UNIVERSITY OF CAMBRIDGE
INSTITUTE FOR SUSTAINABILITY LEADERSHIP

Banking Environment Initiative

Case Study

BNP Paribas and right. based on science

Developing climate-related financial covenants with clients

The University of Cambridge Institute for Sustainability Leadership

The University of Cambridge Institute for Sustainability Leadership (CISL) is a globally influential Institute developing leadership and solutions for a sustainable economy. We believe the economy can be 'rewired', through focused collaboration between business, government and finance institutions, to deliver positive outcomes for people and environment. For over three decades we have built the leadership capacity and capabilities of individuals and organisations, and created industry-leading collaborations, to catalyse change and accelerate the path to a sustainable economy. Our interdisciplinary research engagement builds the evidence base for practical action.

The Banking Environment Initiative (BEI)

The Banking Environment Initiative (BEI) is a group of global banks committed to pioneering actionable pathways towards a sustainable economy. The BEI co-produces horizon scanning applied research, develops leadership tools and convenes academic and industry collaborations. It is a member-led, not-for-profit group convened by CISL and initiated in 2010 with the support of The Prince of Wales.

Authors

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This case study by the University of Cambridge Institute for Sustainability Leadership (CISL) focuses on how bank relationship managers can support clients on their net zero carbon transition.

To demonstrate the Design phase of the Guide for Bank-Client Engagement, this case study draws on insights from BNP Paribas' experiences during a previous case study led by the German model and software developer, right. based on science.

A. Situation

An aviation company ("Company") is considering an investment in a power-to-liquid synthetic fuel plant, for which it requires external funding.

BNP Paribas ("Bank") is looking to provide "green" loans based on transparent and tangible Temperature Alignment criteria[1] and has partnered with right. based on science ("right."), a German provider of climate metrics and software, for a joint case study ("right. case study") on "<2°C-aligned investments".

right.'s calculation of the Company's contribution to global warming, which considers various business scenarios, is the bridge between both parties, Bank and Company.

B. Bank relationship managers' client engagement approach

The Bank starts a strategic dialogue with the Company to understand their level of ambition in terms of sustainability (risks and opportunities, target-settings, etc.) and other key elements of the project. This is in order to then link the Company sustainability strategy and project with appropriate sustainable finance solutions.

The Bank's relationship manager ignites this strategic dialogue and manages it end-to-end. Steps include:

- Understanding potential sustainability impacts of the company project/ transition plan, also involving colleagues from the bank's sustainability expert team;
- Talking not only with the usual company point-of-contact (e.g. CFO) but also involving other relevant company executives (e.g. head of sustainability, COO);
- Introducing third-party experts (e.g. right. based on science) and their respective methodologies to the client;
- Involving the bank sustainable finance products team to set-up a customised financial product (i.e. transition bond), where company-specific science-based KPIs can be implemented as "climate-relevant covenants".

[1] Temperature Alignment is the concept of calculating the compatibility of investments and economic activities with a certain temperature or global warming scenario. The term is used by Bank of England: "Discussion Paper, The 2021 biennial exploratory scenario on the financial risks from climate change, December 2019".

In this type of client engagement, the banking relationship manager collaborates with:

- Bank's sustainability expert team, who dive deep into the client's transition plan, during specific meetings with company executives together with the relationship manager, and shape customised sustainable finance solutions grounded in science-based models and measurable outcomes;
- Third-party expert (e.g. right. based on science), which supports the Company to calculate its Temperature Alignment under different business scenarios, using the science-based X-Degree Compatibility (XDC) Model.

In this context, the Company (client) has an active role to define and share its sustainability strategy, engage the third-party expert, provide input data such as its Gross Value Added (i.e. EBITDA, personnel costs) and its carbon footprint (CO2e emissions - Scopes 1, 2, 3). Then, the Company reviews and understands its current and future carbon footprint together with the third-party expert.

C. Quantifying the Company's Temperature Alignment

The Bank can evaluate the Company's transition plan based on a Temperature Alignment analysis using the XDC Model.

The XDC Model calculates the climate change contributions of a company, portfolio, or any other economic entity, answering the question: How much global warming could we expect, if the entire world operated at the same Economic Emission Intensity as the entity in question? Results are expressed in a tangible degree Celsius (°C) number: the X-Degree Compatibility. This science-based temperature alignment metric offers increased transparency to companies, banks, investors, and the public on climate risks and opportunities.

The XDC Model's calculation process is illustrated in Fig. 1.

