Financial Institutions - In Scope

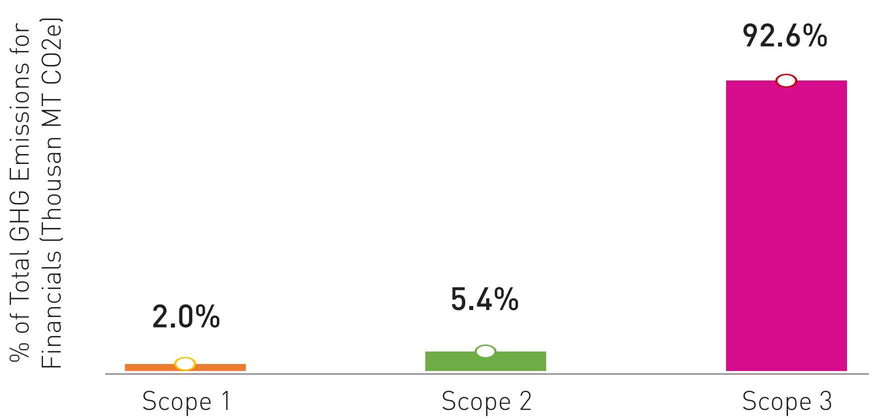
The Role of Financed Emissions on the Path to Net-Zero

Financial institutions have a critical role to play in the path to a global net-zero carbon economy, not through their physical footprints, but through their financed and portfolio emissions.

As one of the key capital-providing sectors to the global economy, financial institutions have a meaningful role to play in reducing carbon emissions in the coming years. We welcome the progress made in recent years by many financial institutions to achieve net-zero carbon emissions from their own operating infrastructure through a focus on "greening" their real-estate footprints, relying on renewable energy sources and/or carbon offset purchases, among others. However, we believe that the more challenging work lies ahead.

Scope 3, financed emissions - the proportion of the carbon footprint that a financial institution has exposure to through lending, investment, or underwriting activities to each client - represents the largest exposure to carbon emissions for financial companies. A recent study by the Carbon Disclosure Project ("CDP") showed that financed emissions of reporting institutions were ~700 times larger than their operational emissions.[1] **Reducing Scope 3 emissions is a necessity and represents the largest opportunity for financial institutions to cement their positive impact on improving climate risks in the coming years.**

Greenhouse Gas Emissions for Financials, by Scope Type



[1] "The Time to Green Finance" - CDP Financial Services Disclosure Report 2020.

Definitions of GHG Scopes

Greenhouse gas emissions are categorized into the following three scopes:

Scope 1: Direct emissions from owned/controlled sources.
Example: Emissions from a company's motor vehicle fleet/property.

Scope 2: Indirect emissions from purchased electricity, steam, heating and cooling.
Example: Company purchasing electricity to run their operations.

Scope 3: All other indirect emissions that occur in a company's value chain.
Example: Emissions that occur from the use of products sold/financed.

Engagement with global financial issuers from various subsectors is essential to improve the measurement and disclosure of existing financed emissions, and establish ambitious targets for reducing these emissions while supporting their clients through the transition.

Our focus on engagement in 2022 is significant given the relative importance of these companies' financed emissions versus their own operational emissions.

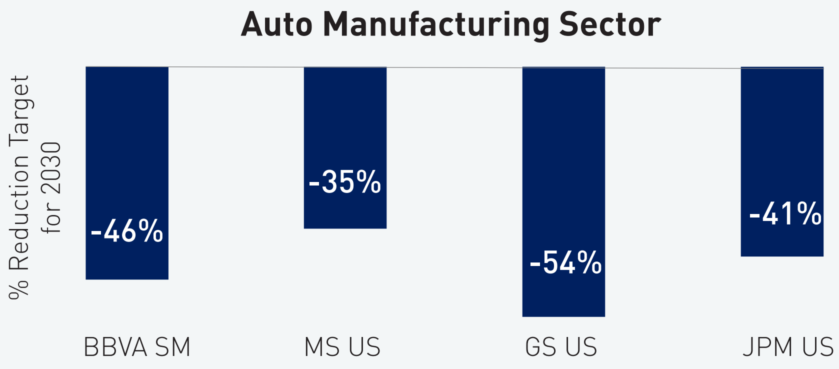
Although engagement is seen as an equity investor's domain by some market participants, we firmly believe that fixed-income investors can and should be able to influence management teams on ESG issues. Many of the issuers in the bond markets, including many in the financial institutions' sectors, do not have publicly-traded equity and/or have sizable debt footprints which need to be refinanced regularly. This presents opportunities for our Portfolio Management Team to effect change.

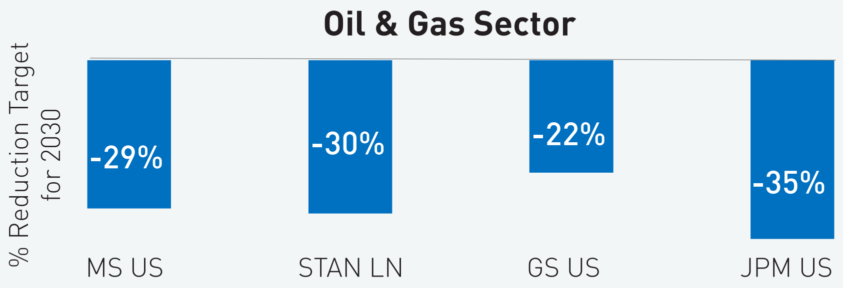
We applaud recent disclosure improvements and target-setting by some companies, but more is needed. For example, of the financial issuers who report into the CDP, only 25% currently measure their financed emissions.

