

Climate change and the banking industry

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A sector note setting out the key considerations arising for the banking industry concerning climate change, as well as a discussion of sustainable finance offerings in the industry. This sector note focuses primarily on UK law and provides a high-level overview of EU law, where it may be of relevance to UK banks.

Scope of this note

This note sets out the key considerations arising for the banking industry in relation to climate change, including:

- The banking industry's direct and indirect impact on climate change.
- Existing and anticipated climate change law and regulation that specifically relates to the banking industry.
- Key risks identified in banks' climate change disclosures.
- Emerging trends and the industry's reaction to climate change.

The note also includes discussion of the growing number of sustainable finance offerings from the industry.

For an overview of:

- The key climate change legislation that can impact businesses more generally, see [Practice note, Climate change issues for companies](#).
- Practical Law's resources on climate change, see [Climate change toolkit](#).
- Practical Law's resources on the climate-related and environmental disclosures required as part of annual corporate reporting, see [Climate-related and environmental disclosures toolkit](#).

The banking industry's direct and indirect impact on climate change

The banking industry is in a unique position to influence the transition to a low-carbon economy. Financing companies gives it a degree of control over the allocation of capital both towards and away from specific industries. Owing to this position, the banking

industry has become a focus for those advocating climate change action, who say that the industry should restrict or stop financing for sectors that contribute materially to climate change.

Most banking industry participants measure the direct impact of their own operations on climate change and either consider their operations to be net zero already or have plans in place to become net zero.

The more challenging aspect for banking industry participants is the indirect impact of their operations or the emissions they finance. CDP Worldwide, which is responsible for a global disclosure system to help investors, companies and cities manage their environmental impact, estimates that emissions arising from banks' financing activities are approximately 700 times higher than their direct operational emissions.

Steps are being taken to establish consistent ways of measuring financed emissions. For example, the Partnership for Carbon Accounting Financials (PCAF) has established a global accounting and reporting standard for measuring and disclosing emissions financed via various asset classes including listed equity and corporate bonds, business loans and unlisted equity, project finance, commercial real estate, mortgages and motor vehicle loans. The PCAF approach has wide support across the banking industry, though many UK-based banks have yet to make disclosures in line with PCAF's recommendations. Some UK-based banks have developed their own methodologies for measuring the emissions they finance (for example, Barclays has created a system for measuring and tracking financed emissions at a portfolio level against Paris Agreement goals) and have acknowledged the areas of their business that are particularly carbon-intensive in terms of emissions financed. Banks look at new business opportunities with a view to reducing their carbon exposure to carbon-intensive industries by

measuring their carbon content, reducing the share of coal in the financed energy mix and by setting reduction objectives. For example, leading banks have been co-operating (in the Steel Climate-Aligned Finance Working Group) on establishing climate standards for funding the steel sector, to help drive decarbonisation, including establishing a framework to assess and disclose how greenhouse gas (GHG) emissions associated with a financial institution's steel portfolio line up with the Paris Agreement's 1.5°C climate targets.

Banks are also offering greener investment opportunities such as green loans or green bonds to corporate and retail investors and providing sustainable investment opportunities to the clients of their asset management arms. For more information, see [Green loans: checklist](#) and Increase in sustainable finance products being offered by industry participants.

While climate change is generally considered to be an important subject in its own right in the banking industry, it is sometimes considered together with other environmental, social and governance (ESG) or sustainable finance considerations (and the terms ESG, sustainable finance and green finance are often used interchangeably). For further information on ESG generally, see [Environmental, social and governance \(ESG\) toolkit](#).

Existing and anticipated law and regulation relating to climate change

As with many industries, the banking industry is affected by a range of climate-related law and regulatory measures. Key areas of existing and developing regulation in this area include:

- Financial risk requirements from the UK Prudential Regulatory Authority (PRA) (see [Managing financial risks](#) below).
- Amendments to the Listing Rules to align with the Task Force on Climate-related Financial Disclosures (TCFD) recommendations (see [Amendments to Listing Rules for TCFD disclosure](#) below).
- The Bank of England (BoE) Climate Biennial Exploratory Scenario (see [The BoE Climate Biennial Exploratory Scenario](#) below).
- The EU Sustainable Finance Disclosure Regulation ((EU) 2019/2088) (SFDR or Disclosure Regulation) and the Taxonomy Regulation ((EU) 2020/852) (see [The EU's Sustainable Finance Disclosure Regulation and Taxonomy Regulation](#) below).
- The UK Stewardship Code (see [The UK Stewardship Code](#) below).

