

Science-Based Targets for Financial Institutions: Criteria Deep Dive Webinar *FAQ Document*

January 2021

Introduction

In October 2020, the Science Based Targets initiative (SBTi) released a new framework that enables financial institutions to set science-based targets that align lending and investment activities with the Paris Agreement. Since then, we have received numerous inquiries on the target validation criteria and expressions of interest for participation. On January 14th, 2021, we hosted a webinar to provide an in-depth explanation of this new framework to help financial institutions and other stakeholders better understand this framework and how to prepare for science-based target submissions.

690 participants from financial institutions, rating agencies, non-profit organizations, academic research institutions, and consulting firms registered for the webinar, representing 46 countries. A total of 80 questions were received on the Q&A panel. This FAQ document is prepared to answer a selection of 33 key common questions raised.

General criteria and submission related questions

- 1** The Target Language Template in the submission form is articulated around targets for “asset classes” and “sectors”? How does this fit with the criteria on setting targets on “required activities” e.g., for Real Estate (an asset class but also reported under commercial loans)?

If the asset class already has a sector orientation, such as commercial real estate, it's not necessary to provide sector information again. However, if for instance a FI is setting SDA targets on certain sectors in a general asset class without sector orientation (e.g., Corporate loan), it's useful to communicate that information in the target wording.
- 2** Can I set a SBT for my scope 1, 2 and 3 operational GHG emissions now (e.g., gas use, electricity use and business travel) and then one for scope 3 investments at a later date?

For financial institutions, scope 1+2 targets can be preliminary validated by the SBTi now, but targets covering financed emissions must be submitted to achieve an official and public approval by the SBTi.
- 3** Can the scope 1 and scope 2 reduction target be an intensity target, such as the one defined for the Real estate portfolio (i.e., reduction of scope 1 and 2 emissions linked to offices xx% per square meter by xxx from a xx base year)?

Yes, FIs may set intensity targets on their scope 1 and 2 emissions are well and Chapter 4 of the financial sector SBT guidance covers this topic.

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| <p>4 Loans to SME (<500 employee) is an optional category. So, we assume that all the corporate loans been required, concern only big companies (>500 employees)?</p> | <p><i>Yes, that's correct. However, we are looking to refine the SME definition and the fewer than 500 employee threshold might change.</i></p> |
| <p>5 Are there different requirements for different regions on the coal phase out, e.g., institutions in developing markets?</p> | <p><i>In consistency with SBTi approaches to companies, the phase out requirement is the same for all regions.</i></p> |
| <p>6 Are Coal investment phase out and fossil fuel investments disclosures required to validate Targets? Indeed, these are specified under recommendations and additional guidance</p> | <p><i>Coal phase out and fossil fuel investment disclosures are recommended but not required at this point for SBT validation.</i></p> |
| <p>7 Do you include also coking coal for steel production? In addition to coal for power. This needs to be phased out, too; producing about one third of all coal pollution and with renewable hydrogen there are now viable alternatives.</p> | <p><i>Good question. The SBTi coal recommendation currently covers thermal coal; as hydrogen and other coking-coal alternatives reach commercial scale we will adjust our criteria.</i></p> |
| <p>8 For the assets of cat.15 that are out of the scope for reduction targets, for example motor vehicle, do you still recommend that the financial institutions include these emissions in their scope 3 GHG inventory?</p> | <p><i>Yes, we encourage reporting of financed emissions for out-of-scope activities and information on the method used to calculate these emissions.</i></p> |

Framework requirement for different types of financial institutions or asset classes

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| <p>9 What flexibility will be allowed for different types of institution looking to set a portfolio coverage target. For example, a private equity company may be investing in quite immature companies who won't have an SBT, but if the target is 100% coverage by 2040, that could make the target infeasible. Could a caveat, for example only companies that have been in the portfolio for 3 years to be covered, be included?</p> | <p><i>We are currently developing the minimum target coverage requirement for private equity firms as they were not a primary audience of the project in the pilot phase. In theory, the SBT portfolio coverage method allows a lot of room for flexibility as it only asks for an incremental increase of SBT companies based on where the FI is starting out. For example, a financial institution starting with 10 percent coverage in 2020 would need to increase coverage by 4.5 percent per year $(90 / (2040 - 2020) = 4.5)$ and reach at least 32.5 percent $(10 + [5 \times 4.5] = 32.5)$ coverage by 2025.</i></p> <p><i>For immature companies, they may go through the streamlined SME route through SBTi.</i></p> |
| <p>10 Do FIs include any emissions for instruments they underwrite and securitize, or only investments held?</p> | <p><i>Currently we only require your investment and loans portfolio to be covered. For instance, underwriting may be included in a future version of our framework.</i></p> |

