Analysis of Absa's June 2022 coal, oil and gas standards and TCFD report

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1. Introduction

In April 2020, Absa published a Coal Financing Standard,[1] and in April 2021, the bank published its first standalone report on climate risk, which was partially aligned with the recommendations of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD).

In May 2022, more than two years after the publication of its first fossil fuel financing standard, Absa released two additional standards - one relating to its financing of oil and gas, and the other related to its financing of mining. It released an updated Coal Financing Standard and its second TCFD report ("2021 TCFD Report") at the same time.

Given the delays in the release of these standards, Absa had fallen behind its peers in the South African banking market in relation to its position on climate risk and the financing of fossil fuels. Unfortunately, Absa's recently-published policies and disclosures do not take the bank's position on climate change forward in any significant way. Although all South Africa's major banks' fossil fuel policies leave significant room for improvement, Absa's policies demonstrate that it still lags in its understanding of climate risk and the imperative to transition to a low-carbon, resilient, and sustainable economy.

In order to meet the goals of the Paris Agreement, which Absa claims to support, financial institutions must rapidly limit their exposure to fossil fuels and scale up and direct financing towards assets and investments necessary for transitioning to low-carbon, resilient and sustainable economies. Absa's financing standards do not demonstrate sufficient urgency in this regard. In fact, Absa's policies envisage that the bank will continue to fund new coal projects (excluding new coal-fired power plants), and Absa's oil and gas standard is enthusiastic about what it regards as the opportunities presented by Africa's "significant oil and gas reserves".

As one of Africa's largest diversified financial services groups with a presence in 12 African countries, Absa's lending, investing, and other financial intermediary activities will influence the achievement of a just transition on the continent.

Absa's latest standards contain some worrying errors and gaps in its understanding of the core issues and of why it is crucial for financial institutions to have robust policies and stringent exclusions for financing fossil fuels in a world facing an urgent and escalating climate crisis.

[1] Absa refers to policies on fossil fuel financing as "standards"

2. Summary highlights and lowlights of Absa's latest standards and 2021 TCFD report

Highlights

- Some detail of the enhanced due diligence required for certain fossil fuel funding.
- Exclusion of funding for new coal-fired power plants.
- Disclosure of estimated scope 3 financed greenhouse gas (GHG) emissions from the bank's lending to the agriculture and real estate sectors (financed emissions are the emissions that banks and investors finance through their loans and investments – in other words, the emissions associated with the projects and entities to which they lend).

Lowlights

- Enhanced due diligence does not adequately consider climate risk.
- The targets, set out in the TCFD report, for reducing Absa's exposure to climate risk from the fossil fuel sector are not aligned with the goals of the Paris Agreement.
- No targets (Paris-aligned or otherwise) for the reduction of Absa's exposure to climate risk in other sectors (for example agriculture or real estate).
- No engagement with climate science and its implications for funding fossil fuels.
- Reliance on a false dichotomy between climate action and socioeconomic development.
- No exclusions for new coal projects other than new coal-fired power plants.
- No meaningful oil and gas exclusions.

Before addressing some of these points in further detail, some key aspects of the Coal Financing Standard, the Oil and Gas Financing Standard, and the 2021 TCFD report are addressed below.

3. Coal Standard

Reclaim Finance's Coal Policy Tool found that, at the time, Absa's 2020 Coal Standard "left almost everything still to be done", stating that to improve its policy, Absa must "urgently close its loophole at the project level, adopt stringent exclusion thresholds, exclude all coal developers and adopt an overall strategy to fully exit coal at the latest by 2030 in the EU/OECD, and 2040 worldwide."

Unfortunately, the updated Coal Financing Standard still does not rule out financing new coal projects, including coal mining, industrial and metallurgical use of coal, new coal-fired industrial boilers or furnaces, or existing coal-fired electricity generation power plants, despite Absa's recognition that "power generation from coal is the largest source of GHG emissions that lead to global warming" and that it "contributes to significant air pollution, which is particularly evident in South Africa due to its reliance on coal-fired power plants".

The only thing that Absa excludes outright is financing for new coal-fired power generation plants. This is long overdue. In 2018, Nedbank became the first bank to exclude new coal-fired power generation, followed by FirstRand in 2021, and Standard Bank in 2022.

