Getting Down to Business

Enabling Action and Enhancing Credibility in Net-Zero Banking Using a Portfolio-Led Approach

Authors: Kaitlin Crouch-Hess, Elizabeth Harnett, Whitney Mann, and Ella Warshauer (listed in alphabetical order)

Report / December 2022

Table of Contents

Executive Summary

Financial institutions are increasingly recognizing the risks and opportunities of the net-zero transition, and many have set net-zero decarbonization targets. Robust and credible action must follow.

This report introduces a **portfolio-led approach to enhance credibility and robustness of net-zero banking.** Designed to help banks translate their net-zero commitments into action, this approach can help bankers navigate increasing stakeholder expectations, an evolving landscape of net-zero guidelines, and complex organizational structures. The portfolio-led approach promotes a holistic view of net-zero activities across a firm.

In practice, the portfolio-led approach is a way for firms to assess **where (through sectors and geographies) and how (through asset classes and business units) they can best support the real-economy net-zero transition.** The portfolio-led approach is therefore based on analyzing and activating four key portfolio pillars:

1. **Sectors:** A sectoral lens can help banks focus where they have the most influence, expertise, and exposure to climate change.
2. **Geographies:** A geographic lens can help banks identify the best strategies to support transition based on contextual barriers and opportunities.
3. **Asset classes:** An asset class lens can help determine how and when in the deal process a bank can facilitate transition and mitigate climate-related risks.
4. **Business units:** A business unit lens can unlock key parts of a financial institution to achieve climate outcomes, building on their unique levers of influence and competitive advantages.

Most banks undertake a three-stage process to make progress toward net-zero targets, comprising (**1) strategy design, (2) implementation, and (3) reporting.** A portfolio-led approach can help banks enable action and enhance credibility across each stage of the process:

- **Strategy design:** By facilitating development of individually optimized climate strategies and transition plans that leverage unique influence levers, capabilities, and expertise
- **Implementation:** By helping translate high-level, long-term climate commitments into appropriate actions, tools, governance, and incentive structures
- **Reporting:** By enabling creation of clear, compelling, and comprehensive narratives to explain net-zero strategies and actions, and track progress across a firm

The portfolio-led approach can help banks optimize for their individual traits and potential for influence, while also tailoring net-zero approaches to real-economy conditions and financing needs across sectors and geographies. Importantly, this approach is compatible with existing net-zero guidance. For example, it can be used in conjunction with the Glasgow Financial Alliance for Net-Zero (GFANZ) guidance on transition plans, and it can complement the Net-Zero Banking Alliance (NZBA) sectoral target-setting guidance by offering additional categories for consideration (e.g., geography, asset class, business unit) to further enable action and enhance credibility.

Overall, the portfolio-led approach is meant to be an iterative process to embed the four pillars of sectors, geographies, business units, and asset classes into strategy design, implementation, and reporting to help support net-zero-aligned outcomes in the real economy. Firms can use it to identify transition hot spots, opportunities for real-economy influence, and potential organizational blind spots in the net-zero transition based on their unique portfolio, regardless of where they are in their net-zero journey.

Introduction

Background and Context

Three years into the decisive decade for climate action, the urgency for delivering on climate commitments has never been clearer. Although extreme weather around the world is already demonstrating the stark human and economic costs of climate change, more green and transition investments are becoming commercially viable, boosted by legislation such as the United States' Inflation Reduction Act.[i] Against this backdrop, the legal and reputational risk of inaction or greenwashing has intensified for banks that face mounting pressure from clients, regulators, and civil society to publish credible transition plans and demonstrate net-zero aligned activity. As such, taking action can be a competitive advantage.

Three Stages of Net-Zero Banking

Existing net-zero guidance highlights three stages of activities financial institutions must undertake to shift from commitment to action:

- **Strategy design,** including setting targets and developing transition plans
- **Implementation** of strategies and plans through financial and nonfinancial activities
- **Reporting** on progress to key stakeholders

Significant guidance has been published to support financial institutions in designing net-zero strategies, implementing those strategies, and reporting on and tracking progress.[ii] However, much of this guidance remains high-level and tends to overlook important distinctions among the roles for different types of financial actors as well as the climate-related financial risks and opportunities they face. Many financial institutions use top-down and bottom-up approaches in interpreting guidance and acting on firm-wide climate commitments, but a lack of organizational coordination could lead to blind spots and missed opportunities for strategic prioritization, effective action, and real-economy impact.

---

i For more on the Inflation Reduction Act, see **"Four Ways the Inflation Reduction Act Speeds the Shift to a Cleaner, More Affordable Energy Future,"** from RMI.

ii Groups that have published such guidance include but are not limited to the Glasgow Financial Alliance for Net Zero (GFANZ), the Net Zero Banking Alliance (NZBA), the Climate Safe Lending (CSL) Network, the Sustainable Markets Initiative (SMI), and the World Wildlife Fund (WWF). The Center for Climate-Aligned Finance (CCAF) also published the *IMPACT+ Principles* to help private-sector financial institutions create the strategies and conditions through which they can have an impact while pursuing their climate targets. For more details and a comparison on each of these guidance documents, see the ***Appendix: Summary and Assessment of Existing Net-Zero Banking Guidance***.

To facilitate outcomes-oriented action against climate commitments, we propose **a tailored, portfolio-led approach.** This can support and enhance application of existing guidance, addressing many challenges banks face in making and demonstrating credible, coordinated, and robust action. In practice, a portfolio-led approach means conducting net-zero strategy, implementation, and reporting in a way that **accounts for a firm's unique characteristics, competitive advantages, and role in the real and financial economies;** in particular, it means looking at net zero through the lens of transition-related risks and opportunities across four pillars of a bank portfolio (**sectors, geographies, asset classes, and business units**).

