Investor expectations on just transition for the banking sector

What is a just transition?

Rapid climate action is required to prevent the worst human and economic costs of climate change and a just transition aims to ensure that decarbonisation is both fast and fair. The social impact of the low carbon transition on workers, communities, customers and supply chains has the power to either accelerate or prevent progress to decarbonise the economy, creating competitive advantages or uncertainty and added costs. Just transition aims to connect climate goals with associated social outcomes and seeks to promote and encourage development of a sustainable economy by mitigating social risks, seeking social opportunities, and focusing on place-based impacts.

How does it impact the banking sector?

Banks have a key role to play in the green transition, both via capital allocation and support for customers to transition. They are better placed than most companies to consider place-based investment at a regional level and have material social risks that require management. Given this, we believe a compelling reason exists for investors to help banks increase their awareness of and approach to a just transition, for the benefit of our holdings and society. We believe banks that integrate just transition into their net zero strategies will be in a better position to manage the transition and benefit from lending, investment and reputational opportunities presented. Moreover, just transition is a hallmark of credible climate action, and is becoming a core expectation for various frameworks as shown later.

Risks and opportunities will present themselves in different ways in banks' core business activities, which may include:

- *Corporate banking and project finance*
- *Commercial banking (Small and medium-sized enterprise (SME))*
- *Retail banking*
- *Investment banking*

What do investors expect banks to do?

It is necessary to integrate just transition across products and services and operations. Given the expectation that many banks will follow the Transition Pathway Taskforce's (TPT's) guidance for their transition plans, we have used the TPT Disclosure Framework to break down just transition integration in a way that is consistent with the TPT Bank Sector Guidance. Structured through the three guiding principles of the TPT Disclosure Framework (see Figure 1), our expectations focus on *Action*, but also highlight important considerations of just transition relating to *Ambition* and *Accountability*.

Figure 1: Principles and corresponding disclosure elements adapted from the TPT Disclosure Framework.

Source: TPT Disclosure framework 2023

1. Ambition

We expect banks to either have a standalone just transition plan or explicitly and judiciously incorporate just transition into a wider climate transition plan. Mitigating risks and harnessing the opportunities of a just transition requires articulating what it means for the bank, and it needs to be connected to its profile. This includes the nature of its operations, sectoral and geographical footprint, the client segments served and its overall strategy.

2. Action

To implement just transition, we expect banks to consider their relevant stakeholder groups (customers, workers, communities, and supply chains). We believe that three lenses, namely at product, sector and region level, can help identify areas of implementation. The table below showcases the integration of risks, opportunities and processes which banks could consider when translating just transition ambition into action.

Banks should also conduct inclusive human rights and environmental due diligence, consistent with the UN Guiding Principles for Business and Human Rights (UNGPs), to identify and mitigate potential adverse impacts.

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Products

- **Ensure inclusion and accessibility** are features in new green product development, to enable all customers to participate and benefit from the transition (e.g., home retrofitting loans).
- Develop and implement a **responsible decarbonisation strategy** for existing products and portfolios, such as mortgages, ensuring that decarbonisation is achieved without excluding customers and mitigates 'stranded customer' risk.
- Offer **financial instruments promoting transition** and combined environmental and social impact (e.g., sustainability-linked loans or bonds, where the interest rate or coupon is tied to the borrower's achievement of predetermined environmental and social targets).
- Develop partnerships with public banks and community development finance institutions (CDFIs) or equivalent to support SMEs and microenterprises and **provide blended finance solutions** to support place-based just transition.
- Ensure that corporate and commercial banking products **respect and promote stakeholders' fundamental rights** (e.g., the ILO's Declaration on Fundamental Principles and Rights at Work).

Sectors

- Facilitate investment and leverage lending relationships to support corporates and SMEs in high-emitting sectors **access the capital required** to enable and encourage the just transition to net zero.
- Develop **sector-specific transition roadmaps** for high-emitting sectors where appropriate, encouraging a managed phase-out that ensures worker dialogue, retraining, redeployment, and fair early retirement/redundancy to mitigate 'stranded worker' risk.
- Integrate just transition strategy into **client transition plan assessments**, particularly for high-risk sectors, and include sector specific expectations in client engagement covering workers, customers, communities, and supply chains.
- Enable and encourage companies involved in transition sectors to seek **community benefits** as part of transition plans.
- **Build internal capacity** to engage and advise corporate and SME clients on a sector-specific basis on transition opportunities.

Geographic regions (applying to both national and sub-national regions)

- Integrate just transition into **regional corporate banking decarbonisation strategies** and identify geographic areas with high exposure to transition risk, seeking to mitigate 'stranded community' risk.
- **Use banks' regional reach** to provide strategic advice and guidance through lending relationships to help mitigate place-based risks and seek place-based opportunities (e.g., signpost regional support and incentives available to customers).
- **Establish dialogue and feedback mechanisms** with trade unions, communities, local authorities, NGOs and policymakers that will enable community voices to be heard. Reflect outputs in bank decarbonisation strategy and develop **partnerships** to advocate for just transition policies at local, national and international levels.
- **Recognise global disparities between developed and emerging markets** in client transition plan expectations and assessments, with differentiation in timeframes where appropriate.
- Consider implementing specific **support for retail clients** in regional communities which face asset or industry closure.

3. Accountability

Banks should describe their just transition integration and delivery plans with robust governance and reporting on progress. Integrating just transition into governance mechanisms encourages consideration in internal decision making. By making a high-level commitment and assigning clear roles and responsibilities, the necessary environment for execution and accountability can be fostered.

Metrics and targets are an important way for banks to internally assess progress and outcomes and learn and adapt. They also enable investors to monitor the progress and success of banks' integration of social considerations. Metrics are commonly split into process and outcomes metrics, with several examples of metrics below:

Process metrics

- How many of the bank's staff have received training on just transition?
- How many SMEs has the bank provided climate transition advice to?

Outcomes metrics

- How many corporate clients have published transition plans with just transition factors incorporated and/or a standalone just transition plans?
- How many corporate clients are monitoring just transition metrics?
- What percentage of retrofit loans resulted in an improved SAP rating for low-income households?

For further guidance, the TPT's Just Transition Working Group advisory paper provides general industry examples, and the ILO and UNEP FI Just Transition Finance Pathways for Banking and Insurance provides sector-specific examples.

Helpful resources

These investor expectations have been created with the use of detailed resources, which are listed below for further reading and help.

- ILO and UNEP FI Just Transition Finance Pathways for Banking and Insurance
- TPT Banks Sector Guidance
- LSE and ILO report
- TPT Just Transition Working Group advisory paper
- IIGCC and TPI Net Zero Standard for Banks