Managing financial risks

Both UK-based financial regulators, the PRA and the Financial Conduct Authority (FCA), now specifically recognise that climate change is a potential material financial risk. In April 2019, the PRA issued a supervisory statement setting out its high-level expectations on climate change for certain firms it regulates, including banks and building societies (see [PRA: Supervisory Statement 3/19: Enhancing banks' and insurers' approaches to managing the financial risks from climate change \(15 April 2019\)](#)). In July 2020, it wrote to those firms clarifying some of the expectations and explaining that it expected firms to have their climate-related financial risk plans fully embedded by the end of 2021 (see [PRA: Dear CEO letter: Managing climate-related financial risk – thematic feedback from the PRA's review of firms' SS3/19 plans and clarifications of expectations \(1 July 2020\)](#)). In brief, the PRA expects firms to:

- Embed consideration of climate change risks in their governance arrangements, including by dedicating adequate resources and expertise to these risks and by allocating responsibility to the relevant senior management function.
- Incorporate climate change risks into existing financial risk management practice, including by updating their existing risk management policies, monitoring and reporting, and by having a credible plan in place for managing exposures.
- Use scenario analysis to inform their strategy and risk assessment (including shorter-term analysis within a firm's business planning horizon and longer-term analysis, in the order of decades, on a range of different climate pathways).
- Develop an approach to disclosure of these risks, which includes engaging with TCFD recommendations. See [Practice note, Task Force on Climate-related Financial Disclosures \(TCFD\): recommendations for disclosing climate-related financial information: overview](#).

In implementing these expectations, the PRA expects firms to take a proportionate approach that reflects their exposure to climate-related financial risk and the complexity of their operations. For more information about how the PRA supervises firms, see [Practice note, PRA supervisory model](#).

Amendments to Listing Rules for TCFD disclosure

The TCFD recommendations aim to provide a standardised approach to climate-related financial reporting, so that risks and opportunities can be categorised consistently, and organisations across different sectors and jurisdictions can be compared.

The TCFD recommendations comprise overarching recommendations and specific recommended disclosures in relation to governance, strategy, risk management, and metrics and targets. The TCFD recommendations are intended to improve and increase reporting of climate-related financial information (see [Practice note, Task Force on Climate-related Financial Disclosures \(TCFD\): What are the TCFD recommendations?](#)).

Some banks are either listed companies or within listed groups and, as such, the FCA's Listing Rules apply to them or their group holding companies. The FCA has amended its Listing Rules to require companies with a premium listing to make disclosures in line with the TCFD's recommendations or explain why they are not able to do so, which applies for accounting periods beginning on or after January 2021. See [Practice note, TCFD recommendations: climate-related financial disclosures for premium listed companies \(LR 9.8.6R\(8\)\)](#).

The FCA also launched a consultation on enhancing climate-related disclosures by standard listed companies (see [FCA: Enhancing climate-related disclosures by standard listed companies and seeking views on ESG topics in capital markets \(CP 21/18\) \(22 June 2021\)](#)). The FCA proposes to extend the application of the climate-related disclosure requirements in LR 9.8.6R(8) to issuers of standard listed equity shares (excluding standard listed investment entities and shell companies). The new rule will apply on a comply or explain basis, and take effect for accounting periods beginning on or after 1 January 2022.

These disclosure rules are likely to become mandatory at some point, moving away from the comply or explain model.

The BoE Climate Biennial Exploratory Scenario

The BoE is also conducting its biennial exploratory scenario (BES) during 2021 with seven large UK banks and building societies (as well as certain insurers). The BES is intended to test the resilience of those banks' business models and the financial system to climate-related risks, and the scale of the adjustment that will be needed in future for the sector to remain resilient. The BoE will measure the impact of the BES on those banks' end-2020 balance sheets with a focus on the credit risk exposure of the banking book to large corporate counterparties. The results of the exercise are expected to be published in May 2022. While the main aim of this exercise is to inform the Financial Policy Committee's (FPC's) approach to system-wide policy issues and the PRA's approach to supervisory policy,

it is likely to create additional pressure for banks to reduce their exposure to climate change. See [Practice note, Climate change and sustainability initiatives from UK financial services regulators: tracker: 2021 Biennial Exploratory Scenario on climate-related risks \(BoE\)](#) for more information.

