Submission to UN High-Level Expert Group on the Net-Zero Emissions Commitments of Non-State Entities

Reclaim Finance welcomes the opportunity to submit comments to the High-Level Expert Group (HLEG). Our comments are focused on the net-zero commitments of the financial sector, particularly in the context of the Glasgow Financial Alliance for Net Zero (GFANZ).

1) Standards and Definitions of Net Zero: 1.5 C degrees alignment

"Net Zero" in itself is mostly meaningless as a concept unless it is linked to a temperature goal and pathways for reaching that goal. **To be consistent with the Paris Agreement, "net zero" commitments should be based on a temperature goal of 1.5°C with no or low overshoot and on pathways which do not exceed the IPCC's assessment of the feasible and sustainable levels of carbon capture and storage and of CO2 removal from the atmosphere.** For information on these pathways see Olivier Bois von Kursk and Greg Muttitt, "Lighting the Path: What IPCC energy pathways tell us about Paris-aligned policies and investments," International Institute for Sustainable Development, June 2022.

The HLEG should note von Kursk and Muttitt's finding that:

> "these feasible 1.5°C pathways imply that no new oil and gas fields should be developed, and no exploration conducted in order to limit warming to 1.5°C. According to these pathways, the world must decrease global oil and gas production and consumption by 30% by 2030, in just 8 years. This is equivalent to an annual average decrease of 3% for both oil and gas until the end of the decade."

This rate of decline of is similar to that noted in the UNEP Production Gap Report 2020 which found that 1.5° alignment would require fossil gas production to be reduced between 2020 and 2030 at an annual average rate of 3%, while oil production would need to be cut by 4% p.a. and coal by 11% p.a.

The finding of no room in net-zero pathways for new oil and gas fields is of course consistent with the conclusion of the IEA's 2021 net zero roadmap — and it should be noted that this also requires an immediate end to any new coal infrastructure. This position is also supported by the One Earth Climate Model (OECM) from the University of Technology Sydney (UTS). The latest report from the team behind the OECM states that staying within the 1.5°C carbon budget without relying on unrealistic assumptions about carbon capture technology will require immediate, steep cuts in emissions from the fossil fuel industry and all other carbon-intensive sectors. **To achieve this, the report says, industry, finance and governments must all push for an "immediate cessation of investments in new oil, coal and gas projects."**

The serious questions over the technical, economic and social viability of carbon removal technologies at a large scale mean that it is extremely dangerous to believe that continued high levels of fossil fuel emissions can be compensated for with negative emissions in future. **Net-zero commitments must therefore be based on rapid emission reductions over the short and medium terms. Negative emissions, offsets and other tradeable permits such as clean energy credits must not be allowed for the purposes of meeting interim reduction targets.**

Carbon removal can only be justified for reaching carbon negative in the long term, or for compensating for residual emissions from carbon-emitting technologies and processes that are necessary for their social benefits and do not have viable non-carbon alternatives. It should be assumed that at least 90% of emission reductions under net-zero commitments should be met by stopping emissions at source. This is in line with the definition of residual emissions in the SBTi's Corporate Net-Zero Standard.

Any removals to neutralize residual emissions should follow the position of the Race to Zero and be "like-for-like," meaning that fossil carbon emissions should be compensated with permanent removals. **Permanent should be defined as at least 1,000 years to be "like-for-like" with fossil CO2 emissions.** This is the number used by the private sector CO2 removal initiative Frontier and consistent with the IPCC position that permanent equals more than 10,000 years (AR6 WGIII p.12-47).

Under the UN equity principle of common but differentiated responsibilities (CBDR), actors in the global north have a responsibility to cut emissions more rapidly than those in the global north. This means that financial institutions with most of their business in the global north must adopt targets that are more ambitious than the global target of reaching net zero by 2050.

