Recommendations to GCF on

Contribution of overall portfolios of accredited entities to GCF objectives

Introduction

The GCF Board, at its 11th meeting, adopted the decision to take account of the overall portfolios of accredited entities in its accreditation and reaccreditation processes.[1] At its 12th meeting the Board mandated the Accreditation Panel, with the support of the Secretariat as necessary, to begin work immediately on establishing a baseline for assessing the extent to which these portfolios have shifted towards low-emissions and climate resilient development pathways.[2] The objective is to ensure that the accredited partner entities of the GCF make their maximum possible contribution to the mandate of the Fund. We believe these decisions are of the utmost importance, and can greatly assist the GCF in fulfilling its objectives, and enable it to greatly expand its leadership role in global efforts to combat climate change.

This joint submission reflects contributions by a group of civil society observer organizations actively engaged in the GCF[3] in response to the invitation by the GCF Secretariat from April 18, 2016 for "inputs on the strategy on accreditation in relation to the questions in the report of the Accreditation Committee on the progress on developing a strategy on accreditation." This document should be seen as a companion to the document: ***Joint CSO Submission: Green Climate Fund Strategy for Accreditation***

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[1] From B.11 Monitoring and Accountability decision, November 2015:
35. In accordance with decision B.10/06, paragraph (j), to advance the GCF's goal to promote the paradigm shift towards low-emission and climate-resilient development pathways in the context of sustainable development, the re-accreditation decision by the Board will take into account the Secretariat and Accreditation Panel's assessment of the extent to which the AE's overall portfolio of activities beyond those funded by the GCF has evolved in this direction during the accreditation period.
https://www.greenclimate.fund/documents/20182/24952/GCF_B.10_17_-_Decisions_of_the_Board_-_Tenth_Meeting_of_the_Board__6-9_July_2015.pdf/1238c5ad-8686-4cf9-a401-aa4893818215>

[2] From the Decision accrediting new entities. March 2016 - DECISION B.12/29:
The Board, having considered document GCF/B.12/07 titled "Consideration of accreditation proposals",
...
(c) Recalling decisions B.10/06 (j) and B.11/10 para 35, underlines its expectation that accredited entities will advance the goal of the GCF to promote the paradigm shift towards low-emission and climate-resilient development pathways in the context of sustainable development, which includes **shifting their overall portfolios in line with this direction**.
(d) **Requests the Accreditation Panel, with the support of the Secretariat as necessary, to establish a baseline on the overall portfolio of accredited entities, including those already accredited at an earlier stage, that allows for an assessment of the extent to which the accredited entities' overall portfolios of activities beyond those funded by the GCF have evolved in this direction during the accreditation period**. (emphasis added)

[3] *CSO accredited observer organizations that contributed to this joint CSO submission: WWF International, Friends of the Earth US, Heinrich Böll Stiftung North America, Sierra Club.*

Climate Related Financial Disclosures – a rapidly evolving field

The past couple of years have seen a rapid expansion of efforts to assess the climate-related impacts and exposure of investments and financial flows. There are a wide range of initiatives available and under way, using a wide range of approaches, methodologies, and indicators. This proliferation of initiatives and methodologies creates both opportunities and challenges for the Green Climate Fund in its efforts to assess the extent to which the accredited entities shift their investment portfolios in line with the Fund's mandate, and in the short term, to establish a baseline at the point of accreditation or shortly thereafter in order assess subsequent shifts. In terms of opportunities, these initiatives provide a solid and rapidly developing set of methodologies from which the GCF can choose those most suited to its purposes. The GCF can also drive further development of these methodologies, but setting high expectations for measurement of climate impacts by its accredited entities, as well as for the scale of the shift of portfolios.

Some of these approaches are still at an early stage of consolidation and development, while others already have proven track records and many others are rapidly maturing. Certainly in a few years, when decisions will need to be made on reaccreditation, the field will have become much more consolidated and the methodologies more mature, and hopefully increasingly harmonised. A short-term request from the GCF to accredited entities to disclose indicators and approaches for their shift of portfolio emissions against a baseline will be an important contribution to the development of transition-relevant and forward-looking investment strategies. As a continuously learning institution, the GCF is actually a well-placed setting in which to hone in on the most effective and practical methodologies for establishing baselines, an exercise whose importance will only increase with time.