The benefits of a portfolio-led approach span the three stages of net-zero banking in the following ways:

Strategy design: By facilitating development of individually optimized climate strategies and transition plans that support real-economy decarbonization and transition through leveraging the variety of unique influence levers, capabilities, and expertise across a firm

Implementation: By helping translate high-level, long-term climate commitments into appropriate actions, tools to gather necessary data and metrics, governance, and incentive structures that mobilize internal units in a tailored but coordinated manner, support organizational and culture change, and ensure firm-wide accountability and progress

Reporting: By enabling creation of a clear, compelling, and comprehensive narrative for how and why firms are prioritizing certain activities, addressing stakeholder demands for enhanced transparency and accountability, showing the impact of the firm's climate activities on the real economy,[1] and tracking progress against climate targets

Designing tailored approaches, however, does not mean that firms should start from scratch, operate in a silo, or create all their own metrics and methodologies. Collaboration, including participation in net-zero initiatives and adoption of existing guidance, can help streamline and reinforce individual efforts, contributing to credibility and robustness. Further, firms already on a net-zero journey should not start over or face criticism because they are not yet doing everything outlined in this brief. Rather, the portfolio-led approach is meant to be complementary to NZBA sectoral target-setting guidance and GFANZ recommendations on transition planning, for example, with both target setting and transition planning representing critical pieces of the strategy design process that can then inform implementation and reporting.

Introducing the Portfolio-Led Approach to Net-Zero Banking

What Is the Portfolio-Led Approach?

The portfolio-led approach is a way for banks to enhance credibility and robustness of their net-zero activities by approaching them through the lens of sectors, geographies, asset classes, and business units.

> **We have to become much more holistic. It's not about adding on a green finance activity; it's about the entire portfolio. All the products and services that a financial institution — and any actor in the real economy — offers. . . . The next stage is to prioritize and focus where it matters most.**
>
> — Eric Usher, head of the U.N. Environment Programme Finance Initiative

Regardless of where a financial institution is on its net-zero journey, breaking down net-zero strategy, implementation, and reporting across the four pillars of a portfolio-led approach can help comprehensively assess, prioritize, and communicate how and where firms can best support — or are best supporting — the real-economy transition.

While business units and asset classes determine *how* banks can influence the transition through their financial and nonfinancial products and services, sectors and geographies make up the nodal connection to the real economy through which banks can know *where* they can — or are best positioned to — have impact. Exhibit 1 (next page) highlights some key questions firms might use in applying the portfolio-led approach across the four pillars.

Exhibit 1 Guiding Questions for the Four Pillars of a Portfolio-Led Approach

Where portfolio supports transition

Sectors

Which sectors does the firm have the highest exposure to?

What are the financial opportunities of the transition in each sector?

Which sectors have the highest concentration of climate-related risk?

What net–zero aligned technology and policy pathways exist for those sectors?

How can finance be deployed to fit the needs of the sectoral transition?

How can the firm measure and report progress on net–zero activities in each sector?

Geographies

Which geographies does the firm have the highest exposure to?

What are the financial opportunities of the transition in each geography?

Which geographies have the highest concentration of climate-related risk?

What net-zero aligned technology and policy pathways exist for those geographies?

How can finance be deployed to fit the needs of the geographic transition?

How can the firm measure and report progress on net–zero activities in each geography?

How portfolio supports transition

Asset Classes

Which asset classes does the firm invest in?

Which asset classes are priority sectors and geographies invested through?

How can the firm mobilize each asset class to support the net–zero transition?

How can the firm measure and report progress on net–zero activities in each asset class?

Business Units

Which business units does the firm operate through?

Which business units are priority sectors, geographies, and asset classes invested through?

How can the firm mobilize each business unit to support the net–zero transition?

How can the firm measure and report progress on net–zero activities in each business unit?

Source: Center for Climate-Aligned Finance, 2022

The portfolio-led approach is predicated on a few core ideas:

1. **Each bank is unique.** Each firm has different institutional structures, financial priorities, and investment histories. These unique characteristics and other related factors should inform the design of a tailored net-zero strategy, including setting ambitious climate targets and developing a transition plan.[iii]

2. Likewise, **different business units and asset classes possess different capabilities, tools, expertise, exposures, and opportunities.** To bolster implementation of climate strategies across a firm, governance structures, incentives, and directives can be tailored for those unique characteristics and designed to leverage comparative advantages.

3. Meanwhile, net-zero transformation will unfold across **real-economy sectors**, with **geographic-specific considerations.** The most credible and robust net-zero strategies will be optimized for an individual firm's role and potential for influence, and tailored to real-economy conditions and financing needs across sectors and geographies.

4. **A credible approach should consider the entire firm** and how the individual parts add up to the whole, while leveraging areas of comparative advantage. This can safeguard against blind spots, capture value through synergies, and minimize counterproductive activities and unintended consequences.

iii Each bank has specific levers of influence and requires tailored strategies to transition. However, this does not negate the need for aligned approaches and comparability in the market. Firms should still apply ambitious market standards when deploying metrics and targets across sectors, geographies, asset classes, and business units.

Alignment and Compatibility with Existing Net-Zero Guidance

A portfolio-led approach can support banks in enhancing credibility while navigating the complex and evolving landscape of net-zero guidance. The objective is to offer a pathway to best practices while also allowing firms to build from existing guidance, targets, and strategies.

For example, the portfolio-led approach is complementary to guidance on transition planning, such as that proposed by GFANZ.[2] A transition plan is likely to be an integral part of a firm's net-zero strategy design, which should then inform implementation and reporting activities.