The EU's Sustainable Finance Disclosure Regulation and Taxonomy Regulation

The EU's SFDR and its Taxonomy Regulation 2020 are both part of the European Commission's package of reforms relating to sustainable finance. See [Practice note, Hot topics: EU sustainable finance regulation](#) and [Practice note, EU sustainability disclosures for financial institutions](#).

The SFDR has imposed transparency and disclosure requirements relating to sustainability matters and risks, such as climate change, on certain financial market participants including, for example, private banks providing portfolio management and investment advice. The SFDR sets out, among other requirements, the information firms must disclose and maintain on their websites, the information that must be provided to investors and the requirements for periodic reporting to investors. See [Practice note, Sustainable finance: SFDR: overview](#). The SFDR entered into force on 29 December 2019 and most of its provisions have applied since 10 March 2021.

The core provisions of the SFDR did not apply until after the end of the Brexit transition period and it has not been comprehensively onshored in the UK. However, the SFDR remains relevant for UK firms. Practically, a UK firm may decide to voluntarily comply with the SFDR because of investor pressure. In addition, UK firms marketing funds into the EU or managing EU funds may also be within scope of the SFDR.

The FCA has proposed, in a [consultation](#), rules on mandatory climate-related disclosures based on TCFD recommendations for asset managers (as well as life insurers and pension providers). While this proposal does not contradict the SFDR, the UK proposal will focus on climate risks as opposed to broader sustainability issues. For further information, see [Practice notes, Sustainable finance: EU SFDR: overview: Application of the SFDR in the UK and EU sustainability disclosures for financial institutions : UK applicability](#).

The Taxonomy Regulation establishes criteria for determining whether an economic activity is environmentally sustainable. It applies to financial market participants as defined in the SFDR and certain large public-interest entities. It is intended to provide investors with a common language to identify to what

degree economic activities can be considered and labelled environmentally sustainable (or “green”). It also obliges the entities that are in scope to make statements about how their financial products and activities align with the taxonomy it specifies. See [Practice note, Sustainable finance: EU Taxonomy Regulation: overview](#).

As with the SFDR, the Taxonomy Regulation’s disclosure provisions entered into effect after the Brexit transition period and it has not been comprehensively onshored in the UK. All provisions of the Taxonomy Regulation could still apply to UK firms, for example, where UK firms market funds into the EU. Further, on 9 June 2021, HM Treasury published a press release announcing the establishment of the Green Technical Advisory Group (GTAG), an expert group that will provide independent advice to the government on the development and implementation of a UK green taxonomy, which will build on existing international taxonomies, including the EU taxonomy (see [Legal update, HM Treasury establishes Green Technical Advisory Group](#)). For more information, see [Practice note, EU sustainability disclosures for financial institutions: UK applicability of the Taxonomy Regulation](#).

The UK Stewardship Code

The UK Stewardship Code 2020 sets out responsible business standards for, among others, asset owners and asset managers, as well as the service providers who support them. It applies, therefore, to banks’ asset management and private bank divisions. Although adherence to the Code is voluntary, it is widely supported. Principle 7 of the Code requires signatories to systematically integrate stewardship in investment decisions, including material ESG issues and climate change, to fulfil their responsibilities. In practical terms, the Code also provides a basis for asset managers who hold shares in listed banking entities to apply pressure to those entities to have regard to material ESG issues (including climate change). For further information, see [Practice note, UK Stewardship Code 2020](#).

Key risks identified in banks’ climate change disclosures

Many banks already produce a non-financial report covering ESG matters, including climate change, and disclose in line with the recommendations of the TCFD. In line with TCFD guidance, risks are generally categorised as either:

- Transition risks (see Transition risks below).
- Physical risks (see Physical risks below).
- Connected risks (see Connected risks below).

For more information on non-financial reporting and climate risks, see [Practice note, Narrative reporting: climate-related and environmental disclosures in annual company reports: overview](#) and [Climate change toolkit: Summary of risks](#).