These initiatives have been driven by two different interests – some are focused on risks to the financial system and assets posed by climate change, while others are aimed at incorporating climate change related objectives, such as contributing to meeting temperature targets or minimizing emissions footprints, into finance and investment decision-making. However both of these broad approaches depend on developing metrics for assessing the mismatch or alignment of investments, policies and practices with climate objectives.

A key limitation of existing initiatives is that they are almost exclusively focused on mitigation. The extent to which investment portfolios strengthen resilience to climate change, and avoid climate vulnerability and maladaptation, is much less analyzed. This is an area where the GCF can clearly contribute in terms of stimulating more research and analysis. Some specific work by the insurance sector on asset climate - related vulnerability and risk can be used as a starting point.

Some of the most important and relevant of the initiatives currently under way are the following:

> **Sustainable Energy Investment Metrics (SEIM):** a forward-looking framework for assessing financial portfolio's alignment with 2°C[4] pathways: This consortium led by the 2° Investing Initiative includes CIRED, CDP, WWF, Frankfurt School of Finance & Management, University of Zurich, Kepler-Cheuvreux, and the Climate Bonds Initiative. The consortium has developed a climate performance framework which enables the assessment of a financial portfolio's alignment with IEA & IPCC scenarios and

[4] Probably to include 1.5°C in the near term.

decarbonization pathways. The model is currently applied to more than 60 financial equity portfolios and will be expanded to also cover corporate bonds (http://2degrees-investing.org/IMG/pdf/2dportfolio_v0_small.pdf?iframe=true&width=986&height=616).

The Science-Based Targets Initiative: The CDP, UN Global Compact, WRI and WWF have created a consistent framework which enables companies to set emission reduction targets in line with what the science says is necessary to keep global warming below 2oC. Since its inception in 2015, 155 companies have made commitments to set such targets, including Coca Cola, Dell, Procter & Gamble, IKEA, Enel, NRG Energy, BNP Paribas, Honda Motor, and Stora Enso. The initiative has collected a set of different methods that have been used in the past and has developed a specific new methodology, called "sectoral decarbonisation approach", which maps remaining carbon budgets to specific industry sectors and assigns corresponding intensity and reduction targets according to technical feasibility and necessity. The methodology is based on a similar approach as SEIM for financial portfolios, and allows investors to ask for science-based targets in their engagement with companies they invest in. (http://sciencebasedtargets.org/).

Financial Stability Board – Task Force on Climate Related Financial Disclosures (FSB-TCFD): "Mission: The Task Force on Climate-related Financial Disclosures (TCFD) will develop voluntary, consistent climate-related financial risk disclosures for use by companies in providing information to investors, lenders, insurers, and other stakeholders. The Task Force will consider the physical, liability and transition risks associated with climate change and what constitutes effective financial disclosures across industries. The work and recommendations of the Task Force will help firms understand what financial markets want from disclosure in order to measure and respond to climate change risks, and encourage firms to align their disclosures with investors' needs." https://www.fsb-tcfd.org/

BankTrack

http://www.banktrack.org/show/pages/banks_and_financed_emissions

Montreal Carbon Pledge:

http://investorsonclimatechange.org/portfolio/montreal-pledge/

Portfolio Carbon Initiative:

http://www.ghgprotocol.org/Portfolio_Carbon_Initiative

Climate Strategies and Metrics: Exploring Options for Institutional Investors

French Energy Transition Law: Requires publicly traded companies and institutional investors to disclose climate risks of their operations and adoption of a low carbon strategy to reduce and avoid such risks in the future.
http://www.unepfi.org/fileadmin/documents/PRI-FrenchEnergyTransitionLaw.pdf

The law calls on entities to disclose "**the exposure to climate-related risks**, including the **GHG emissions associated with assets owned**, the **contribution to the international goal of limiting global warming and to the achievement of the objectives of the energy and ecological transition.** That contribution will be assessed in particular with regards to indicative targets defined according to the nature of their activities and investments, in a way that is consistent with the national low-carbon strategy."

… the notion of the contribution of a portfolio of financial assets to the energy transition is a rather recent one, only partially tested on portfolios , though applied conceptually to the French public bank since 2012 (see box).48 Despite its recent nature, the concept is fundamental to assessing the financial sector's contribution to realizing the low-carbon economy, arguably a central point of Art. 173 itself. Art. 173 represents an important opportunity to build on existing approaches, and develop a framework that connects finance and the real economy.[5]

From these various initiatives, it is possible to identify four broad types of metrics or indicators that can be used to assess portfolios and their shift towards compatibility with a low emission and climate resilient development pathways[6]:

1. **Green/brown share of activities financed**, based on a taxonomy of activities, typically across different sectors. Such indicators give only a general qualitative idea of the nature and climate impact of the activities financed. The taxonomy could be provided commercially by a data provider, or based on a publically available or made to measure classification.[7] For the purposes of the GCF, the Initial Results Areas could play a role in the green side.