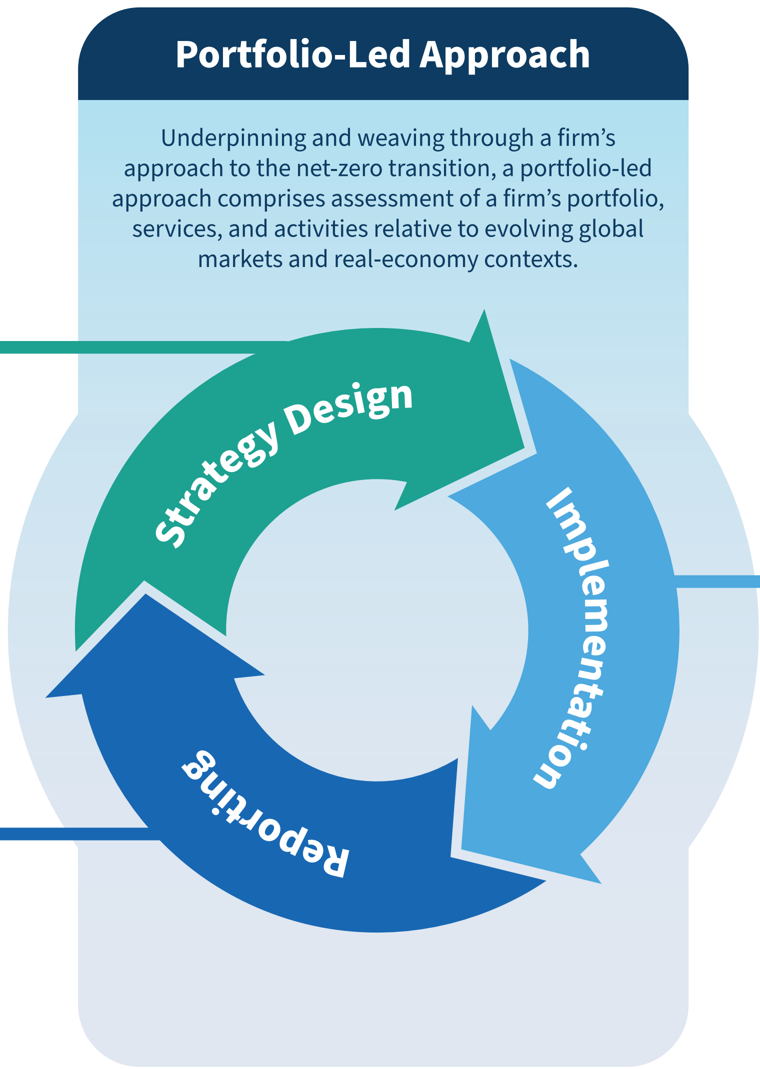
The portfolio-led approach is also complementary to a sectoral approach to net zero, such as those proposed by groups like NZBA. Firms that have already started their net-zero journey using a sectoral approach can use the portfolio-led approach to refine and bolster efforts under way, including by exploring synergies across the firm and opportunities to optimize capital allocation for net zero across real-economy sectors. For example, the portfolio-led approach could help make a sectoral focus more actionable by considering the financing needs (which may bring in different asset classes) and distinct geographical variations in sectoral transition pathways.

Integrating consideration of the four pillars of a portfolio-led approach into strategy design, implementation, and reporting can therefore reinforce and enhance existing approaches and guidance, provide a framework for explaining how and why certain choices have already been made within a firm, and help capture and capitalize on new opportunities for a credible, targeted, efficient, and effective approach to net zero.

The ***Appendix: Summary and Assessment of Existing Net-Zero Banking Guidance*** summarizes and compares key existing guidance documents. Notably, it highlights how the portfolio-led approach goes beyond existing guidance, demonstrating that while sectoral approaches are frequently recommended, consideration of geographies, asset classes, and business units are less standard but arguably equally important.

A portfolio-led approach complements and goes beyond existing guidance by offering a **more constructive, iterative, and systematic approach, uniquely tailored to an individual firm, that underpins net-zero strategy, implementation, and reporting** (Exhibit 2).

Exhibit 2 **A Portfolio-Led Approach Underpins Three Stages of Net-Zero Banking**



STRATEGY DESIGN

Identifying levers of influence to support real-economy transition, accounting for the firm's portfolio exposure and expertise

Setting ambitious firm-wide climate goals

Crystallizing and communicating how the firm will initiate and prioritize actions (e.g., publication of a transition plan)

IMPLEMENTATION

Enacting a transition plan by:

Mobilizing financial and nonfinancial activities to support the real-economy transition

Updating governance procedures and decision-making processes

Upskilling employees with climate expertise

REPORTING

Assessing a firm's performance against its transition plan

Communicating whether the firm is on track to achieve climate targets

Source: Center for Climate-Aligned Finance, 2022

Why Apply the Portfolio-Led Approach?

The portfolio-led approach offers potential benefits across three stages of net-zero activities:

Strategy design

- Uncovering portfolio-wide hot spots of transition-related risk and opportunities
- Increasing awareness of how some parts of the portfolio may unwittingly be inconsistent with net-zero progress and transition-related opportunities
- Enabling flexibility to allow the firm's approach to evolve over time as learning occurs, data and methodologies develop, and the portfolio and real-economy transition contexts change

Implementation

- Empowering the firm to begin from where it can have the greatest impact on the real economy across the spectrum of transition finance (e.g., financing climate solutions as well as the early phaseout or transition of high-emitting assets)[iv]
- Mobilizing all employees to take actions that increase the effectiveness of the whole firm to reach net-zero targets over time (e.g., upskilling and capacity building)
- Putting in place the tools and analytics to support internal analysis and decision-making capabilities to direct capital allocations that enable real-economy transition

Reporting

- Enabling a comprehensive internal and external narrative of why a firm is making particular choices in its net-zero approaches, including clear and comprehensive communication of whether and how every part of the institution is contributing to firm-wide climate goals and real economy transition
- Motivating regular tracking and reporting of progress against core targets
- Helping firms link reporting to strategy and implementation across the firm in a way that promotes an iterative approach to net zero

---

iv For a broader overview of activities that can contribute to real-economy outcomes, firms could consider the four approaches outlined in GFANZ's *Recommendations and Guidance on Financial Institution Net-Zero Transition Plans*. Namely, (1) finance the development and scaling of net-zero technologies or services to replace high-emitting sources, (2) increase support for companies that are already aligned to a 1.5°C pathway, (3) enable high- and low-emitting real-economy companies to align business activity consistent with a 1.5°C pathway for their sector, and/or (4) accelerate managed phaseout of high-emitting assets through early retirement.