Besides coal-fired power plants, any other new coal projects will instead be subject to Absa's "enhanced due diligence". Such projects include:

- coal used in industrial boilers and furnaces that are coal-fired;

- projects making use of metallurgical coal;
- new greenfield coal mining projects; and
- all expansion for existing facilities and mines.

In addition to the "enhanced due diligence", Absa has retained the requirement from its 2020 Coal Financing Standard for a "climate-related transitional risk review" to be performed for all new coal finance transactions. According to this review, the bank considers, among other things, the impact on water quality, water availability and air pollution, and the direct GHG emissions related to the project in its design, construction, and operation phases.

This is a wholly inadequate assessment of climate risk. In any event, it is inconsistent for Absa to claim to be aligned with the goals of the Paris Agreement while still supporting new coal projects, including new greenfield coal mining projects.

Nedbank and FirstRand are the only two banks that have ruled out financing all new coal-fired power and all new coal mining which, at this stage of the transition, should be a minimum requirement for any financial institution claiming to support climate action.

Absa fails to demonstrate an understanding of the fact that coal is the most carbon-intensive GHG and the single largest contributor to climate change. Climate Analytics' research shows that coal needs to be phased out globally by 2040 to meet the goals of the Paris Agreement. Globally, coal use in electricity generation must fall by 80% below 2010 levels by 2030.[2]

4. Oil and Gas Standard

This is Absa's first policy relating to oil and gas, and its scope covers all products, services and financing of upstream and midstream oil and gas activities. However, it does not extend to consultants and managed services workers, unless seconded to Absa. Also exempt are:

- products and activities of retail downstream oil and gas, including transportation, storage and import/export infrastructures, and services industry; and
- financial advisory and mergers and acquisitions in relation to exploration assets/reserves and related activities.

In the oil and gas standard, Absa is enthusiastic about what it regards as the opportunities presented by Africa's "significant oil and gas reserves", emphasising the so-called strategic importance of oil and gas for economic growth in Africa, and for itself as a pan-African bank. It does so without a single reference to the significant contribution of fossil gas to global emissions, or to the associated risks of developing economies based on gas, despite scientists and many world-leaders' clear statements on the need to rapidly transition away from fossil fuels.

Absa has based its approach to oil and gas purely on what it sees as "continued demand for natural gas and oil". In this way, it has failed to show climate leadership.

[2] https://climateanalytics.org/briefings/coal-phase-out/

The standard **has no relevant exclusions** when it comes to potential services and financing of oil and gas. The only exclusions relate to:

- the development, extraction or associated activities of tar oil/sands, Arctic oil and gas and Amazon forests (which are immaterial to the regions in which Absa operates), uncontrolled/unrestricted flaring of gas, or where human settlement is not appropriately managed; and
- greenfields exploration where repayment is based on cashflows from the exploration assets. For upstream oil and gas, Absa may provide general corporate services, even where the proceeds may potentially be applied to exploration activities, provided that the primary source for repayment of the facilities is from existing or developed fields.

This second restriction is to account for commercial risk but has nothing to do with the additional climate risks and/or impacts of new oil and gas projects on global emissions.

In other words, Absa will include advisory services, products and funding in its oil and gas portfolio, provided that the activity meets certain restrictions, which primarily refer to compliance with various applicable internal and external standards, regulations and laws. In addition, such activities must (among other things):

- *meet Absa's lending requirements and environmental and social due diligence process;*
- *have appropriate Environmental, Social and Governance policies in place;*
- *develop projects and manage operations in accordance with the National Development Commitment* [sic] *plans of countries to the Paris Agreement;*[3]
- *have formal commitments in place to monitor and minimise GHG emissions from upstream and midstream activities with target dates; and*
- *commit to zero-routine production flaring for new assets and have a due date plan to implement alternative solutions to flaring for existing assets*.

It is notable that Absa requires a commitment from its oil and gas clients to minimise GHG emissions from upstream and midstream activities, with target dates. However, the standard needs to include much clearer parameters on what it considers to be adequate GHG emission reduction targets and deadlines. Such deadlines and targets should be Paris-aligned.