2. **Sector/technology specific metrics** for green/brown activities, which can provide a more precise assessment of the positive or negative climate impacts of the activities financed in the energy or transport sectors, for example.

3. **GHG emissions/ carbon footprint approaches** to portfolios, which can provide intensity or absolute values of emissions or climate impact of an investment portfolio. Such estimates are data intensive and complex, and methodologies for investment and lending portfolios are still being developed. Despite the difficulties, this is the potentially most accurate and rigorous measure of the climate performance of financing portfolios. The carbon footprint is a snapshot based on historic data, often capturing only Scope 1-2 of companies emissions which represents only ~20% of its

[5] http://2degrees-investing.org/IMG/pdf/2dportfolio_v0_small.pdf
[6] P. 3, Measuring Progress on Greening Financial Markets: Briefing note for policymakers. http://2degrees-investing.org/IMG/pdf/2ii_measuringprogress_v0.pdf?iframe=true&width=986&height=616
[7] One example of such a classification, focused on the green side, is provided here: IFC Definitions and Metrics for Climate-Related Activities. IFC CLIMATE BUSINESS DEPARTMENT: JUNE 2015. http://www.ifc.org/wps/wcm/connect/534495804a803b32b266fb551f5e606b/IFC_Climate_Definitions_2013.pdf?MOD=AJPERES
An overview of diferente metrics data sources is provided in Table 4.3 here: CLIMATE STRATEGIES AND METRICS Exploring Options for Institutional Investors
http://2degrees-investing.org/IMG/pdf/climate_targets_final.pdf

entire Scope 1-3 emissions. A Scope 1-2 carbon footprint may even penalize important climate solutions; high and growing emissions from a solar PV manufacturer will come across as a large carbon footprint since the key contribution of renewable energy production (Scope 3) is not included. While these metrics are fairly well-developed, useful for awareness rising and are starting to be widely adopted[8], their limitations must be considered:[9] Scope 3 emissions can be calculated already today, explicitly or in terms of their magnitude for a given company or financial portfolio. Methodologies and services for calculating or estimating Scope 3 are being developed rapidly[10]. Use of carbon footprint reporting should be accompanied by clear explanations of what they reflect, and not reflect, to enable informed decisions by investors and regulators.

4. **Quantitative forward-looking metrics:** A carbon footprint does not provide guidance for how to align investments with a <2°C pathway. Quantitative forward-looking metrics, can play a vital role to enable a pre-assessment of projects and monitoring of its continuous contribution to science-based decarbonisation pathways and international agreements.[11] Such metrics allow asset owners and other stakeholders to evaluate the merits of an investor's or a company's climate mitigation strategies, relative to science-based transition scenarios. Compared to the rear-view mirror approach of the carbon footprint, this forward-looking transition alignment approach informs a conversation around the relevance of selected measures and the roles of key stakeholders (e.g. investee companies, asset managers, asset owners, financial advisors, governments & regulators, etc).

The potential methodological approaches are much more varied and complex than just the four described here, but these should provide a starting point to understand the different methodologies and options available to the GCF. As noted above, the approaches described here are most appropriate to mitigation activities, and especially the energy sector. New ground will need to be broken for assessment of portfolios in terms of adaption and resilience, and likely also for non-energy sector mitigation activities.

The GCF has two separate but interrelated tasks before it. First, as specified in the Board decision, the Accreditation Panel is to establish a baseline on the overall portfolios of accredited entities. This will require requesting information from the accreditation applicants and entities already accredited that can be used to establish a baseline – a snapshot of the current portfolio or an analysis on the evolution of the portfolio over a given period. The GCF must determine the type of information requested from the entities to establish this baseline. The second task is to determine the methodology to be used in assessing the shift in the investment portfolio over the period between accreditation and the re-accreditation assessment. Given the current proliferation and rapid evolution of assessment methodologies, the GCF should take an approach of continual improvement and evolution of its

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[8] See for example the UNPRI initiated Montreal Carbon Pledge http://montrealpledge.org/
[9] Se for example "Carbon Intensity vs. Carbon Risk Exposure", 2 Degrees Investing Initiative (2015) http://2degrees-investing.org/IMG/pdf/rapport_correlations_en_v8_combined.pdf?iframe=true&width=986&height=616
[10] See for example https://www.cdp.net/en-US/Programmes/Pages/ghg-emissions-dataset.aspx
[11] ASSESSING THE ALIGNMENT OF PORTFOLIOS WITH CLIMATE GOALS . CLIMATE SCENARIOS TRANSLATED INTO A 2°C BENCHMARK (2015) http://2degrees-investing.org/IMG/pdf/2dportfolio_v0_small.pdf?iframe=true&width=986&height=616

methodologies, to reflect the state of the art and ensure that the GCF contributes to continued advances in such methodologies.