Considerations for Applying a Portfolio-Led Approach

A bank cannot be expected to achieve everything, everywhere, all at once. A portfolio-led approach should support a more informed discussion and prioritization of actions.

In practice, the portfolio-led approach means identifying where (via sectors and geographies) and how (via asset classes and business units) substantial opportunities exist to support the net-zero transition and maximize impact. Firms should take the following into consideration: evolving real-economy contexts, unique structures and competitive advantages, and how relevant levers of influence can be deployed, including nonfinancial levers such as engagement and policy advocacy.

To apply a portfolio-led approach, firms must think carefully about several key enabling elements, including identifying, accessing, and using transition-relevant metrics and data, and establishing clear governance processes to ensure accountability and progress on transition activities. Embedding net-zero targets across performance management, incentives, and remuneration structures, and empowering and educating employees across the firm, will be critical to ensuring that the portfolio-led approach can lead to enhanced credibility and robustness in a firm's net-zero strategy design, implementation, and reporting.

Transition-Relevant Metrics and Data

CCAF defines transition-relevant data and metrics as: "Data and metrics that most effectively enable day-to-day decision-making toward the highest impact on the real-economy transition to net zero." [3] This could include, for example, forward-looking data and metrics such as client capital expenditure plans and transition plans.

Transition-relevant data and metrics can help close the gap between climate commitments and net-zero action by helping guide decisions that can direct financial flows toward the areas of the economy that need the most support to mobilize and accelerate transition solutions.

In a recent insight brief,[4] CCAF outlined the barriers and areas of innovation related to the identification, access, and use of transition-relevant data and metrics. Firms should collaborate with clients, peer financial institutions, and data providers to enhance their ability to deploy transition-relevant data and metrics in their adoption of the portfolio-led approach and should avoid using gaps in data as an excuse for inaction.

Center for Climate Aligned Finance

Organizational change requires clarity of vision and transparent communication, including breaking down silos among teams to develop and deliver appropriate action. When applying a portfolio-led approach, firms should look to maximize synergies among pillars (e.g., taking action in priority sectors with high exposure in key business units, or enhancing collaboration among sector and geography heads if a priority sector has a high concentration of finance exposed to a specific geography), as well as actively address barriers to progress (e.g., counterproductive corporate lobbying activities, misaligned internal incentives, or governance structures that obstruct transparency and reinforce silos across the firm).

As an example, if a firm has committed to net-zero targets for its steel portfolio, activities across the firm should be working in the same direction to support sectoral decarbonization. This might include asset management teams engaging steel clients on their transition plans and wholesale banking teams deciding not to finance development of new high-emitting steel plants while simultaneously creating sustainable finance instruments for steel producers. Additionally, wholesale banking can work to develop products across asset classes and business units to foster complementary investments, such as green hydrogen to accelerate green steel's commercial viability.

Finally, to ensure that the portfolio-led approach can be applied and maintained, firms should consider upskilling and empowering existing employees, and hiring new employees or external consultants to fill talent gaps where needed. Teaching sector heads about relevant sectoral decarbonization pathways and associated transition-relevant data and metrics, and business unit heads about the specific hot spots and levers of influence in their control, can, in turn, mobilize all employees through strategic capacity building and communication.

The Four Pillars of the Portfolio Transition

In the following section, we outline how and why a firm might apply the four pillars — sectors, geographies, asset classes, and business units — to its net-zero strategy design, implementation, and reporting. We also highlight ongoing work streams from RMI and CCAF that support the financial sector in its net-zero approaches across pillars. For further information, please contact us via **climatealignment.org**.

Sectors

Sectoral transition is required to facilitate the building of a net-zero economy. Every sector in the real economy must scale up low-carbon assets and transition high-carbon assets and companies.

Focusing first on high-emitting sectors where firms have the most exposure may be warranted in some circumstances, but there are other factors to consider. For instance, a firm may have outsize influence on driving decarbonization of a high-emitting sector that represents only a small percentage of its portfolio. Firms may also see significant opportunities to support scaling the transition in lower-emitting sectors based on their exposure and other competitive advantages. To design effective strategies, targets, and reporting structures, banks should focus action in **sectors where they have the most influence, expertise, and exposure to climate change.**

> **A sectoral approach gives financial institutions and stakeholders transparent insight into the emissions implications of their activities within the sectors most critical to transition.**
>
> *IMPACT+ Principles for Climate-Aligned Finance, Center for Climate-Aligned Finance*[5]

Sector-specific strategies provide banks with the insights necessary to guide financing flows to meet the unique transition needs of each sector. Effective sectoral frameworks should support banks in working directly with clients to set clear expectations, as well as develop the financial products and services needed to transition the sector. This can include strategies to invest in innovation and mobilization of low-carbon assets, as well as to finance the transition away from high-emitting assets, with recognition that priority transition financing needs and opportunities will be sector-specific and evolve over time. A robust strategy should be forward-looking to anticipate and proactively plan for sectoral transition risks and opportunities, and flexible enough to adapt to quickly evolving real-economy conditions.

RMI Sectoral Activities and Resources

- CCAF facilitates working groups to develop sector-specific climate-aligned finance agreements for banks, enabling the measurement and disclosure of 1.5°C alignment and supporting the practical achievement of net-zero emissions. As an example, the **Sustainable STEEL Principles (SSP)** were launched in September 2022 by six leading lenders — Citi, Credit Agricole CIB, ING, Standard Chartered, Société Générale, and UniCredit — which committed to measure and disclose the climate alignment of their steel lending portfolios according to a common methodology. Under the SSP, a climate alignment score is generated for each steel producer, revealing the emissions intensity of each client compared with two net-zero pathways — critical to supporting client engagement efforts. The methodology applies sector-specific considerations, optimized for the industry, that are necessary to compare clients more accurately and equitably. CCAF is building on this work to develop sector-specific methodologies in other hard-to-abate sectors, including aluminum and aviation.