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| <p>11 Bank's asset management divisions are currently not required to follow table 5.2 and set targets, on the funds they manage, how about asset manager division of the Insurance company?</p> | <p><i>This is a good question and something we will consider in the next phase of the criteria. In the meantime, please feel free to reach out if you have thoughts or suggestions.</i></p> |
| <p>12 Do you foresee the "required", "optional" and "out of scope" to change in the future?</p> | <p><i>As methods, tools and processes are being developed it is likely that the table 5.2 on p 54 in our guidance will be revised. However, for the criteria update this year we do not envision to make major changes to this table. We will likely add clarifications and refinement.</i></p> |
| <p>13 What about company pension schemes?</p> | <p><i>These are covered insofar as they are invested in listed equity and bonds (see activity coverage requirements table).</i></p> |
| <p>14 Could you please talk about why some activities are optional to include, and what FI's should consider when deciding whether to include them?</p> <p>For a number of asset classes SBTi is requiring 100% coverage. Please outline the rationale for this requirement. Would 67% not be more feasible given difficulties in obtaining data?</p> | <p><i>The SBTi aims to strike a right balance between robustness and practicality of the criteria. Factors such as data availability, financial institutions' level of influence, and sector's contribution to climate change have been taken into consideration when determining if an activity should be included and the corresponding minimum coverage requirements.</i></p> <p><i>The asset classes and activities with 100% coverage requirements generally have more available data and influence by financial institutions.</i></p> |
| <p>15 Where the requirement is 67%, does the FI choose which 67%? If so, does this raise a risk they will cherry pick the data inputs that make them look best?</p> | <p><i>Yes, FIs have flexibility on choosing which 67%. This is intended to provide some flexibility especially for sectors that are not fossil fuel. The targets are based on percentage reduction or %companies engaged or portfolio temperature score alignment, so the risk of helping FIs look better is limited from this aspect.</i></p> |
| <p>16 What is the rationale for 100% coverage for electricity generation, but 95% coverage from fossil fuel sector</p> | <p><i>Whereas electricity generation data are widely available, broader fossil fuel sector data are not. Many financial institutions are just starting their fossil fuel disclosure journeys and SBTi does not want lack of comprehensive data to be an impediment to target-setting.</i></p> |
| <p>17 Is the loan maturity somehow considered when looking at the scope?</p> | <p><i>In table 5.2 on p55 we specify that short-term debt is optional</i></p> |

Method data requirement and application questions

- 18** A financial institution has preferred stocks of companies belonging to sectors (e.g., food industry) not covered by SDA. In addition, none of these companies has been engaged with SBTi so it is not feasible to apply Portfolio coverage or temperature scoring. So how to deal with this problem? Thank you in advance
- For these companies, the **temperature rating approach** can still be used as it uses any public GHG target of the companies (even ones that have not been validated by the SBTi). The temperature rating approach also has a default scoring methodology which gives scores to companies in the absence of valid target information.*
- 19** What can financial institutions do if **no data is available** for some of the assets in a 100% required category, i.e., some listed equities or bonds?
- SBTi accepts high level estimations to be used as input data for target modelling and encourages FIs to improve data quality over time. For instance, we accept "scope 5" level data in the PCAF scheme. In addition, you can always use **portfolio coverage (PC) and/or the temperature rating (TR)** for 100% of your listed equity and corporate bonds. E.g., for PC is just means that the investees that have not set an SBT (this data is freely available on our website (<https://sciencebasedtargets.org/companies-taking-action> and from commercial data providers) reduces the portfolio coverage %. In TR, if you don't have data from some investees, the method and tool apply a default score (currently 3.2C) to these investees. Hence you can always cover all companies in these portfolios.*
- 20** If an investor uses the **SDA** to set a target, where the input would be the current carbon intensity, the output or the target, respectively, is again a (lower) carbon intensity. Does an investor simply need to state that the target intensity will be reached at a certain point in time (e.g., 2030) or does he also need to explain how (engagement, divestment, etc.)?
- Both, as in the target language template we require the SDA targets to be expressed in % of emissions intensity and in the summary of actions to achieve targets to communicate the actions to achieve the target.*
- 21** When using the **SDA tool** for e.g., large equity portfolios, does every single company need to be entered individually or is there some other tool to do this on an automated basis?
- You can set one SDA target on all companies in the same sector. The SBTi tool can be used to set targets and there are instructions in the guidance for target modelling.*

22 If investee companies have already set SBTs, can this be counted towards reaching an FI's portfolio coverage target or do new investees need to set SBTs?

