

**Preliminary recommendations
from the Scientific and Expert committee**



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Policy statement

The Scientific and Expert Committee welcomes the creation of the Sustainable Finance Observatory, an initiative that will be even more useful as it will respect five main principles that are found in many of our recommendations:

- Transparency
- Readability
- Consistency
- Reliability
- Relevance

These five main principles must be the pillars of each indicator published in the Sustainable Finance Observatory.

Recommendations on the "coal" scope

Introduction:

The Scientific and Expert Committee considers necessary to compensate the initial lack of framework of the Financial Center commitment of July 2019, addressing the publication of sectoral policies relating to coal. This absence of clear direction has led to the emergence of differentiated strategies by market players in the Paris Financial Center, both in their levels of ambition and in view of their technical characteristics. In this context, and given the request from the Minister of the Economy, Finance and Recovery announced on October 29 2020 for a **common basis of commitment shared by all**, the Scientific and Expert Committee recalls the following elements:

- Coal combustion, especially in the energy sector, remains the main source of greenhouse gases (GHGs) and is responsible for around a third of the increase in global average temperature since the pre-industrial eraⁱ. However, climate change mitigation scenarios must imperatively be associated with a reduction in revenues from coal, oil and gas: all the scenarios – including those published by the IPCC and the IEA – thus retain the exit of coal as an obligation to be met in order to limit warming below 1.5° C by 2100ⁱⁱ. This requirement was reiterated by a recent publication in the journal Natureⁱⁱⁱ: past GHG emissions will inevitably lead to a temperature increase of 2.3° C by 2100, except in the event of a rapid end of financing of electricity and heat production capacity from coal. What is more, the magnitude of the decrease in funding to be sought by 2030 must correspond, as provided by the commitment of July 2019, to a total exit of coal by 2030 in the countries of the European Union and of the OECD and in the rest of the world by 2040.
- In this context, the Scientific and Expert Committee recalls that an irreproachable conduct of the Paris Financial Center is necessary on the financing/investment/insurance (hereinafter "support") of coal^{iv}. A financial center aligned with the Paris Agreement must inevitably end the financing of coal to help achieve this objective: it is an issue of **scientific credibility and integrity**.

Following an approach based on the methodological principles of comparability, reproducibility, exhaustiveness and reliability, the Scientific and Expert Committee recommends the following elements to professional federations within the framework of the publication of harmonized data relating to the release of coal^v (which it will ensure to specify, particularly on the methodological level, in its exchanges with the federations):

Recommendation n°1: The Scientific and Expert Committee recommends that coal policies cover all the activities of market players, without distinction.

- The policies must explicitly cover all the activities of the groups concerned, whether it involves dedicated financing (project financing, buyer loans, consultancy mandates, etc.) or not ("general purpose"), investments in equities/bonds, structuring of bond or equity issues, advice, interest rate and foreign exchange products, active and passive asset management, property insurance or other activities (leasing, factoring, rental of various equipment, etc.) without distinction.
- The scope of activities covered by current sectoral policies suffers from significant heterogeneity, undermining the very credibility of the latter. It is important to compensate for the span of the existing exemptions in the application of these policies to certain services, strategies or clients or, otherwise, to make them explicit.
- Furthermore, the Scientific and Expert Committee emphasizes a **holistic coverage representative of the group's activity and business model** (and of the assets under management in the case of portfolio management companies), covering the financing and refinancing (dedicated or not), management for own account, investments, equity investments, ancillary services (advice, trading, hedging products, leasing, factoring, etc.), the entire scope of management on behalf of third parties (collective and individualized under mandate) and for all assets (managed actively or passively), and the structuring of issues. Any exemption must be justified in the presentation of the data in view of the group's business model.

Recommendation n°2: The Scientific and Expert Committee explicitly recommends specifying the policy's scope of application, which must systematically cover the main elements of the thermal coal value chain, including development projects. Any exemption must be accompanied by an associated justification.

