

-  **Green economy financing:** Serving new and emerging sectors in the green economy
-  **Transition financing:** Products that reward the transition efforts of brown companies
-  **Adaptation financing:** Supporting activities that build resilience to climate change impacts

## Liability-side

-  **Green structuring of own liabilities:** Structuring towards green finance market (bonds, institutional investment)
-  **Originate to distribute:** Asset-backed securities, loan funds

## Fees, trading & other services

-  **Debt Capital Markets / Equity Capital Markets:** Underwriting Green bond and ECM issuances, development of transition and sustainability-linked bonds
-  **Advisory:** Helping clients access green capital pools and improve ESG profile
-  **Risk management:** Distribution of insurance and other products to address physical risks
-  **Carbon credits / offsets:** Carbon credit trading platform for corporate clients
-  **Rating service:** branded climate scores to support client investor communication
-  **Platform:** Ecosystem services such as trade finance or SME-tailored offerings with green metrics and features embedded across the platform
-  **Climate tech/venture incubation:** Direct/co- investment to scale climate solutions

Banks can apply **traditional products & services** to green and transition sectors.

But there is also potential for exploring **new products & services**.

For example:



Design new green funding mechanisms for trading (e.g. digital funding tools such as ICOs<sup>1</sup>)



Develop new product structures such as ESG-linked swaps and impact-linked structured notes



Embed presence in the green tech ecosystem as a bank for venture funds or taking equity positions in future technologies



Explore Green infrastructure Public-Private Partnerships; especially for adaptation finance



Use measurement of sustainability impact and risk to support clients in their transition



Provide deal tools / templates to enable financing for emerging green sectors / tech



# OWNING THE NARRATIVE: COMMUNICATION IS KEY (1/2)

## THREE BIASES SHAPE PEOPLE'S VIEWS ON CLIMATE CHANGE – COMMUNICATION NEEDS TO EMBRACE THESE

### Good vs. bad

“ Wind and solar are good: coal, even oil and gas, are bad – there is nothing in between ”

39%

think there is no such thing as a sustainable oil company (vs. 8% who disagree)



- Stigmatises industries in transition, driving divestment over engagement
- Only values “pure-green” companies, rather than “olive”

### Me

“ I’m just a small cog in a big machine – the best I can do is focus on the little things I can control ”

50%

believe the biggest impact they can make is to reduce their own carbon footprint (versus 7% who disagree)



- Champions incremental changes at the end of the value chain over more fundamental (and essential) changes at earlier stages

### Now

“ Action is urgent – climate actions that companies take now matter more than what they plan to do in the future ”

46%

do not trust the commitments companies are making on climate change (versus 10% who trust)



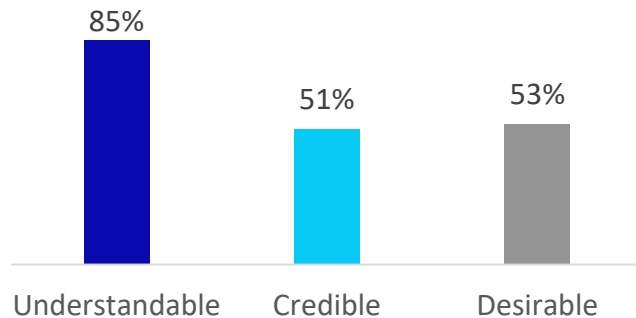
- Sees “smooth transition” as an excuse for inaction, underestimating the social impact of disruptive change

Lippincott Survey 2021. N=200, multi-country. Percentages are agreement of 6-7 (vs. 1.2) on 1-7 scale

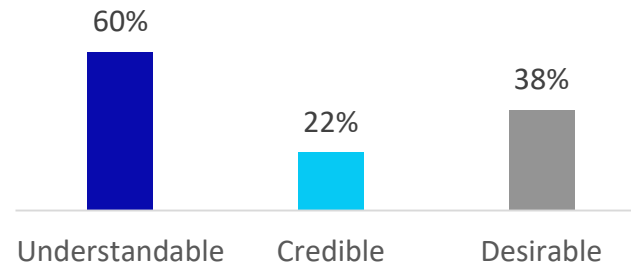
# OWNING THE NARRATIVE: COMMUNICATION IS KEY (1/2)