Transition risks

Transition risks identified in TCFD reports include policy, regulatory and legal changes initiated as a response to climate change, as well as technology shifts and changing market demand. Specific examples include:

- Rapid policy or regulatory changes, for example in relation to carbon taxes, which could lead to the increased credit risk of clients and counterparties.
- Credit risk in sectors particularly vulnerable to climate change (for example, aviation, oil and gas), where clients or counterparties may fail to fully honour their obligations to the bank (see [Sector note, Climate change and the oil & gas industry](#)).
- Market risk resulting from changes in market conditions adversely impacting the value of assets or liabilities (including “green swans” or sudden market shifts).
- An increased risk of potential climate-related litigation, including in relation to stranded assets, acute climate events or resulting market price declines. This type of risk (liability risk) is often categorised as a stand-alone category of risk, along with transition, connected and physical risks, see Climate-related activism and litigation in the banking industry below.

Physical risks

Physical risks identified in TCFD reports include risks from extreme weather events (classified as acute physical risks) and longer-term shifts in climate patterns, such as sustained higher temperatures or sea-level rise (termed chronic physical risks).

Such events or patterns could affect supply and demand, which could impact on market prices in susceptible sectors or countries, resulting in market risk. In particular, extreme weather events may present operational issues relating to property owned by the bank and ongoing business continuity.

For example, extreme weather events pose a risk to banks’ infrastructure and could jeopardise their operational continuity by damaging offices and data centres. Banks may also suffer reputational harm if their clients and customers perceive them to have mismanaged physical risks or if they fail to provide adequate support to communities and customers affected by extreme weather events.

Banks may also be vulnerable to fluctuations in commodity and other asset prices caused by extreme weather events. If customers' income or profitability is reduced, banks will be exposed to a greater risk of credit losses. Further, rising sea levels and increased flood risk or increasing forest fires could increase the risk of customer default. In particular, the cost of damage to residential or commercial property may leave borrowers unable to meet mortgage payments.

Connected risks

Connected risks are second-order risks arising from transition or physical risks. Examples include recessionary pressures and reputational risk if a bank's clients include those that have the potential to cause or contribute to significant adverse impacts on the climate.

In modelling these risks, banks use different quantitative and qualitative methodologies to calculate a counterparty credit risk that incorporates data from physical, transition and connected-risk scorecards. For example, banks assess their counterparty's reliance on non-green energy, or their strategy to protect physical assets from future physical risks, as well as transition initiatives for a more sustainable operating model. The main issue is the lack of reliable and objective data that would enable comparisons between counterparties.

In April 2021, the [Basel Committee on Banking Supervision \(BCBS\)](#) published two reports exploring both how climate-related financial risks arise and affect banks and the financial system, and banks' and regulators' current and emerging practices in measuring these risks. The reports noted that additional work was needed to reliably estimate risk, given persistent data gaps and the unpredictability of climate change in the long-term. For further information, see [Basel Committee on Banking Supervision: Basel Committee publishes analytical reports on climate-related financial risks \(14 April 2021\)](#).

The industry's reaction to climate change and emerging trends

The banking industry's response to climate change and emerging trends in the industry include:

- The climate goals and commitments being made by industry participants (see [Climate goals and commitments](#) below).
- The increase in sustainability-linked products being offered by industry participants (see [Increase in sustainable finance products](#) being offered by industry participants below).
- Industry groups and reports (see [Industry groups and reports](#) below).

Climate goals and commitments

Banks are committing to a growing number and variety of climate-related goals and metrics. These include measures to reduce their environmental impact through net zero carbon commitments, reducing or stopping funding of fossil fuel projects and directing investment to more environmentally friendly products and sectors.

Net zero carbon emissions

In line with the UK's 2050 net zero target, many UK-based banks have made commitments to become net zero (including in relation to their emissions financed or "scope 3 emissions") by 2050 or sooner.

Some UK-based banks are members of the [Net Zero Banking Alliance \(NZBA\)](#), which is a UN-convened but industry-led alliance of more than 40 of the world's major banks, which have committed to align their lending and investment portfolios with net zero emissions by 2050.