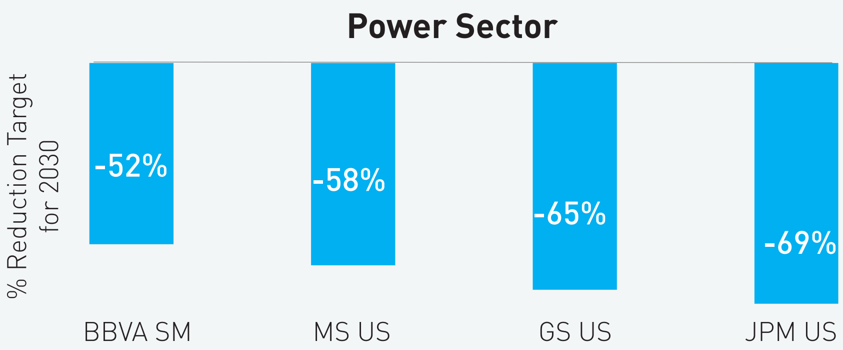
Nevertheless, in conjunction with COP26, we have seen some banking groups commit to decarbonization targets for their financing activities. In our view, targets are most credible when the following key elements are present:

- Methodology consistent with Partnership for Carbon Accounting Financials (PCAF)
- Interim targets included, not just a "net-zero by 2050" commitment
- Industry-specific goals informed by scientific pathways

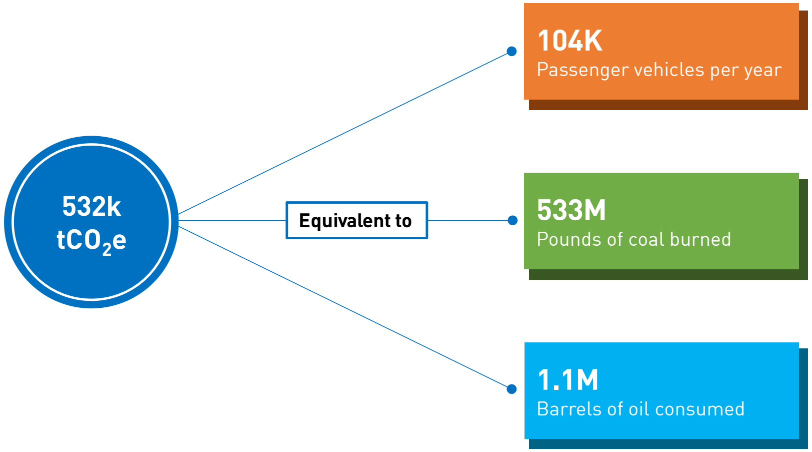
Several large US and European financial institutions have already published credible reduction goals related to their lending/financing operations. These include in-depth methodologies, interim targets, and a focus on high-emitting sectors, where reductions will be impactful for the global economy.







In November 2021, Canadian Equitable Bank became the first domestic bank to quantify its Scope 3 emissions at 532,000 tCO2e, the majority of which was generated from their mortgage lending business. Management noted that these results "have underscored the need for better data availability across the industry and have ignited internal conversations on what reductions might be achieved in Scope 3 emissions." We commend management for their leadership in this aspect and look forward to additional disclosure and target-setting from Equitable in the future.



Quantifying, and subsequently reducing, financed emissions will create a virtuous circle where capital providers help transition the decarbonization efforts of their clients and consumers.

Capital markets underpin the global economy, with financial institutions acting as providers and allocators of capital in developed and emerging markets. The providers of financing have a meaningful and outsized role to play in establishing the virtuous circle by advising and enabling their clients to transition their operations to lower-emitting activities and, in turn, reaching their own Scope 3 reduction goals. We believe net-zero financing is a key component of collaboration across capital markets and industries and will continue to focus on this theme in 2022 as a means of adding value to our funds.

Unique Areas of Focus for RPIA – BDCs and Aircraft Lessors

Aside from the global and regional banking groups, we have identified specific subsectors within financial institutions that we think need to improve disclosure of financed emissions and targets for reducing those where relevant. Many of the issuers in these sectors do not have public equity and offer fixed-income-specific engagement opportunities.

These include:

A **Business Development Companies, whose disclosure is less comprehensive than many sectors to date and who need to measure the emissions footprint of their underlying private debt/equity portfolios.**

B **Aircraft Leasing Issuers, whose Scope 3 emissions include the output from their leased aircrafts and whose reduction somewhat relies on upgrading their fleets with more fuel-efficient planes and/or the use of alternative fuels.**

We acknowledge that these areas will evolve over the long term, but more progress in standardized disclosure and engagement is needed even in the near term and we have already begun discussions with some companies in these sectors.

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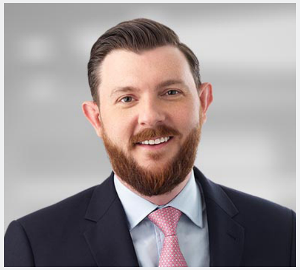

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NA = North American HY = High-Yield EM = Emerging Markets

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For more information, visit www.rpia.ca/esg.

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