Finally, Absa declares that it will manage its oil and gas portfolio by striving to have a diversified portfolio of energy financing within the bank's existing risk parameters: environmental, regulatory, operational and maintenance, and reputational. It will also subject upstream and midstream operations to its enhanced due diligence which, as is addressed below, does not include any stringent climate parameters.

[3] By which we assume Absa intended to refer to countries' Nationally Determined Contributions in terms of article 4, paragraph 2 of the Paris Agreement.

5. 2021 TCFD Report

Overall, while Absa has increased its compliance with the TCFD's detailed guidance since its last TCFD report, there are many recommended elements of reporting which are still missing from the bank's TCFD report. Absa has mostly taken the approach of providing more detail for the guidance points with which it already complied, rather than substantively increasing the number of guidance points with which it attempts to comply.

For instance, the bank still has not provided any information on whether and how climate-related performance metrics might be incorporated into remuneration policies, not going much beyond stating that "non-financial" metrics are part of management's short- and long-term incentives. The bank has also still not disclosed its internal carbon price.

Importantly, however, the bank has taken a first step towards disclosing its scope 3 financed GHG emissions from its lending using the Partnership for Carbon Accounting Financials (PCAF) methodology. Absa has estimated emissions for its agriculture loans and real estate finance, including residential mortgages and commercial property finance (real estate represents 35% of its total group loans, its largest book, while agriculture represents 5%).[4]

While it is important and positive that Absa has disclosed the emissions for its agriculture and real estate finance, it is an odd omission, considering how large a proportion of the bank's total loans these sectors represent, that Absa does not set any accompanying targets or strategy for reducing these emissions, nor does it mention any plan to do so.

As discussed below, the bank does, in its 2021 TCFD report, set (inadequate) targets for reducing its exposure to the fossil fuel sector, but does not attempt to estimate the financed emissions for this sector.

6. Enhanced due diligence

Absa refers to an "enhanced due diligence" process for financing certain carbon-intensive projects and activities. Financing policies often do not specify what is envisaged by this, so the standards are helpful in that they set out what constitutes enhanced due diligence. In Absa's case, this mostly relates to compliance with various international standards and practices, including the Equator Principles and the World Bank's Environmental Health and Safety Guidelines, and Absa's internal frameworks, including its Group Environmental and Social Management System.

Somewhat confusingly, Absa also refers to alignment with a country's NDP (National Development Plan) and contributing to the goals of the Paris Agreement under sections dealing with enhanced due diligence, but fails to make clear whether or how these are fed into its due diligence process. Presumably the bank instead intends to refer to a country's NDC (nationally-determined contribution), in terms of the Paris Agreement. In addition, the bank commits to reporting according to the recommendations of the TCFD but, again, it is unclear whether it requires this of the projects or entities that it is financing, as part of its due diligence, or whether these are only its own commitments.

[4] 2021 TCFD Report p. 15.

The standards provide no detail regarding the procedures to be followed should the enhanced due diligence process raise red flags.

Although knowing what Absa regards as constituting enhanced due diligence is helpful, Absa's enhanced due diligence does not take special account of climate risk, except for the requirement that a "climate-related transitional risk review" be performed for all new coal finance transactions". This review includes, *inter alia*, consideration of the "direct GHG emissions related to the project in its design, construction and operation phases when considering alternatives available for fuel or energy sources".

The enhanced due diligence process for "upstream and midstream" oil and gas projects (and for all products and activities of mining, metals, minerals and precious/semi-precious stones) merely evaluates whether the project under consideration violates broad international standards, and appears to apply the bank's existing risk assessment structures which consider the commercial viability of the activity.

7. No Paris-aligned fossil fuel sector targets

Absa's financing standards do not mention fossil fuel financing reduction targets, but some targets appear in the TCFD report.