In April 2021, the Glasgow Financial Alliance for Net Zero (GFANZ) was launched, bringing together existing net zero finance initiatives (including the NZBA) into one forum, with over 160 firms, including 43 banks, working to accelerate the financial sector's progress towards net zero. Signatory companies are required to show credible plans for reducing investment in high-carbon assets (see [reuters.com: Carney, Kerry launch global finance plan to boost climate action \(21 April 2021\)](#) and [Sector note, What's on the horizon for banks?: The focus on sustainable finance will intensify](#)).

Many banks have also signed the [Paris Pledge for Action](#), which allowed businesses to demonstrate their commitment to the objectives of the 2015 Paris Climate Agreement.

Reduction in fossil fuel investing

Some banks are beginning to take action to reduce, or entirely halt, their investment in carbon-intensive or ecologically damaging fossil fuel projects, often as a result of growing public pressure. For example, French bank [Crédit Mutuel](#) announced in February 2020 that it was adopting a "zero tolerance" attitude to coal developers and a total phase-out of coal investments by 2030.

Several banks have also made commitments to restrict funding for oil and gas exploration in the Arctic.

Green investment strategies

In addition to restricting investments in fossil fuel projects, many banks are actively directing their investment strategies to greener products and industries. In particular, investment is being channelled into renewable energy and low-carbon

vehicles, as well as to enable clients to make the low-carbon transition. For example, over the next ten years, HSBC aims to provide between \$750 billion and \$1 trillion of financing and investment to assist in the transition to lower-carbon emissions (see [reuters.com: HSBC targets net zero emissions by 2050, earmarks \\$1 trillion green financing \(9 October 2020\)](#)).

Increase in sustainable finance products being offered by industry participants

There has been a huge growth in the market for green and sustainable financing products over the last few years. Demand is expected to surge as market participants seek to demonstrate their commitment and ambition to a more sustainable future, by utilising an existing financing need to firstly support and complement wider environmental strategies, including climate change mitigation, and secondly to help drive behaviours.

Banks have a key role to play in steering capital towards sustainable economic activity, through lending, structuring, underwriting, intermediating, purchasing and trading sustainable finance products such as:

- Equity in corporates that meet environmental, social or governance sustainability criteria, such as FedEx that aims to convert its entire 35,000-vehicle fleet to electric or hybrid engines, or are ranked in sustainability indices such as the FTSE4Good.
- Green, social and sustainable bonds (GSS bonds).
- Green and social loans (GS loans).
- Sustainability-linked bonds (SLBs).
- Sustainability-linked loans (SLLs).
- Sustainable commercial paper.
- Green securitisation.
- Green asset-backed financing.
- Green project financing.
- Related ESG-linked derivatives.

Banks are also using a range of green and sustainable finance products to finance their lending portfolios.

Green financial products

GSS bonds and GS loans are relatively established financing instruments. They are often referred to as “use of proceeds” financing as they require net proceeds to be used for specific green or sustainability projects (such as projects related to climate change mitigation), with associated ongoing tracking of funds and related reporting. This means that borrowers need to have a sufficient volume of green or sustainability projects to be able to use the net proceeds of the bond or loan.

By way of example, the European Investment Bank (EIB) has issued several climate awareness bonds, with net proceeds earmarked for projects contributing to climate action in the renewable energy sector (such as wind, hydro, solar and geothermal energy production targets) and the energy efficiency sector (such as building insulation and energy loss reduction in transmission and distribution projects), as well as projects related to research, development and deployment of innovative low-carbon technologies. See [EIB: Climate awareness bonds](#).

The market for “use of proceeds” asset-backed or securitised bonds remains small, mainly due to a lack of green underlying assets, but there are a few examples of such bonds where recourse is to a group of climate-related projects such as solar leases or to mortgages that finance energy efficient homes. There are also examples of project bonds where proceeds are ring-fenced for specific green projects, such as wind farms, which can aid climate change mitigation efforts by plugging the investment gap in greener infrastructure.

A number of banks and other market participants helped to formulate the voluntary principles set out in the [Green Bond Principles](#) and the [Green Loan Principles](#) in connection with GSS bonds and GS loans and are encouraging their use in connection with green bond and loan issuance. While these principles are the main principles guiding the green bond market, there are other industry guidelines that may also be relevant, including the Climate Bonds Initiative’s climate bonds standard and certification scheme. See [Climate Bonds Initiative: Climate bonds standard and certification scheme](#).