- RMI has also recently taken ownership of the **Paris Agreement Capital Transition Assessment (PACTA),** a free, open-source approach to portfolio alignment measurement that comprises methodologies and tools for use by banks and investors. PACTA provides forward-looking, actionable metrics based on granular asset-level business intelligence data, which financial institutions can use to assess their portfolio alignment for the climate-critical sectors of power generation, fossil fuels, automotive, steel, cement, and aviation. Alignment assessment is made using sectoral decarbonization pathways taken from scenarios modeled by, among others, the International Energy Agency, thereby enabling the forward production commitments of companies to be compared with the technology transitions required to achieve specific climate goals such as limiting warming to 1.5°C.

Geographies

Climate change is an inherently geographic phenomenon, with both the source and impact of emissions localized across communities, regions, and nations. Accordingly, climate-related risks and financial opportunities to invest in the transition vary geographically. Different regions will transition at different speeds, which is increasingly reflected in target-setting as part of banks' strategy design process. **The geographic exposure of a firm's portfolio will influence the strategies necessary to support transition based on contextual barriers and opportunities.**

A geographic approach is complementary to a sectoral approach, offering an additional level of insight into how the firm is connected to the real-economy transition. Although the transition may unfold within real-economy sectors, the rate and nature of change will differ from place to place because of a range of factors, including political risks, technology transfers, and physical climate risks.

Consider timelines for coal phaseout commitments, for example, where several banks have set targets based on scientific guidance that coal should be phased out in OECD countries between 2025 and 2030, but by 2040 in the rest of the world.[6] Similar geographic variation can be seen in oil and gas and deforestation policies.

Without sufficient financing — through public and private sources — global economies and local communities will struggle to realize the net-zero transition at the pace required, with significant impacts in socioeconomic systems globally and locally. The geographic pillar of the portfolio-led approach can be particularly helpful in integrating context-specific just transition considerations into net-zero strategy design, implementation, and reporting.

Along with transition timelines, different regions will set priorities based on their stage of development and comparative socioeconomic advantages. **Awareness of these macroeconomic trends and transition financing needs in the next decade will allow banks to develop profit- and impact-maximizing strategies that contribute effectively to real-economy transition.**

RMI Geographic Activities and Resources

- RMI's **Climate Finance Access Network (CFAN)** is building a network of hyper-local, highly trained climate advisors who are embedded within national financing ministries to help accelerate access to and deployment of global climate finance resources.[7]

- **RMI is working with a range of stakeholders in the Caribbean,** including the national electric utilities, governments, and financial institutions, to advance the energy transition. Introducing renewable energy projects into island grids is a unique challenge because these grids are small and need to provide enough redundancy to maintain the electricity supply in case there is a problem with any generator on the island. De-risking the projects is important not only to get these projects to a bankable stage where they are attractive to financiers and lenders, but also to ensure successful commissioning and operation throughout the projects' financial life. The Caribbean Development Bank in collaboration with the Government of Canada has funded a de-risking and technical assistance program to the national utility of the British Virgin Islands. RMI is supporting British Virgin Islands Electricity Corporation in site studies and battery optimization studies as well as in procuring a qualified engineering, procurement, and construction company to build a utility-owned solar and storage microgrid that will serve critical facilities in case of a hurricane or other event during which the grid cannot operate in its entirety.

Asset Classes

Asset classes represent the different categories of financial structures, mechanisms, and products that a firm can use to finance the transition. Asset classes have different return profiles, behave differently in different market conditions, and are each tied to distinct rules and regulations. They also have different capacities and levers to influence the real economy.[8]

Asset classes can help determine when in the deal process and how a bank can assess and facilitate transition in a particular transaction. It is therefore important for banks to consider asset class characteristics to design optimal transition plans and implementation approaches. Reporting at the asset class level can also demonstrate the breadth of transition-related activities and how each can contribute to progress over time.

Every asset class can support net-zero pathways, but **bank strategies should prioritize asset class activities based on the intrinsic characteristics that affect how each asset class can enable the transition,** as well as the banks' exposure to transition-relevant activities in each asset class.

This approach should then encourage the **design and implementation of new products and services, and the adaptation of existing ones,** to better facilitate transition across priority sectors and geographies. Consider the following examples:[v]

- **Fixed income:** Banks can have impact by making lending conditional on the adoption of sustainable practices. They can also engage with company management, particularly when assessing primary issuance (e.g., at the underwriting and due diligence stages) and when discussing refinancing agreements.

- **Private equity:** Banks can accelerate the transition through material equity investments in low-carbon solutions and high-emission companies undertaking credible transition plans. Majority equity stakes in companies can also enable the appointment of climate expertise on executive and management boards, which gives ongoing influence over company decisions.

- **Public equity:** Firms that are public equity shareholders can encourage more sustainable behavior and accelerated climate-aligned corporate practices through engagement with counterparties. Firms can also invest in climate-aligned and transition index funds and work with index providers to ensure that these are rigorous and transparent and contribute to climate goals.

- **Real assets:** Banks can enable transition of real assets by making lending conditional on the adoption of sustainable practices and can also engage with company management while negotiating future funding agreements, as well as equity and debt re-issuance.

---

v In this section and the next, we include examples of potential levers of influence across illustrative asset classes and business units. These are not comprehensive lists of all potential asset classes and business units, nor exhaustive lists of the levers of influence available. A firm can use the examples provided as prompts to more fully assess and prioritize the opportunities within its own business.