*That is exactly what the **Portfolio Coverage method** does. You measure the proportion of your portfolio that has set SBTs and then set a target that makes sure that 100% of your portfolio has set SBTs by 2040. You find more about this method on p 80 of our [guidance](#).*

23 Is it correct that it is expected from an investor to have all the information needed in the temperature rating approach available himself, which in practice might prove to be quite challenging for e.g., large equity portfolios?

Good question. Several data providers have most or all of the data available for the temperature rating method. We worked together with CDP, Bloomberg, ISS ESG, MSCI, S&P Trucost and Urgentem and these providers and others have some or all of these data points. The difficult dataset is usually the companies' targets and CDP has a good dataset for this, which is also "resold" or included in other data providers' data sets, but other data providers are also building out their own data collection for target data. Initially you may need to use more than one data provider to get all the data.

24 The IEA ETP data used in the **SDA** only provides carbon data as far as I know, how was it transformed to overall GHG data?

Yes, this is correct. SBTi made a comparison between IEA emission reduction scenarios to WB-2°C and 1.5°C scenarios in the [Foundations of SBT setting paper](#) (pg. 28) and concluded that targets modeled with the SDA using the B2DS scenario can be considered aligned with a WB-2°C temperature goal.

25 Can you please **compare / contrast** the three methodologies? What makes one preferable over the other? Naturally, it seems that SDA is the most detailed and difficult one, especially in comparison to portfolio coverage, but a bit in depth discussion on what would speak in favor or against for the different methodologies would be appreciated.

In general, SDA is suitable to portfolios with high exposures to the specific sectors covered by SDA and SBT portfolio coverage is suitable for smaller portfolios with fewer number of clients. Temperature rating can be applied to asset classes without specific sector orientations and larger portfolios.

Project outlook and resources

26 Given the accelerating rate of sign up, roughly when would you envisage there being a tipping point for the FS when there is strong pressure for everyone who has not yet signed up to do so? On a related note, to what extent do you envisage a 'name and shame' approach being used (by SBTi or others) to encourage compliance, vs. more carrot-based approaches (and what might they be)?

Our optimistic scenario has rapid uptake this year with certain types of institutions (perhaps banks) approaching tipping points with new announcements around COP26. SBTi does not engage in 'name and shame' though the initiative is planning to commence an MRV process this year.

27 Do you help FIs with estimating their scope 3 emissions associated with investments before setting the targets? If not, are there third parties you would recommend?

The SBTi does not assist FIs in the development of GHG inventories for financed emissions. The SBTi does also not officially recommend specific third parties, but many consultancies will be able to assist with this work

Peer initiatives collaboration and integration

28 Hello, what is your view and possibilities for SBT integration with **ESG reporting standardization initiatives**? Have you held talks with EU, IFRS and other bodies which are working on ESG reporting standard-setting?

Thanks for your question. We are presently focusing on TCFD reporting integration and would welcome additional conversations.

29 Can you please detail the connection with the **Net-zero asset owner alliance**?

The UNEP-FI Net-Zero Asset Owners Alliance is a partner of the SBTi. As such, the initiatives collaborate on resource development and outreach.

30 I wanted to know why **GRI** is not involved in your partner organization group.

We do use GRI's sector classification system to categorize companies joining SBTi. The initiative mapping figure we presented on the webinar today might be more euro-centric and is not comprehensive. We are aware that in Asia, for instance, there's presently more focus on GRI and disclosure-related initiatives.

Future work

31 Could you explain how the **net-zero approach** would look like and differ from current target setting approach?

We plan to scope out net zero for financial institutions in the next phase (2021-2022) of our project and our current work on net zero for companies will inform the NZ definition for FIs.

The SBTi has begun work on the corporate net zero pathways, the latest guidance can be found here: <https://sciencebasedtargets.org/net-zero>

32 Which **additional asset classes** are being considered to be added?

Thanks for your question. We are considering investment banking, insurance underwriting, and agricultural lending though we have not finalized and would welcome suggestions.

33 Could you please elaborate a little bit on **capital market integration**? Does that mean the framework will cover underwriting of capital markets instruments by banks for example?

Capital market integration is a potential focus area for SBTi Finance that's contingent on funding and partner availability. Banks underwriting of capital market instruments is of interest, but such work is not likely to commence until latter 2021 at the earliest.