From a regulatory perspective, in July 2021 the European Commission published a proposal for the creation of an EU Green Bond Standard (EU GBS). The EU GBS is intended to be a new voluntary “gold standard” for green bonds with a common framework of rules, intended to help finance sustainable investment while addressing concerns around greenwashing. The proposal as put forward by the European Commission will:

- Establish a voluntary standard for green bonds made available to investors in the EU, where the proceeds are used to finance green assets or projects that pursue, and are fully aligned with, environmentally sustainable objectives under the EU Taxonomy Regulation, or that contribute to the transformation of activities to become environmentally sustainable.
- Increase transparency by establishing a new system for registering and supervising external reviewers for green bonds aligned with the framework, and require issuers of EU green bonds to obtain a pre- and post-issuance review from an external reviewer that is registered and supervised by the European Securities Markets Authority.

This development may help to further energise climate change mitigation efforts by green bond issuers that have a sufficient volume of climate change mitigation projects to fund, and banks may notice a new surge of interest in the green bond product by issuers that are keen to demonstrate compliance with this new “gold standard”. For further information on the development of the EU GBS, see [European Commission: EU Green Bond Standard](#).

See also Practice notes,

- [Green, social and sustainability bonds](#).
- [Green loans](#).
- [Green loans: what an in-house bank lawyer should know](#).
- [Green loans: checklist](#).

Sustainability-linked finance

Banks have also helped to develop sustainability-linked finance products, which corporate borrowers are increasingly turning towards to finance their sustainability strategy. SLBs and SLLs are highly flexible financing products, as the proceeds may be used for general corporate or other specified purposes. The use of proceeds is not restricted to specific projects, unlike GSS bonds and GS loans, and there is no need for ongoing tracking of proceeds.

SLBs and SLLs are forward-looking performance-based instruments that involve both:

- The selection of key performance indicators (KPIs), which are predefined, quantifiable metrics used to measure the performance of selected indicators.
- The calibration of sustainability performance targets (SPTs), which are ambitious (beyond business-as-usual) and measurable improvements in KPIs that a borrower commits to over a predefined timeline.

The KPIs and SPTs are aligned to a borrower’s sustainability goals, which allows them to be individually tailored. While the regulator’s approach suggests that banks may need to play an important role in attaching ambitious but appropriate environmental targets to SLBs and SLLs, considerations such as competing offerings on the market and alignment with customers need to be taken into account. Many borrowers have set targets to reduce the GHG or carbon emissions of their own operations. Some borrowers have gone further by committing to decrease such emissions in their supply chains too. KPIs could also cover increased use of renewable energy sources, energy efficiency of buildings, water usage and waste or recycling targets. A structuring mechanism such as a coupon step-up mechanic is built into the terms of the SLB or SLL and this acts as an incentive for an issuer to

meet its SPTs or otherwise face the prospect of higher interest payments to investors. In the SLL market, it is fairly typical to see a two-way margin ratchet, with a coupon step-down mechanism that kicks in if a borrower meets its SPTs, as well as a coupon step-up mechanism that applies if a borrower fails to meet its SPTs.

A number of banks helped to formulate the voluntary principles set out in the [Sustainability-Linked Bond Principles](#) and the [Sustainability-Linked Loan Principles](#) and are encouraging their use by bond and loan market participants.

See also [Practice note, Sustainability linked loans](#).

Transition finance

Some banks have indicated that they intend to help clients in carbon-intensive sectors (such as oil, gas and aviation) to progressively transition towards a low-carbon emission future. The International Capital Market Association’s (ICMA’s) [Climate Transition Finance Handbook](#) provides clear guidance and establishes common expectations for capital markets participants on the practices, actions and disclosures to be made available when raising funds in bond markets for climate transition-related purposes. See [Legal update, Climate Transition Finance Handbook and Q&A](#).

