Executive summary of the third ACPR-AMF joint report on the assessment of the climate-related commitments of French financial institutions

Chairmen's foreword

For the past three years, the ACPR and the AMF have published a joint annual report focusing on the commitments of French financial institutions to combating climate change and achieving carbon neutrality by 2050. This third report provides an opportunity to take stock at the end of this three-year period.

The objective of the monitoring exercise, which was set up in 2019 at the same time as the ACPR's and AMF's Climate and Sustainable Finance Advisory Commissions (CCFD), is to measure the evolution of financial institutions' commitments to combating climate change, as well as the credibility of their fossil fuel policies and their implementation.

The first report published in 2020 made several key points, first among which was the recognition that financial sector participants have a responsibility in fighting climate change, even though they cannot substitute for public policies. We nonetheless identified some important avenues for progress regarding coal financing exit strategies and made a set of recommendations encouraging financial institutions to make voluntary commitments that are rigorous, clear and comparable.

The second report published in 2021 covered a broader scope, including sector-wide policies on hydrocarbons in general. While highlighting a few improvements, it also stressed that several recommendations made in the previous report still needed to be addressed. This observation was echoed by the Minister for the Economy, Finance and the Recovery, who urged the financial sector to move further and faster on the issue.

This year, the third edition of the report includes a focus on the governance frameworks set up by sector participants to monitor their climate commitments.

Following the analyses conducted by the two Authorities, and the work of their respective Climate and Sustainable Advisory Commissions who helped in preparing this report, several areas of improvement were identified.

Furthermore, the ACPR and AMF found that a significant number of financial institutions have committed to net zero initiatives, grouped together under the "Glasgow Alliance", the evolution and impacts of which will need to be monitored. However, over the past few years, financial players have reduced their coal financing at varying rates, and there has been no notable change in sector policies on other fossil fuels. Moreover, approaches continue to differ widely, commitments have not been sufficiently implemented on an operational level, and many of the previous reports' recommendations can thus be reiterated.

European and global standards on non-financial reporting, and in particular climate-related information, are set to evolve significantly thanks to the efforts of the European Financial Reporting Advisory Group (EFRAG) and the International Sustainability Standards Board (ISSB). Over the next two years, the regulatory texts should strengthen requirements for financial players to report non-financial information on their environmental and climate policies. We are therefore taking the opportunity, with this third report, to encourage French financial institutions to increase their efforts and transparency regarding the implementation of their voluntary commitments and the requirements arising from current and future regulations.

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Background

At a meeting with the Paris financial centre on 2 July 2019, chaired by Bruno Le Maire, Minister for the Economy and Finance, financial sector participants (banks, insurers and asset managers) made a series of commitments to combating climate change and meeting the goal of net zero carbon emissions by 2050. They notably agreed to end the financing of thermal coal according to a defined divestment timetable and, more generally, to put in place solid sector-wide policies on fossil fuels.[1] In addition, in October 2020, the Minister for the Economy and Finance and Minister of State for the Social, Solidarity and Responsible Economy asked the financial community to develop a strategy for exiting the financing of non-conventional activities.

In parallel, the *Autorité de contrôle prudentiel et de résolution* (ACPR – Prudential Supervision and Resolution Authority) and *Autorité des marchés financiers* (AMF – Financial Markets Authority) took the opportunity to set up a framework for monitoring and evaluating these commitments. This led to the publication of two assessment reports, in 2020 and 2021.[2] The reports summarised the results of the monitoring exercise and proposed a number of recommendations aimed at increasing the transparency of the information published by financial sector participants, and making their commitments regarding fossil fuel policies more credible. They also included a detailed analysis of financial institutions' fossil fuel exit strategies and their implementation.

In this report, we continue this assessment by providing an overview of banks and insurers' commitments using the inventory compiled by the Sustainable Finance Observatory. We supplement this overview by a review of the governance of all market players' commitments. Like the previous editions, this report examines the fossil fuel policies (coal, oil and gas) of the main financial institutions, and provides new estimates of their exposure. It also assesses the implementation of the 2021 recommendations, and makes a number of new recommendations.

The work was carried out by the Authorities based on publicly available information and detailed questionnaires sent out to the largest financial sector participants (9 banks, 17 insurers and 18 asset managers).[3] This was supplemented with bilateral discussions and exchanges.

[1] See Declaration of the Paris Financial Centre 07022019.pdf (financefortomorrow.com)
[2] First Joint ACPR/AMF Report, 2020 and Second Joint ACPR/AMF Report, December 2021 ».
See list in the Appendix 1.