RMI Asset Class Activities and Resources

- CCAF strategically tailors market interventions based on the role that different asset classes play in different sectors. For instance, **climate-aligned finance (CAF) agreements** in the shipping and steel sectors focus on lending because these sectors are financed primarily through fixed income. The power sector in the United States, however, is primarily financed through capital markets, making CAF agreements a less suitable intervention point to drive sector-level change. In response to these market realities, RMI developed the EnAct platform to support financing a power sector transition. The EnAct platform aggregates public data to estimate future emissions trajectories based on utility capital expenditures plans and compares those with a 1.5°C-aligned carbon budget. EnAct's focus on empirical, forward-looking metrics offers unmatched transparency and accountability for US utilities and their investors.

Business Units

Business units are the fundamental building blocks of organizations — each with unique revenue drivers, performance incentives, and operational scopes. As a result, business units each have a particular capacity and responsibility for meeting climate goals. A primary motivation to approach climate strategies, implementation, and reporting by business units is to **activate the individualized influence levers and competitive advantages of each to advance climate outcomes.** Ignoring the differences and applying a one-size-fits-all approach will not be productive and risks overlooking opportunities for influence and impact across the firm.

Importantly, considering the unique influence of each business unit can also ensure that no part of the firm and no employee is left behind in the transition, offering insight into organizational structure and operational contribution to net zero. A sector-led approach, for example, will inevitably prioritize the potential for a sector head to lead change, and/or sector analysts to integrate transition analysis into their decision-making. Taking a business unit approach — as part of a wider portfolio-led approach — enables every corporate employee to be engaged and empowered, and ensures that firm-wide efforts are coordinated across corporate structures.

> **The ultimate responsibility for execution remains with the business units.**
>
> — "How to Implement a New Strategy Without Disrupting Your Organization," *Harvard Business Review*

By assessing and activating business units, firms could also reduce the likelihood that actions in different parts of the firm are inconsistent or counterproductive. Corporate lobbying or asset management decisions should be assessed to ensure that they are not undermining efforts in wholesale banking, for example. Although progress in individual parts of the firm is important, holistic assessment of how business units are contributing individually and in aggregate can help ensure that activities are mutually reinforcing and drive progress toward net-zero targets.

Linking a financial institution’s net-zero journey to organizational structures can help align business unit goals, strategies, and performance with firm-wide theories of change. This can reduce the frictions involved in integrating climate considerations into firm-wide operations and make implementation processes more intuitive. Examples might include providing clear governance, operational and decision-making procedures, incentives, and capacity building relative to each front-office employee’s role. Such an approach can offer consistent, credible, and comprehensive assessment, prioritization, and activation across the whole firm.

Identifying which business units are responsible for executing firm-level strategy makes the path to real-economy outcomes concrete and allows a firm to communicate exactly how different parts of the company contribute to net-zero pathways. Tying net-zero approaches to business units also facilitates transparent reporting, as financial filings often account for business unit activities. Having a clear sense of how each business unit is contributing to, and performing against, climate targets and transition plans will allow firms to easily translate this information in climate and relevant financial reporting structures.

Examples of how business units can contribute to transitioning a firm toward net-zero outcomes include:

- **Wholesale banking:** Through financial capital allocation, pricing, and structuring, as well as engagement, wholesale banking teams are well positioned to support transition efforts among counterparties. Key opportunities include offering products and services that reduce the cost and increase the availability of capital for low-carbon solutions and carbon-intensive clients where financing is linked to decarbonization outcomes, and requiring counterparties to provide information on climate alignment practices as part of the underwriting process.
- **Asset management:** Asset managers can accelerate investment in low-carbon solutions, incorporate transition-relevant data into investment evaluation and monitoring, support carbon-intensive industries pursuing active, substantial decarbonization by reducing the cost of capital for transition-relevant projects, and increase the availability of capital to aligned counterparties. They can also engage with counterparties over time to encourage more climate-aligned corporate practices using shareholder rights such as direct engagement, proxy voting, and the proposal of shareholder resolutions.
- **Retail banking:** Retail banking units can drive consumer demand for, and education on, climate-aligned solutions by providing financial products that enable individual consumers to align financial decisions with a low-carbon future. Examples of initiatives include lower rates of interest for electric vehicle loans and green mortgages.
- **Global markets:** Global markets units can undertake climate-aligned activities such as developing clearer, more restrictive trading policies to have an impact on liquidity of financial products linked to unfavorable real-economy impacts, as well as developing climate-aligned trading products to enable market creation and growth.

Conclusion

This report introduces the concept of a **portfolio-led approach to net-zero banking.** A portfolio-led approach involves the assessment of climate-related risks and opportunities, and a bank's potential influence in supporting the transition, across **four pillars of sectors, geographies, asset classes, and business units.** It is predicated on the idea that each bank is unique, with different capabilities to transition, and that meeting net-zero goals will therefore require the development and implementation of tailored approaches across a firm's asset classes and business units that optimize for real-economy impact in sectors and geographies.