- A credible sectoral policy must cover the upstream supply of electricity or heat from coal (i.e. exploration and production, all operations leading to the removal of coal from the ground, in particular drilling installations); intermediate activities (i.e. processing and transport) and downstream (i.e. refining, storage, transport and marketing of products).
- It is essential that the policies cover the companies planning/developing mining projects, power plants and infrastructure development projects linked to the thermal coal value chain. Policies should also cover companies purchasing existing assets, with no associated closure commitments in the European Union and OECD countries by 2030 and in the rest of the world by 2040.
- The perimeter must also include services related to the construction of power plants (e.g. engineering; building and public works services, etc.) and insurance and financing organizations for such installations.

Recommendation n°3: The Scientific and Expert Committee recommends that the procedures for applying the policies be specified, especially regarding the database used and the level of application concerning subsidiaries and groups.

- The inclusion of the entire perimeter of the enterprise concerned appears as well necessary (i.e. conglomerates and diversified groups). It is fundamental to apply the policies in such a way as to cover the different subsidiaries/groups involved in the coal sector by their activities, their decision-making activity and their function in raising capital linked to coal activities.
- Details must be provided on the database used, and precise explanations must be included in the case of restatement of information.

Recommendation n°4: The Scientific and Expert Committee recommends that, on the basis of definitions and shared metrics, the exclusion thresholds in absolute value be published, and that a justification reinforces, if necessary, the publication of relative thresholds. Details must be provided on the database used.

- The criteria and thresholds retained by the sector policies must be based on clear definitions (i.e. made explicit within the policies) and shared (via a common glossary accessible) on the Financial Center, distinguishing the criteria according to the actors of the value chain concerned.
- The choice of relative thresholds (e.g. weight of thermal coal in turnover; production of electricity from coal) must be justified given the existing lack of comparability.

Recommendation n°5: The Scientific and Expert Committee recommends that the exit plans required from companies (clients, investors, etc.) include with the greatest precision the following key elements: date of entry into application of each criterion; timing and exit scenario required by asset type; conversion, closure or sale/disposal for each asset^{vi}; deadlines for producing an exit plan and consequences of failure, if applicable; social support modalities or not. For assets for which a sale/disposal is planned instead of a closure, the future of the asset must be described, accompanied by information justifying the situation on the principle of "report or explain".

- Regarding the aforementioned mitigation scenarios, the players must adopt an exit schedule (overall with regard to the financial player and its clients, securities held, partners) in line with the mitigation objectives of climate change, according to the geographical areas concerned, in line with the recommendations of Climate Analytics^{vii}.

Recommendation n°6: The Scientific and Expert Committee recommends that federations collectively publish, based on the NACE and ISIN codes, the exhibitions of their members on entities operating thermal power stations, functioning totally or partially thanks to the combustion of coal, insofar as the latter represent a significant portion of greenhouse gas (GHG) emissions linked to human activity.

Recommendation n°7: The Scientific and Expert Committee recommends that federations collectively publish the carbon footprint of said exposures in the financing, investment and insurance portfolios of their members, using a reproducible, exhaustive, comparable and reliable methodology.

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The Scientific and Expert Committee emphasizes that the principle-based approach (comparability, reproducibility, exhaustiveness and reliability) can be more widely applied to all sectoral policies, in particular on unconventional oils and gases (e.g. chains of shale gas and oil values, tar sands, extra heavy oil, deep water and arctic oil and gas drilling as defined by the Arctic Council's *Arctic Monitoring and Assessment Program* (AMAP)), on which the Scientific and Expert Committee will publish recommendations in the coming months.

Recommendations on the "climate indicators" scope

Introduction

The Scientific and Expert Committee based its reflections on the declaration of July 2, 2019 by market players, which announced the "creation of an observatory of the achievements and actions of players in the Paris financial center in terms of green and sustainable finance ... A privileged tool to demonstrate the **progressive greening** of the Paris financial center to stakeholders, in particular through **appropriate indicators**".

The commitment of July 2, 2019 thus specifies that it must inform about achievements in green and sustainable finance and bear witness to the gradual greening of the Paris financial center. Therefore, it follows that the Observatory must adopt a double focal length:

- "Green finance" or more exactly finance favorable to the financing of the transition to a low carbon economy; and
 - Sustainable finance, more broadly, integrating criteria E, S and G.