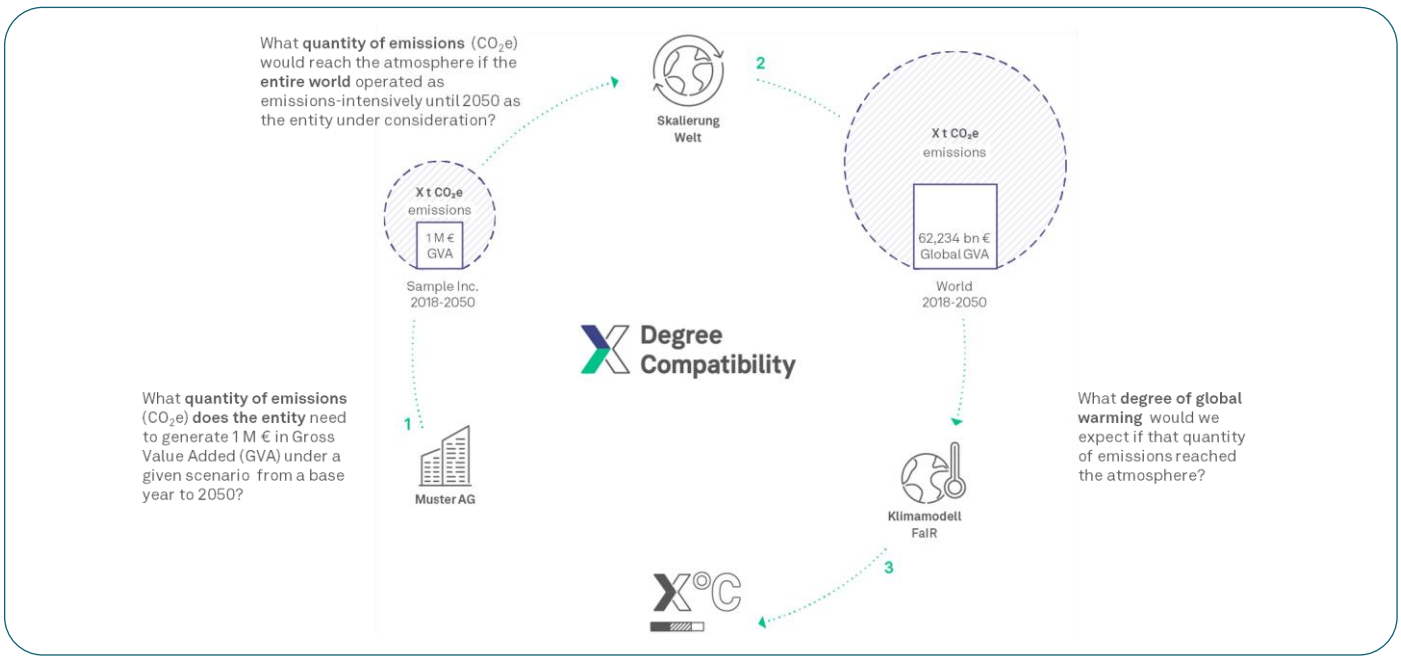

Fig. 1 - The XDC Model calculation process

For the right. case study with the aviation Company, three XDC metrics were calculated:

- The Baseline XDC, which expresses the degree of expected global warming if the entire world were to operate at the same Economic Emission Intensity as the Transport Company from the base year until 2050 under baseline assumptions;
- The Target XDC, which is defined as the sector-specific benchmark or temperature threshold which all companies from the Transport Company's sector must align with, in order to be compatible with a given global warming scenario (e.g. max. 1.75°C or 2°C);
- A Scenario XDC, which represents the degree of expected global warming if the entire world were to operate at the same Economic Emission Intensity as the company in question under a chosen scenario, e.g. fulfilment of certain emission reduction targets. For the right. case study's XDC analysis, right. considered the scenario in which the Transport Company invests in the construction of a synthetic fuel plant.

The relevant indicator for the Bank is the difference between the Transport Company's Scenario XDC and Target XDC – the so-called XDC Gap. An XDC Gap of 0 or less indicates that the Transport Company's strategy to build a synthetic fuel plant is aligned with its target temperature, while an XDC Gap of above 0 indicates non-alignment.

D. Key Learnings

For bank-client engagements focused on accelerating companies' net zero carbon transition, key takeaways for banks and their client-facing teams from this CISL case study are:

- Invite and encourage client companies to develop transition plans with science-based models and set measurable targets that banks can rely on (no black boxes), in order to implement "climate-relevant covenants";
- Create a shared vision with clients and third-party experts in order to co-develop customised solutions (ref. Bank 2030: Accelerating the transition to a low carbon economy (CISL, 2020)), with the support of science-based methods and tools such as XDC Model, Transition Pathways Initiative, Net Zero Climate Tools and Project Drawdown.
- Strengthen and keep updated knowledge of sustainability topics (e.g. climate change, ESG, etc.) and correspondent dependencies and impacts on their clients, in order to have specific dialogues with clients;
- Involve bank's sustainability expert team to have a deep-dive dialogue with clients and to set-up innovative sustainable finance products.

"Participation in the case study of right. has provided interesting insights into the thinking and working methods of the participating actors and has shown what potential the XDC Model offers for the individual stakeholders. In particular, individual KPIs can be derived for companies, which can be implemented as "climate-relevant covenants" in sustainable finance products. The transformation path of companies can thus be financed in a targeted manner."

Frank Sibert, Head of Sustainable Advisory & Finance, BNP Paribas Germany

For more, see CISL's *Let's Discuss Climate: The essential guide to bank-client engagement*