Main findings

After three years of monitoring, the results remain mixed and further progress is still needed. While the successive reports confirm a strong mobilisation of financial sector participants, with advances noted over the first two years, especially regarding exit dates and exclusion criteria, approaches nonetheless remain heterogeneous. Overall, institutions haven't sufficiently addressed the recommendations made in previous reports. Moreover, the operational implementation of institutions' commitments remains insufficient. The changes in the European regulatory framework and strengthening of requirements for non-financial reporting are liable to lead to changes in the format and scope of the Authorities' next joint reports. In light of this, this report is also an appeal to financial institutions to quickly close the gap between the level of transparency currently observed on their voluntary commitments and the current and forthcoming regulatory requirements.

Regarding the monitoring of commitments

This year again, while banks and insurers essentially communicated on their exit from fossil fuels, the majority of commitments identified by the Observatory for Sustainable Development[4] fall under the category "participation in environmental initiatives".[5] New categories have also emerged, relating notably to biodiversity. This development is in part attributable to the entry into force of Article 29 of the Energy and Climate Law (LEC) which requires institutions to disclose their biodiversity footprint.

Overall, the analyses show that commitments are more detailed. However, further efforts must be made to provide greater detail: regarding commitments related to coal in particular, more detail is needed on the value chain involved in order to meet the "scope of application" criteria defined by the Observatory. In addition, regarding commitments to "green" or "sustainable" financing and investments, there is an overuse of generic terms such as "ecological transition" and "investments with a positive impact", which are explained in the CSR reports but not directly in the commitment description submitted to the Observatory for Sustainable Finance.

The ACPR therefore recommends that institutions continue the observed efforts to improve the quality of their public commitments, particularly in terms of the details provided to the Observatory. Financial sector participants also need to systematically incorporate monitoring indicators for their commitments, to make it easier to steer them over time and determine whether they can be met.

Regarding the governance of commitments

In general, several observations can be made that apply to the majority of financial sector participants (banks, insurers, asset managers):

- regarding institutions' internal organisation, the governance of commitments relies on systems of varying complexity where responsibilities are shared between different departments (CSR, sustainable development, operational departments), with regular progress reports submitted to the general management;
- in certain cases, this organisation is supplemented with internal controls, and even with inspections of climate commitments in the case of banks and insurers;

[4] Observatory for Sustainable Finance homepage

[5] This category (see body of report) groups together commitments based on participation in environmental initiatives or membership of financial centre environmental groups such as the TCFD, the NZA, Climate Action 100+, the TNFD, or Act4Nature.

The indicators for monitoring progress on commitments are most often mentioned in ad hoc presentations and are not incorporated into the risk mapping presented to the board of directors;

- nearly all surveyed banks and insurers, but few asset managers, say they include non-financial criteria in their remuneration policy, especially for managers. However, the achievement of climate commitments is too often "buried" amongst the other non-financial targets, raising the question of what weighting the different objectives are given in variable remuneration, and to what extent the latter is directly linked to purely environmental commitments. In general, there is a lack of detail on how exactly remuneration is indexed to the adopted ESG or climate criteria.

More specifically, regarding the governance of banks' and insurers' commitments on coal and net zero, the main findings are as follows:

- only a few banks and insurers have put in place precise quantitative interim targets setting out a trajectory for exiting coal financing by 2030 or 2040, even if this is more or less mitigated by the inclusion of more qualitative criteria, for example references to their divestment from companies that do not publish an exit plan;
- aside from the fact that a majority of financial institutions have joined global alliances aimed at achieving net zero by 2050, whose actual effectiveness it will be interesting to observe over the coming years, the question of how to measure carbon neutrality remains crucial. Existing metrics are not only biased, they also suffer from methodological gaps and a lack of harmonisation.

The ACPR and AMF therefore urge financial institutions to continue their efforts to properly manage their climate commitments. This notably means reinforcing their governance frameworks by taking better account of environmental policies in staff remuneration, or by broadening the scope of internal audits to include environmental policies. Moreover, the two Authorities recommend greater transparency in the calculation of fossil fuel exposures and of indicators showing how institutions' portfolios are aligned with a trajectory of net zero greenhouse gas emissions, a temperature trajectory or compliance with the Paris Agreement. They also recommend that financial institutions publish interim targets to assess the progress made on their exclusion commitments, as well as interim targets for their clients, with, for example, details of the escalation policy in the event of insufficient progress.

Regarding fossil fuel policies

While the 2021 report found that financial players had made genuine efforts to update and even reinforce their "coal" policies, this year no such trend could be observed.