Furthermore, "witnessing the gradual greening" requires putting in place indicators to measure this gradual transformation of the activity of all financial activities. Concretely, these indicators should make it possible to monitor the progress made in relation to the **three challenges** for financial players set out in the declaration of July 2, 2019:

- Increase support for businesses and individuals towards a low-carbon model;
- Increase the mobilization of capital in favor of the low-carbon transition; and
- Continue the effort to reduce funding for activities that are most harmful to the climate

Recommendation n°8: The Scientific and Expert Committee recommends that federations collectively publish, based on NACE codes, the exposures of their members at least in the five sectors with high greenhouse gas emissions: fossil fuels, steel and cement, housing, transport and electricity production which, according to the European Systemic Risk Board (ESRB), represent a significant portion of financing, investment and insurance portfolios.

- The publications concern at least the five largest sectors and, if possible, other highly emitting sectors (heavy industries, agriculture)

Recommendation n°9: In addition to the evaluations carried out with a bottom-up method, and to put their results into perspective, the Scientific and Expert Committee recommends that federations collectively publish the carbon footprint of the financing and investment portfolios of their members by using a top-down analysis methodology (for example, the PgXCA methodology developed by the Finance and Sustainable Development Chair of Paris Dauphine University, or a variant of the "*Climate Policy Relevant Sectors*" published by Battiston et al. 2017).

Recommendation n°10: The Scientific and Expert Committee supports the regulatory work in progress relating to the implementation of the European Taxonomy. Therefore, the Committee recommends using the European taxonomy to define the share of activities constituting the financing and investment portfolios that have a significant contribution to climate mitigation and adaptation.

Recommendation n°11: Concerning the commitments and achievements in favor of green and sustainable finance made by the actors of the Paris financial center, the Scientific and Expert Committee recommends that the information communicated be in line with the modalities in terms of extra-financial reporting resulting from article L. 533-22-1 of the Monetary and Financial Code (scope, governance, commitment, etc.).

Recommendation n°12: The Scientific and Expert Committee recommends that federations aiming to provide information on green bonds or green investments specify the definitions used and distinguish the share held in the portfolio from the structured share.

Recommendation n°13: The Scientific and Expert Committee recommends that the data on "green" products be systematically put into perspective with data on the total amount of products of the same nature (for example, "green" loans to companies and total business loans or financing for the purchase of electric vehicles and total financing for the purchase of vehicles).

It also recommends the enrichment of certain indicators:

- For each financial institution, there should be a clear definition of what is considered a green or sustainable investment. For this, in line with a harmonization goal, the Committee recommends referring to the European Taxonomy.
- A distinction should be made between data relating to "green" products versus data relating to "sustainable" products.
- When information is provided on "green" products offered to customers, it is also necessary to give the outstanding amounts of products actually distributed, which alone make it possible to judge the real scope of these proposals.

For information, the Scientific and Expert Committee will soon issue recommendations concerning the relevance of using an alignment calculation methodology.

Recommendation n°14: The Scientific and Expert Committee recommends that the terms used by the different sectors of activity to designate the indicators always have the same definition and that the definitions designate the same products, described in an easily accessible glossary on the Observatory.

Recommendation n°15: The Scientific and Expert Committee recommends that the graphs referring to the same indicators be presented in a uniform manner in the different sectors of activity.

Recommendation n°16: The Scientific and Expert Committee recommends that the Sustainable Finance Observatory collect data from the real estate sector to monitor the low-carbon transition in this sector.

Committee composition

The Committee consists of a chairman, a secretary and several colleges: two NGO members, four academic members, two representatives from public authorities and two experts with knowledge of banking and investment.

The members are appointed by the ClimAct Finance Steering Committee 'intuitu personæ'. They therefore speak on their own account and not on behalf of their institutions, exception made for the representatives of the Treasury Directorate and Ministry for the Ecological Transition, although they bring to bear the expertise and knowledge of their respective organisations. They may also act as rapporteurs and communicate internally within the institutions they belong to.

The secretary of the Scientific and Expert Committee assists the Chairman and ensures the smooth running of the Committee.