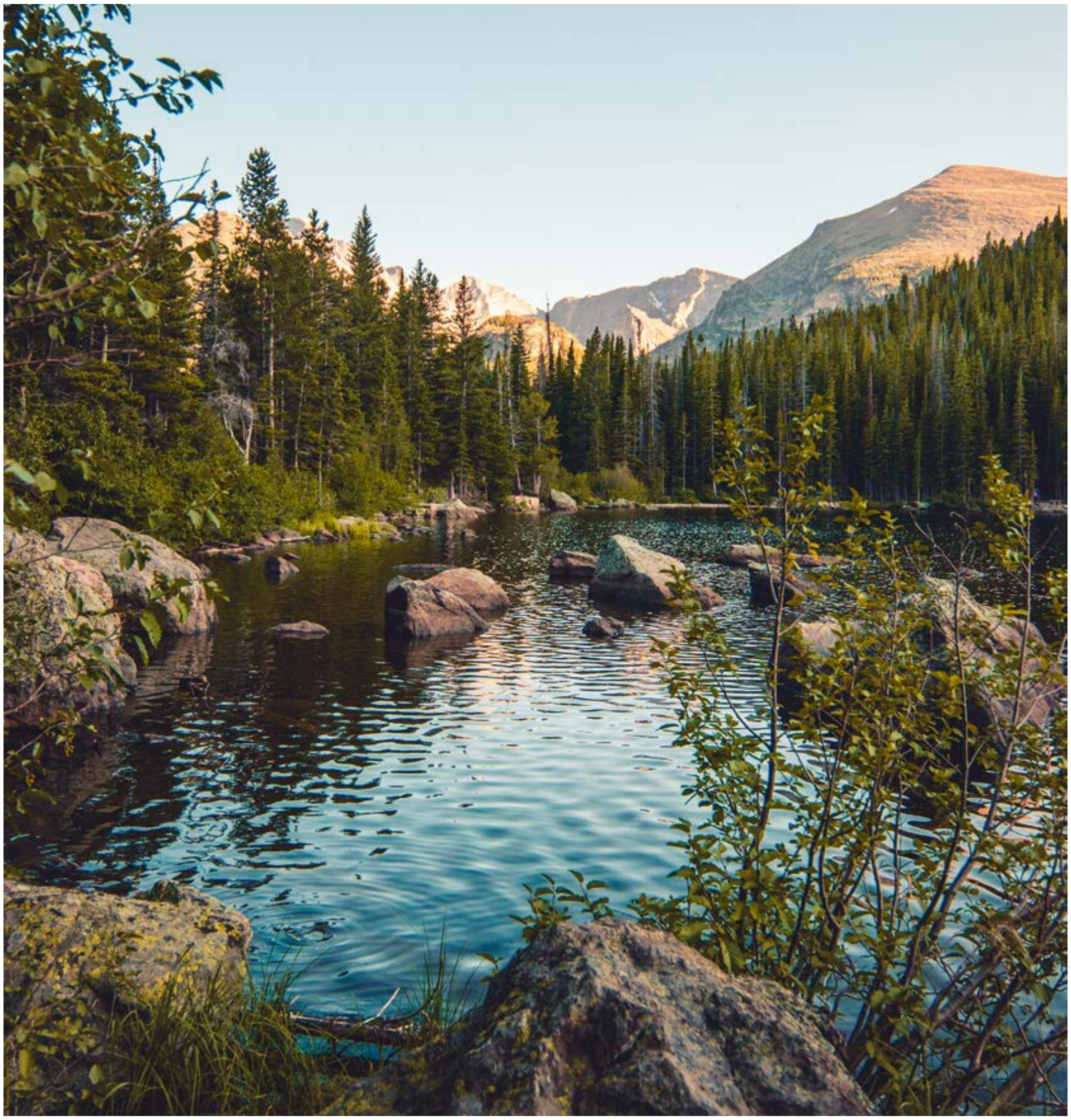
The knowledge and insights gained from conducting an assessment across each of the four pillars can be used to help prioritize and tailor transition-related activities across the firm, offering a way forward for banks seeking **enhanced credibility and robustness in their net-zero strategy design, implementation, and reporting.** Applying a portfolio-led approach to strategy design enables firms to uncover portfolio-wide hot spots of climate risk and transition-related opportunities. For implementation, it supports developing and enacting mechanisms and structures that empower the firm's employees to embed net-zero considerations into financing and engagement decisions. Finally, applying the approach to reporting supports developing a cohesive internal and external narrative around *why* the firm has made certain strategic decisions on climate, and provides a more comprehensive, tailored, and accurate means to track *how* the firm is (or is not) making progress.

The **portfolio-led approach is compatible with existing approaches,** and many banks are already applying pieces of the approach. Firms that have already begun implementing a sectoral approach, for example, can use a portfolio-led approach to continue building on and making progress against sectoral targets, established progress, and lessons learned. Adding consideration of geographies, asset classes, and business units can improve understanding of how and where firms can support sectoral transition, while activating more parts of the firm. Further, this approach can enable the credible implementation of complementary guidance, such as the GFANZ recommendations on transition planning, by ensuring that firms consider their unique characteristics across their portfolio when applying the guidance.

A portfolio-led approach could help firms identify transition hot spots and opportunities for impact, enable the firm to begin from where they can have the greatest impact on the real economy, shine a light on potential blind spots and counterproductive activities, empower employees across the firm, unlock synergies across teams and activities, and offer a coherent, credible narrative to both internal and external stakeholders on how the firm has approached its net-zero strategy design, implementation, and reporting.

Finally, the **portfolio-led approach must be an iterative process** to ensure that firms evolve their net-zero approaches over time to accommodate institutional learning and market-wide innovation. In practice, implementation across the four pillars of a portfolio-led approach will require an assessment of transition-relevant data, new methodologies, and a focus on governance and capacity building, which may take time.

Banks around the world are grappling with how to implement net-zero commitments in a way that is credible and robust, satisfies stakeholder demands, and drives real-economy outcomes. Much of the net-zero finance guidance already in the market is helpful. However, as firms face increasing scrutiny and stakeholder expectations grow, a portfolio-led approach can take strategies to the next level, tailoring priorities to fit the institutional and real-economy context, and mobilizing organizational capacity to support net-zero strategy design, implementation, and reporting. **The portfolio-led approach supports action and raises ambition to accelerate the future of net-zero banking.**



Appendix: Summary and Assessment of Existing Net-Zero Banking Guidance

■ Pillar is highly recommended ■ Pillar is mentioned but not a core consideration ■ Pillar is not mentioned