## OUR CUSTOMER RESEARCH SUGGESTS A NEED TO ENGAGE WITH THE EMOTIONAL AND PERSONAL AS WELL AS THE SCIENTIFIC

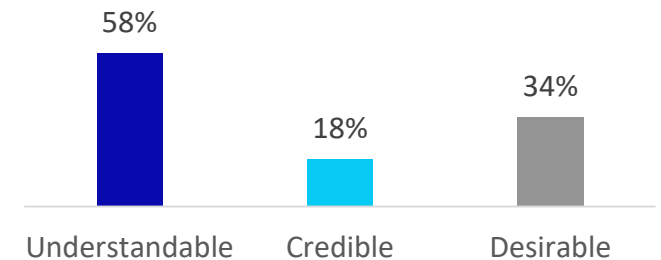
### A tiny but tangible change I can feel *today*



### Positive plans for what we *will* do in future (in unspecified sectors)



### Future road to net zero through what we *won't* do



### No need to pay with plastic

We are accelerating the rollout of eco-friendly cards, reinforcing our commitment to sustainable and responsible banking. By 2025, all debit, credit and prepaid cards will be made of sustainable materials, such as recycled PVC or corn-based plastic substitute

As recycled PVC and corn-based polylactic (PLA) cards require less energy to produce than traditional plastic cards, the bank's adoption of eco cards will save more than 1,000 tonnes of CO2 every year, equivalent to the energy consumption of nearly 1,000 households

### Financing a cleaner future

Our aim is to accelerate the transition to a thriving low-carbon global economy through finance

We help customers cut carbon while ensuring they continue to prosper. Our ambition is to provide between \$750 billion and \$1 trillion in sustainable financing and investment by 2030 (more than any other bank) to support them as they switch to more sustainable ways of doing business

The transition to a net zero economy requires radical new solutions. We are pioneering new financing for nature-based climate solutions, and supporting promising and innovative clean technologies

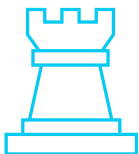
### Net-zero by 2050

To support the goals of the Paris Agreement on climate change, we are announcing our ambition to achieve net zero carbon emissions across the Bank by 2050. The ambition applies to the Bank's own operations, which have been net zero since 2020, and all client emissions that result from any lending, advisory or investment services we provide

By 2030, we will align our power generation portfolio with the Paris Agreement. As part of this, we will stop providing financial services to power generation clients with more than 10% of revenues dependent on thermal coal, and eliminate all exposure to thermal coal mining worldwide

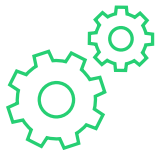
Lippincott Survey 2021. N=200, multi-country. Percentages are agreement of 6-7 (vs. 1.2) on 1-7 scale. Narratives taken from the web sites of actual banks, slightly edited and with identities removed  
 Understandable = I understand what this statement is telling me | Credible = I would trust and believe this statement from my bank | Desirable = If my bank did this, it would improve my opinion of them

# BANKS MUST TAKE 4 STEPS TO TRANSFORM THE ORGANIZATION



## 1 Set the strategy

- 1.1 Where are the opportunities?
- 1.2 What are the risks?
- 1.3 How to measure ESG impact?
- 1.4 What is the role of each unit to enable the bank's ambition?



## 2 Embed the strategy

- 2.1 How to steer the balance sheet?
- 2.2 What changes to processes and frameworks?
- 2.3 What new Business and Risk tools?
- 2.4 What training is needed for front office staff?



## 3 Seize the opportunities

- 3.1 What are the potential products and services?
  - Asset-side
  - Liability-side
  - Fees, trading and other services
- 3.2 What teams and partnerships are needed to seize the opportunities?



## 4 Bring stakeholders with you

- 4.1 External disclosures of climate metrics
- 4.2 Engagement with industry to shape agenda
- 4.3 Active communication with clients
- 4.4 Internal comms aligning climate strategy

**Q&A**

# THANK YOU







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