President: Pierre-Louis is a mathematician and winner of the prestigious Fields Medal. He is a professor at the Collège de France and Chairman of the Scientific Committee of the Institut Louis Bachelier and its "Green & Sustainable Finance" programme

Secretary: Stéphane Voisin

College of NGOs

Lucie Pinson

Michel Cardona

Academic College :

Anna Creti

Delphine Lautier

Augustin Landier

Peter Tankov

Emmanuel Hache

College of Experts:

Jérôme Courcier

Carlouie Delerable

College of Public Authorities

Elise Calais - MTE

Charlottes Gardes – Treasury Directorate General

i Source: IEA, Global Energy and CO2 Status Report, March 2019. According to IEA analysis on the impact of the use of fossil fuels on the increase in global temperature, the CO2 emitted by the combustion of coal is responsible for more than 0.3 °C of the total 1°C increase in annual average earth surface temperatures over pre-industrial levels - making coal the main source of global temperature increases. Coal-fired power plants were thus the main contributor to the growth in emissions observed in 2018, with an increase of 2.9% (or 280 Mt) compared to 2017 levels, exceeding 10 Gt for the first time. Coal-fired electricity production thus represented 30% of global CO2 emissions in 2018. The majority of this production is now found in Asia, where medium-sized power stations are around twelve years old, which is still several decades shorter than their average economic lifespan of around 40 years.

ii IPCC, 2014: Summary for Policymakers. In: Climate Change 2014: Mitigation of Climate Change. Contribution of Working Group III to the Fifth Assessment Report of the Intergovernmental Panel on Climate Change [Edenhofer, O., R and al.]. According to the most recent version of the IEA's SDS scenario (World Energy Outlook 2018), energy-related CO2 emissions are expected to fall by 3.1 Gt by 2025 with respect to 2017 levels, and the entire effort will be done by reducing coal-related emissions (emissions are slightly higher for natural gas in 2025 than in 2017 and slightly lower for oil). In addition, almost all of the reduction in coal-related emissions - 2.83 Gt out of 3.1 Gt in total, or 93% - will need to be provided by power producers. Within its special 1.5°C report, the IPCC deploys modeled trajectories of the various mitigation strategies: all trajectories foresee the elimination of carbon dioxide, with a variable quantity depending on the trajectories, as well as relative contributions of bioenergy (with use of CCS / CCU technologies) and removals in forestry and agriculture. In scenario P1 (i.e. without overrun or with minimal overshoot, without recourse to CCS / CCU technologies and rapid decarbonization of the energy supplied), the IPCC forecasts a reduction in primary energy from coal in 2030 (compared to 2010) of 78% by 2030 and 97% by 2050.

iii Zhou, C., Zelinka, M.D., Dessler, A.E. et al., Greater committed warming after accounting for the pattern pattern effect, Nature Climate Change, 2021, <https://doi.org/10.1038/s41558-020-00955-x>

iv This note mainly concerns thermal coal, but in certain aspects iron and steel coal may be covered by certain recommendations.

v The recommendations cover the supply of electricity and heat from coal (thermal coal value chain), but do not concern the outlets for coal in industry (as provided in the Taxonomy resulting from the regulation EU n°2020/852 of June 18, 2020), in particular the coal coke (called "steelmaking" or "metallurgical"), in particular due to the lack of alternatives to the use of coke for the transformation of molten iron ore and steel as well as the dejection costs involved in the reorientation of steel production from salvaged steels.

vi The sale of assets - especially if it is not accompanied by a closure requirement - has the double problem of (i) the transfer of emissions to another economic actor; and (ii) the lack of listing by buyers, in the majority of cases (i.e. private equity funds, private companies, high net worth individuals), making it difficult to monitor issues and pressure to close (on the part of shareholders, civil society and governments).

vii Source: Climate Analytics, "Global and regional coal phase-out requirements of the Paris Agreement: Insights from the IPCC Special Report on 1.5 °C", September 2019. Whatever the region, the use of coal for the production of electricity must reach its maximum by 2020, and be reduced soon after. In addition, global coal-fired electricity generation is expected to be reduced to 80% below 2010 levels by 2030 and phased out by 2040; and the bulk of reductions in coal consumption in the power sector are due to take place by 2030, when the share of coal in power generation is not expected to exceed 13% in all countries, and around 6% globally. Also, between 2030 and 2040, all regions of the world should gradually abandon coal.