Admittedly, all banks and insurers, and a little over half of the major asset managers in the French financial sector, have set a deadline for exiting the coal industry – generally 2030 for countries in the Organisation for Economic Co-operation and Development (OECD) and 2040 for the rest of the world. However, as in 2021, even though nearly all banks and insurers analysed and half of asset managers refuse to finance companies in the coal industry that are developing new projects, in line with the recommendations of the International Energy Agency (IEA),[6] the exclusion thresholds and criteria incorporated into coal policies have barely changed.

[6] Net Zero in 2050 report: "Beyond projects already committed as of 2021, there are no new oil and gas fields approved for development in our pathway, and no new coal mines or mine extensions are required".

Furthermore, these exit targets are still very rarely accompanied by interim targets. Clearly, the majority of actors consider that the policies currently in place are sufficient to meet their targets, and that the levels of requirement do not need to be revised or reinforced.

For oil and gas, the assessments made in 2021 remain largely valid. Policies in these two areas, for both bank and non-bank players, tend to focus solely on certain non-conventional energies, the definitions of which continue to differ significantly across institutions, despite the efforts observed, for example at banks, to define a common classification. Some institutions have published exclusion policies for conventional hydrocarbons or commitments to reducing their exposure, but these players often have very little exposure to the sector or business model in question. There has also been an improvement in the quality of certain insurers' policies, but this remains limited.

Regarding exposures to fossil fuels

Banks and insurers are continuing their efforts to define a common methodology for measuring their fossil fuel exposure. The exercise remains complex, however, due to difficulties in compiling past data and biases stemming from the choice of database or methodology. In addition, some of the data collected from institutions is of limited quality. Consequently, the results presented in this report aim to describe an overall trend rather than giving a precise appraisal of the situation.

The overall exposure of financial sector participants to companies in the coal sector remains low. However, French funds' exposure increased from 2020 to 2021, rising by between 10% and 26% in absolute terms, depending on the method used. Their exposure nonetheless remains low when measured as a share of total assets under management, accounting for between 0.5% and 3.1%, with disparities across funds. Banks' exposure decreased slightly between 2015 and 2021 (by 3.5%). It is residual when measured as a share of total outstanding loans or total balance sheet. Insurers' exposure to the coal industry also fell between 2015 and 2021, to an average of less than 0.6% of their investments, although again with disparities across firms. In the period 2020-21, insurers' investments linked to the coal industry fell by between 11% and 15% (in absolute value). In addition, more than half of the firms surveyed say they have put in place policies and tools aimed at excluding coal from their subscription policies. Nonetheless, only one insurer was able to provide details of a coal industry exposure on the liabilities side.

Insurers' exposure to oil and gas remained relatively stable from 2015 to 2021 at between 1.1% and 1.6% of total investment holdings. Banks' exposure as a share of the total exposure of all institutions analysed declined over the same period, falling from 3.8% to 3%, and remained stable between 2020 and 2021. Measured in absolute amounts, their exposure nonetheless increased over 2015-21, rising by between 22% (based on reported figures) and 57% (based on statements of large exposures). This discrepancy stems in part from methodological biases and illustrates the uncertainties associated with using the Urgewald lists.[7] The increase observed from the data coming from the prudential reporting of large exposures is the result of an acceleration in 2021when bank balance sheets expanded sharply. The exposure of French funds, which accounts for 2.2-4.4% of total assets under management, also increased by around 20% in absolute terms between 2020 and 2021. These figures are interim values, and upper and lower ranges are provided in the body of this report, depending on the method of calculation and data source used.

With regard to both climate risk monitoring and compliance with the reporting obligations set out in the regulatory texts (notably the Sustainable Finance Disclosure Regulation (SFDR) and Article 29 of

[7] Urgewald is a German environmental NGO created in 1992 that studies actors involved in the coal, oil and gas value chains. It regularly publishes a list of these actors: the Global Coal Exit List (GCEL) for coal and the Global Oil and Gas Exit List (GOGEL) for oil and gas.

the LEC), financial institutions must step up their efforts to take more robust, transparent and homogeneous account of their exposure to fossil fuels.

Overall, many of the recommendations made in the previous report on fossil fuel policies and the measurement of exposures remain valid. As in the previous reports, the Authorities encourage Paris financial centre participants to increase their efforts to better identify their exposures to these fuels and to make their ambitious climate targets fully credible. These policies are an important aspect of the texts which recently came into force (e.g. Article 29 of the LEC) or which are due to come into force – such as the European Banking Authority's technical standards – and will make it possible to clearly explain and implement approaches aimed at meeting the Paris Agreement targets.