Sustainability-linked derivatives

Derivatives markets can also play an essential role in facilitating the transition to a sustainable economy. As well as offering rate and FX hedging solutions for sustainable finance products and offering lenders liquidity and risk solutions for such products, the market has also started to see a handful of OTC derivatives contracts with a specific climate action element. The terms of these contracts include a specific incentive to hit pre-defined climate action targets (such as increased use of renewable energy sources, reduction in GHG emissions or achieving a target ESG score). As with SLB and SLL financing products, this could involve a reduction in the spread payable by a party if the target is met, or the counterparty (such as a bank) contributing to an environmental project if the obligated party hits that target. A small but growing number of these transactions have been executed to date, primarily where the climate action element has been embedded in an interest rate swap. Often the associated financing has included a climate action element or been for a business focused on clean energy. For further details of these transactions and also the wider role of OTC derivatives in sustainable finance, see [ISDA: Overview of ESG-related derivatives products and transactions](#) and [reuters.com: Sustainable finance scramble reaches currency derivatives market \(18 May 2021\)](#).

For further information on green finance generally, see [Practice note, Green finance and socially responsible investing \(SRI\): introduction](#).

Climate-related activism and litigation in the banking industry

Over the past few years there has been an increase in climate activism directed at the banking industry. Shareholders of listed UK-based banks have proposed climate-related board resolutions which have obtained high levels of support (although none have yet been passed) (see [Practice note, Resolutions on climate change at annual general meetings of FTSE 350 companies](#)). Environmental NGOs have run campaigns lobbying for banks to reduce financing of fossil fuel companies and specific projects which contribute to climate change, as well as campaigns criticising the climate commitments and goals that banks have made. There has also been pressure from large institutional investors to focus on climate change risks.

There has not yet been any litigation in the UK against banking industry participants in relation to climate change issues. There has however been one interesting case for the industry brought recently in Europe. In April 2021, the NGO ClientEarth issued proceedings in the Belgian courts against the Belgian National Bank (BNB) on the basis that the bank breached environmental and human rights laws when implementing the Corporate Sector Purchase Programme set up by the European Central Bank (ECB) and purchasing assets under it. ClientEarth alleges that the BNB's asset purchases are effectively directing capital into sectors which fuel the climate crisis. It asks the Belgian courts to refer the question of whether the ECB's decision to establish the purchase programme in 2016 was valid to the European Court of Justice, and to make orders halting the BNB from making purchases under the programme (see [Westlaw Edge UK: ClientEarth launches climate-based legal challenge against Belgian National Bank \(14 April 2021\)](#)). The timing of the litigation coincided with the ECB's review of its monetary policy strategy (see [ECB: Strategy review](#)). There have also been complaints brought against ING Bank in the Netherlands under the OECD Guidelines in relation to climate change-related matters, and some cases brought against banks in Australia relating to non-disclosure of climate-related risk, which have all settled before trial.

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For more information, see [Practice note, Climate change litigation](#).

Industry groups and reports

The most notable national industry group in relation to climate change is the Climate Financial Risk Forum (CFRF), which is jointly convened by the PRA and the FCA in order to advance the banking industry's responses to the financial risks posed by climate change. In June 2020, the CFRF published its guide to help the financial industry approach and address climate-related financial risks. The guide provides industry views on best practice associated with risk management, scenario analysis, disclosures and innovation (see [FCA: Climate Financial Risk Forum \(CFRF\)](#)).

Internationally, the BoE is a founding member of the [Network of Central Banks and Supervisors for Greening the Financial System \(NGFS\)](#) established at the Paris "One Planet Summit" in December 2017. There are now 90 members and 13 observers across the world. The NGFS aims to assist the financial system in providing funding to low-carbon investments in line with a policy of sustainable investment and promotes best practice as well as conducting and commissioning analytical work on green finance.

Climate change and the operation of the industry

The increasing focus by the industry on climate change is creating (and will continue to create for some time) a number of complex issues for banks to consider, including:

- The types of clients and projects a bank supports.
- Whether a bank's subsidiaries and companies in its supply chain have climate change policies that are comparable to the bank's own policies in relation to climate change. (For information on parent company liability for the environmental impacts of their subsidiaries' operations, see [Practice note, Environmental law: overview: Parent company liability for environmental damage](#).)
- How climate change affects the bank's hedging and investment decisions over time.
- How climate change affects the pricing of the risks of investing in commodities and shares, particularly of companies who are seen to be contributing to climate change.
- The impact of climate risk on banks' own financial positions.