Although it is important that the GCF make an initial collection of baseline information at the accreditation stage, this information can be updated to reflect the evolving methodological choices of the GCF and the entities themselves, many of which will be conducting their own portfolio assessments, independent of or encouraged by the GCF requirements.

Recommendations:

Overall scope and ambition of the assessment: The GCF must fulfill the potential of the assessment of overall portfolios to be a ground-breaking and transformative initiative that can contribute significantly to meeting the objectives of the GCF, the UNFCCC and the Paris Agreement, particularly Article 2.1(c), which calls for “Making finance flows consistent with a pathway towards low greenhouse gas emissions and climate-resilient development.” This initiative must send a strong signal to financial institutions and global markets that the world is changing, and partners of the GCF are expected to lead that change. The GCF should aim to use leading edge and state of the art methodologies and drive continual improvements in the assessment methodologies and, to the greatest extent possible catalyze shifts in the portfolios of the entities accredited to the GCF.

Baseline information request: The information request to entities must send a strong signal that the GCF takes very seriously expects its expectation that the accredited entities will advance the goals of the GCF through their entire operations, and not only through the activities financed by the GCF, as the Board has directed. The information requested must signal the direction the GCF expects the entity to move in the future. Thus even if the entity does not measure the emissions profile or footprint of its portfolio currently, or have policies supporting low emissions and climate resilient development, the request should signal that the GCF expects the entity to adopt such policies and practices in the future.

Scope of investment portfolios to be included: Regardless of the methodologies chosen, the parameters of the baseline should be comprehensive, meaning that for financial institutions, it should include lending, underwriting, and asset management. It must be made clear to entities that they must report both the green and brown sides – investments and financing that support both high emissions activities and a shift to low/zero emissions. It may be useful to specify particular sectors, technologies or activities that should be reported. Large parts of the investment portfolios of accredited entities are likely to be irrelevant or tangential to the shift to low emissions and climate resilient development pathways, and can thus be excluded from this analysis.

Alternatively, the GCF could require, at least initially, that FIs disclose their entire portfolio by sector (following the usual ICB or GICS categorisation of sectors for FIs) and compare it with the typical sectorial allocation of the relevant benchmark(s) (e.g. MSCI World Index if it is a global investor). On that basis it is logical to require that the sector allocation of the entity asking for (re)accreditation for climate purposes is significantly and increasingly lower carbon than the benchmark. This would mean both decreased allocation in high carbon sectors (mainly oil and gas) and increased allocation in low carbon solutions (typically renewables and energy efficiency) and NOT simply more allocation to the financial sector which is often considered to be low carbon.

How to address both future applicants and already accredited entities: The information requested for the baseline must be incorporated as soon as possible, and certainly this year, in the Application Form and Checklists, so that the information is submitted as part of the regular application process. For entities already accredited, supplemental information reflecting the new request for baseline information must be submitted to the GCF, within a fixed period, and future project approvals and disbursements to that entity will be withheld pending submission of satisfactory information.

Reflecting different capacities and impacts of accredited entities: While the GCF can and should expect that all accredited entities actively contribute to advancing the goals of the GCF through their broader activities, there are important differences between entities that should be reflected in the GCF's approach to their overall portfolio of activities. Large financial institutions have much greater potential climate impacts, both positive and negative, as well as greater analytical capabilities and disclosure requirements than for example local NGOs or government agencies that do not have financial portfolios. The most rigorous requirements for analysis and disclosure should be reserved for large financial institutions, MDBs and national development banks. These institutions should be expected to meet minimum disclosure requirements, which become more rigorous and ambitious over time, and should be strongly encouraged to adopt leading edge, ground-breaking emissions footprint assessments and disclosure. There should also be clear expectations for significant shifts in their emissions footprints and financing portfolios over time in line with the requirements of agreed temperature targets and adaptation goals.