

Banks and their role in climate change

By Alan Porter, Fund Manager, Sanlam Investments

At the end of the first week of COP26 the Glasgow Financial Alliance for Net Zero (GFANZ) committed over \$130 trillion of private capital to transforming the economy for net zero. Firms across the entire finance spectrum have committed to high ambition, science-based targets, including achieving net zero emissions by 2050 at the latest, delivering their fair share of 50% emission reductions this decade, and reviewing their targets towards this, every five years.

Mark Carney, UN Special Envoy for Climate Action and Finance and the co-chair of GFANZ, said: "The architecture of the global financial system has been transformed to deliver net zero. We now have the essential plumbing in place to move climate change from the fringes to the forefront of finance so that every financial decision takes climate change into account. Only this mainstream focus can finance the estimated \$100 trillion of investment needed over the next three decades for a clean energy future".

At Sanlam, we are big fans of context and context is needed for the grandiose statement we see linked to climate action which are typically littered with numbers in the trillions.

\$100 trillion over three decades equates to \$3.3 trillion a year. S&P Global Intelligence forecast global corporate capital expenditure to be around \$3.7 trillion in 2021. So, the investment needed for a clean energy future is equivalent to annual capital expenditure. Every year. For thirty years.

We often get asked how banks fit in our portfolio ([Sanlam Sustainable Global Dividend Strategy < https://www.sanlam.co.uk/our-fund-range/sanlam-sustainable-global-dividend-fund>](https://www.sanlam.co.uk/our-fund-range/sanlam-sustainable-global-dividend-fund)). This is because many find it difficult to see what role they can play in climate change. Surely bank executives are driven by the profit motive not carbon reduction? But, given the huge investment needed in the transition to net zero it is clear banks will play a pivotal role in providing this capital.

We own JPMorgan who has just joined the Net-Zero Banking Alliance (NZBA), the banking element of GFANZ and the Race to Zero. JPMorgan introduced a methodology called Carbon Compass to create incentives to deliver capital and advice to clients to improve carbon efficiency.

There are four key elements to Carbon Compass:

1. Use science-based targets to align selected portfolios with the Paris Agreement goals.
2. The development of sector-specific metrics focused on activities with material emissions and credible transition pathways.
3. To define which metrics best capture companies' performance and progress towards decarbonization.
4. To make sure that metrics used make use of consistent, well-reported and standardised data.

To begin with, JPMorgan has focused emissions reductions in three key sectors: oil & gas, electric power, and auto manufacturing. Over time these will be expanded. The bank has released data on the Scope 1, 2 and 3 emissions of their portfolio exposure to these sectors and set 2030 portfolio targets for each of them. They intend to align their lending and underwriting decisions in these sectors to work towards achieving these portfolio targets and in so doing support their clients in expanding their investment in low- and zero- carbon energy sources and technologies and reducing their Green House Gas emissions.

The Economist recently highlighted three key issues in the global financials' commitment to a net zero world:

1. Many polluters are state owned companies that do not need private sector banking capital
2. It is very difficult to measure the carbon footprints of a lending portfolio

3. Private financial firms are incentivised to maximise profits not cut carbon.

These are strong arguments but at Sanlam we applaud JPMorgan for their efforts here and believe that perfect should not be the enemy of good when it comes to sustainable lending and underwriting practices.

Fund risks

The Fund has holdings which are denominated in currencies other than sterling and may be affected by movements in exchange rates. Consequently the value of an investment may rise or fall in line with the exchange rates. FPR-0025485