2) Credibility Criteria: Short-term interim targets, transition plans, measurement and reporting

Interim targets: The 2022 report of the IPCC's Working Group III concluded that a "key characteristic" of "mitigation pathways with immediate action towards limiting warming to 1.5°C" are a 50% reduction in CO2 2019-2030 and a 45% reduction in Kyoto-GHGs over the same period (IPCC AR6 WGIII, Technical Summary, Table TS.2, p.TS-31). Net-zero commitments should include these interim targets, as well as annual benchmarks to be met on the way to these 2030 reductions. **These targets should be based on actual, absolute emission reductions. They cannot be based on use of carbon removals or on emission intensity metrics.**

As with the global long-term target of reaching net zero by 2050, the UN's principle of CBDR means that northern non-state actors should adopt more ambitious interim targets than the global average. This means that for northern financial institutions a "fair share" of the necessary global reduction will require cuts by 2030 of more than 50% of CO2 and more than 45% of all Kyoto gases.

Transition plans: In line with the criteria of the Race to Zero, all net-zero committed non-state actors need to adopt credible and transparent transition plans by mid-2023. **These plans should include commitments to reach the interim and long-term targets on the pathways described above, to immediately end support for the coal sector, to stop supporting all fossil fuel expansion, and to phase down support for oil and gas at a rate consistent with feasible net-zero pathways.** As is noted by the Sustainable Finance Group at the University of Oxford's Smith School, "ending fossil reserves expansion in line with the IEA [Net Zero road map] or equivalent scenarios ought to be a prerequisite for a transition plan to be credible." ("Implications of the IEA Net Zero Emissions by 2050 Scenario for

Net Zero Committed Financial Institutions: Briefing Paper," C. Wison et al., Oxford Sustainable Finance Group, 2022, p.22)

Financial institution transition plans should require all their clients and investees to also adopt transition plans. Net-zero committed financial institutions should require their clients/investees to adopt deadlines on ending support for fossil expansion; should put in place mechanisms for monitoring the implementation of corporate plans; and clear and meaningful sanctions for companies that do not comply with their plans.

Also in line with the Race to Zero, transition plans must describe actions to be taken over immediate (1 year), short (2-3 year) and medium (by 2030) timeframes.

Transition plans should not promote the highly controversial position that fossil gas is a "transition" fuel. Note for example that the recent sectoral pathways paper by the OECM shows fossil gas Scope 3 emissions being reduced by 7% 2019-25 and 18% 2019-2030. Note also the recent paper in *Nature Energy* by Kemfert at al. which concludes that **fossil gas as "a fossil fuel with a high climate impact, often hidden under a misleading narrative, which hinders decarbonization via infrastructure expansion, and so creates carbon lock-in effects and bears high economic risk, cannot be a solution towards a zero-emission future."**

Also note that the IPCC in AR6 WG3 states that: "Estimates of future CO2 emissions from existing fossil fuel infrastructures already exceed remaining cumulative net CO2 emissions in pathways limiting warming to 1.5°C (>50%) with no or limited overshoot (high confidence)." The IPCC continues that given the "long lifetimes" of these assets, they "may influence the rate of transformation substantially and lock societies into carbon-intensive lifestyles and practices for many decades". (IPCC, AR6 WG III, p.2-68).

Credible financial institution transition plans will require them to develop corporate engagement policies and practices that have teeth — clearly delineated escalation strategies ending with meaningful sanctions. Financial institutions need to clearly explain what they expect companies to do and by when, and to clarify that if these deadlines are missed there will consequences. Financiers can exert pressure on companies from numerous angles. Examples include "graduated divestment" whereby shares are sold off over time if companies do not meet emission-reduction or other benchmarks; withholding of bank loans and insurance until conditions are met; a refusal to underwrite issuances of debt or buy new bonds for oil and gas companies until they drop any expansion plans; an exclusion of fossil fuel expanders from passive indices; and the refusal of stock exchanges to list new fossil fuel companies. In the case of equity investors, engagement policies should include transparent criteria for proxy votes, and disclosure on voting records. Financial institutions should also report at least annually on the concrete results (or lack thereof) of their engagement strategies.