Document title	Author	Description	Audience	Sector	Geography	Asset Class	Business Unit
Getting Down to Business: Enabling Action and Enhancing Credibility in Net-Zero Banking Using a Portfolio-Led Approach	RMI Center for Climate-Aligned Finance	An approach to support tailored net-zero strategy design, implementation, and reporting through a focus on sectors, geographies, asset classes, and business units.	All financial institutions	Green	Green	Green	Green
A Practitioner's Guide for Banks: Considerations for Banks in Setting Net Zero Strategy	Sustainable Markets Initiative — Financial Services Taskforce	Forward-looking guide to help banks move globally from net-zero commitments to implementation, including potential trade-offs involved when developing and implementing a net-zero strategy.	Banks	Green	Yellow	Green	Yellow
Climate Transition Action Plans	We Mean Business Coalition	Report that outlines the core components of a comprehensive climate transition action plan (CTAP) and how the plans can be used to drive sufficient, near-term action for companies and decision-useful information for stakeholders. This includes a checklist of foundational concepts, a CTAP template, and a progress template.	All companies	Yellow	Red	Red	Red
Guidelines for Climate Target Setting	United Nations Environment Programme Finance Initiative	High-level guidelines for bank net-zero target setting, including scope, sector, and scenario selection.	Banks	Green	Red	Yellow	Yellow
IMPACT+ Principles	RMI Center for Climate-Aligned Finance	Guidance to help private financial institutions identify what matters most when developing climate alignment strategies.	Banks	Green	Green	Green	Red

Appendix: Summary and Assessment of Existing Net-Zero Banking Guidance

■ Pillar is highly recommended (Green) ■ Pillar is mentioned but not a core consideration (Yellow) ■ Pillar is not mentioned (Red)

Document title	Author	Description	Audience	Sector	Geography	Asset Class	Business Unit
Net Zero: An Introductory Guide for Financial Institutions	World Wildlife Fund	Guide to support financial institutions in navigating the technical questions they may ask themselves when assessing their portfolio for alignment with a net-zero scenario and to answer some of the key technical challenges that will support the implementation of robust, science-based strategies.	All financial institutions	Green	Green	Green	Red
Recommendations and Guidance for Financial Institution Net Zero Transition Plans	Glasgow Financial Alliance for Net Zero	Proposed recommendations and guidance for a global framework for ambitious and credible net-zero transition plans for financial institutions. Policy examples and areas for further work are included.	All financial institutions	Green	Yellow	Yellow	Green
The Good Transition Plan: Climate Action Strategy Development Guidance for Banks and Lending Institutions: COP26 version	Climate Safe Lending Network	Guidance for CEOs and bank senior managers to use in designing transition plans, including key actions and considerations for a bank to become a climate-safe lender.	Banks	Green	Yellow	Green	Red
The Transition Plan Taskforce Implementation Guidance	UK Transition Plan Taskforce	The steps companies could take to develop a transition plan, as well as when, where, and how to disclose their plan.	All financial institutions	Yellow	Yellow	Yellow	Yellow
Transition Finance Guide	Net Zero Banking Alliance	Guidance to facilitate clients' decarbonization that is built on the understanding that continuous engagement in carbon-intensive sectors is needed to unlock decarbonization opportunities.	Banks	Green	Yellow	Yellow	Red

Source: Center for Climate-Aligned Finance, 2022

Endnotes

1 *Tracking Real World Emissions Reductions,* 2° Investing Initiative, 2022, **https://2degrees-investing.org/wp-content/uploads/2022/10/2DII_Real_final.pdf**.

2 *Recommendations and Guidance on Financial Institution Net-Zero Transition Plans,* Glasgow Financial Alliance for Net Zero, 2022, **https://assets.bbhub.io/company/sites/63/2022/06/GFANZ_Recommendations-and-Guidance-on-Net-zero-Transition-Plans-for-the-Financial-Sector_June2022.pdf**.

3 *Identification, Access, and Use of Transition-Relevant Data and Metrics,* CCAF, 2022, **https://climatealignment.org//wp-content/uploads/dlm_uploads/2022/09/finance_transition_data_insight_brief.pdf**.

4 *Identification, Access, and Use of Transition-Relevant Data and Metrics,* CCAF, 2022.

5 *IMPACT+ Principles for Climate-Aligned Finance,* CCAF, 2022, **https://climatealignment.org/wp-content/uploads/2022/02/impact_principles_for_climate_aligned_finance_report.pdf**.

6 *Global and Regional Coal Phase-Out Requirements of the Paris Agreement: Insights from the IPCC Special Report on 1.5°C,* Climate Analytics, 2019, **https://climateanalytics.org/media/report_coal_phase_out_2019.pdf**.

7 "Unlocking Climate Finance for Developing Countries," Climate Finance Access Network, accessed November 16, 2022, **https://cfanadvisors.org/**.

8 Ben Caldecott et al., *Sustainable Finance and Transmission Mechanisms to the Real Economy,* Oxford Sustainable Finance Group, University of Oxford, 2022, **https://www.smithschool.ox.ac.uk/sites/default/files/2022-04/Sustainable-Finance-and-Transmission-Mechanisms-to-the-Real-Economy.pdf**.

About the Center

The Center for Climate-Aligned Finance (CCAF) was established by RMI to help the financial sector transition the global economy toward a zero-carbon, 1.5°C future. With deep partnerships in finance, industry, government, and civil society, the center works to develop decarbonization agreements within high-emitting sectors, build global frameworks for climate alignment, and support financial institutions in decarbonizing their lending and investing portfolios. Launched in 2020, the Center builds on RMI's 40 years of experience developing market-based solutions to accelerate the energy transition.

You can find more information about us on our website, **www.climatealignment.org**.

Contacts

Elizabeth Harnett, **eharnett@rmi.org**

Ella Warshauer, **ewarshauer@rmi.org**

Acknowledgments

The authors thank those who informed and commented on this document, and the financial industry partners who continue to support our work at CCAF.

Suggested Citation

Elizabeth Harnett, Ella Warshauer, Whitney Mann, and Kaitlin Crouch-Hess, *Getting Down to Business: Enabling Action and Enhancing Credibility in Net-Zero Banking Using a Portfolio-Led Approach,* RMI, December 2022, **https://rmi.org/insight/enabling-action-and-enhancing-credibility-in-net-zero-banking/**.

RMI Innovation Center

22830 Two Rivers Road

Basalt, CO 81621

www.rmi.org