Understanding that financial pressure on the fossil fuel industry is not just an issue of divesting ownership stakes is important when assessing how pressure can be brought to bear on state-owned oil companies which may not have shareholders but do have bankers and insurers. Between 2016 and 2019 state-owned Saudi Aramco was the 3rd biggest recipient among major oil and gas companies of financing from the 10 leading global banks. Pemex was the 5th biggest recipient and Petrobras the 7th biggest (see "Banking on Climate Chaos," RAN et al., March 2022, p.14).

One concern about corporate transition plans is that decarbonization targets can be met simply by selling off high-emitting assets to other owners. French company Engie, for example, reduced its coal generating capacity by more than 75% between 2015 and 2019. This drastically reduced Engie's emissions but did nothing to mitigate climate change as it was only achieved by selling 14 coal plants to other utilities. Similarly a study by Environmental Defence Fund found 155 transactions worth over $86 billion between 2017 to 2021 that involved oil and gas companies with net-zero commitments selling assets to companies with no such commitments.

The EDF report shows that the top three financial advisors on oil and gas mergers and acquisitions over the five years up to 2021 were Goldman Sachs, JPMorgan and Citi — all members of the NZBA. Out of the top 20 advisers on oil and gas M&A deals over this period, 13 are NZBA members. Net-zero committed financial institutions need to exert influence over their clients to ensure that their transition plans involve shutting down high-carbon infrastructure, and not selling it to new owners. **Net-zero financial institutions should rule out participating in any deals that are likely to prolong the lives of high-carbon assets whether that be as M&A advisers, bankers, investors or insurers of both selling and buying companies.**

Measurement: For financial institutions, reaching net zero must require reducing to zero the Scope 3 emissions from their lending, investing, underwriting, insurance and advisory activities (which must include the material Scope 1, 2 and 3 emissions of their clients and investees). While intensity metrics can be useful for measuring progress, emission targets must be based on absolute metrics in order to ensure real-world reductions, as is stated in the Race to Zero Interpretation Guide (p.8).

Persuade: The Race to Zero now requires members to "align external policy and engagement, including membership in associations, to the goal of halving emissions by 2030". Following this criterion, financial and corporate sector transition plans should include a commitment to cease any policy lobbying which seeks to encourage fossil fuel expansion, such as pushing governments to give new exploration licenses and leases, or to subsidize new production. Similarly they should publicly withdraw from any associations involved in such lobbying.

3) Verification and Transparency: Governance of targets

Some financial institutions already require some form of transition plans from their fossil fuel, and particularly coal, companies. A Reclaim Finance analysis in December 2021 found that 30 leading banks and investors demanded that coal companies present coal exit plans by the end of that year. Yet none of these institutions had published any detailed explanations of what these transition plans should include. Of 47 coal companies which were supposed to have presented coal transition plans to their financiers, Reclaim Finance concluded that only three had actually produced credible plans with commitments to stop building new facilities and shut down old ones on an adequate timeline. **This research illustrates the importance of financial institutions setting up meaningful processes to verify both the content of their clients' and investees' transition plans, and their application.**

As of the time of writing, three of the GFANZ sectoral alliances have established compliance mechanisms, and the Race to Zero is reported to be working on a process for sanctioning non-compliant members. The Race to Zero and the alliances will have to show themselves willing to use these mechanisms up to the point of delisting, including against large and high-profile members. The GFANZ mechanisms must also be used to punish failure to meet targets: as currently worded they may be used only against members that do not meet the low bar of just setting targets and disclosing progress toward meeting them. Furthermore the **mechanisms must be applied in a manner that is transparent, that allows for complaints to be filed by independent parties, and addresses potential conflicts of interest, for example where an institution under investigation by an alliance is also on the steering committee of that alliance.**

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