In the 2021 TCFD report, the bank has set targets for its exposure to the fossil fuel sector as a percent of total group loans over the short-, medium- and long-term. However, no targets for fossil fuel sector emissions reductions have been set that would credibly place the bank on a Paris Agreement-aligned pathway.[5]

The additional detail provided in Absa's TCFD report does not make up for the lack of meaningful targets or strategy in Absa's standards. A fossil fuel policy is there to establish an organisation's overarching strategic direction and to inform decision-making across the business. The recommendations of the TCFD, on the other hand, provide a framework for reporting progress against targets and strategies. A bank's funding policies, therefore, need to contain substantial targets and strategies aligned with the Paris goals. Having targets only in the TCFD report makes it difficult to monitor and hold Absa accountable for its progress in reducing its exposure to fossil fuels. It is not clear why Absa has not, at the very least, included the same targets in its standards as in its TCFD report.

In the 2021 TCFD report (but, not in its fossil fuel standards), Absa states that it has set an "ambitious" group net-zero carbon emission target by 2050 to mitigate climate change. In the first place, it is hard to establish on what grounds the bank considers this "ambitious", given that net-zero by 2050 is the very minimum long-term commitment required to comply with the Paris Agreement goal (with which the bank states that its strategy is aligned) of keeping warming well below 2 degrees Celsius (°C) (and preferably below 1.5°C) above pre-industrial levels.

[5] The bank does, in its 2021 TCFD Report, disclose its scope 3 financed GHG emissions for the agriculture and real estate sectors, but also does not set any targets (Paris-aligned or otherwise) for reducing exposure to climate risk via these financed emissions.

Secondly, beyond a minimum long-term ambition of at least net-zero emissions by 2050 to guide decision-making, meaningful interim targets for achieving the long-term ambition across scope 1, 2 and 3 emissions are required. For a bank, targets are particularly important for scope 3 (financed emissions) reductions, given that these account for most of a financial institutions' emissions.

There are no targets for absolute emission reductions in the bank's financed emissions.[6]

The 2021 TCFD report's financing targets for the oil[7] and coal[8] sectors purport to reduce the bank's exposure progressively from 2024 (oil) and 2025 (coal) onwards - although expressed as a reducing percentage of group loans, rather than aimed at reducing absolute emissions. However, Absa not only plans to increase its exposure to fossil fuels, it also still envisages funding these sectors up to and including 2050. For the gas sector,[9] the bank's position is even weaker, with gas financing increasing until 2030 and only declining thereafter - but still not to zero by 2050.

While the intention to decrease exposure to the fossil fuel sectors over time is important, the bank needs to target 0% of its lending for all fossil fuels as soon as possible, and at least on a timeline compatible with the Paris Agreement goals.

8. Failure to understand climate science, and reliance on a false dichotomy between climate action and socio-economic development

In August 2021, the United Nations' Intergovernmental Panel on Climate Change (IPCC) published the first part of its sixth assessment report, summarising the "physical science basis" for climate change. Relying on more than 14,000 peer-reviewed studies, the IPCC report provides new estimates of the chances of crossing the global warming level of 1.5°C ("more likely than not" by 2040, even in low emission scenarios), and finds that unless there are immediate, rapid and large-scale reductions in GHGs, even limiting warming to 2°C will be beyond reach.

The IPPC re-emphasises the findings of its "2018 Special Report on Global Warming of 1.5°C": that GHGs must be reduced by almost half by 2030 to avoid the most severe impacts of climate change.

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6 Financed emissions are the emissions that banks and investors finance through their loans and investments – in other words, the GHG emissions associated with the projects and entities to which they lend. Absolute emission reduction targets are targets which reduce the physical amount of GHGs emitted into the atmosphere over time. By contrast, emissions intensity targets measure emissions relative to something else.

7 Absa's total exposure to the oil sector (including limits) "is expected to peak at 1.41% of our overall group loans in 2023. Thereafter, we target a significant reduction to 0.46% of total group loans in 2030, 0.22% in 2040 and 0.04% in 2050. Assuming 70% utilisation, we expect our oil sector loans to reduce significantly to 0.32%, 0.15% and 0.03% of total group loans in 2030, 2040 and 2050 respectively. We have also set an internal cap on our total oil and gas financing" (2021 TCFD report p. 16).

8 Absa's total exposure to the coal sector (including limits) "is expected to increase to 0.20% of our total group loans in 2022 (still well below 2020 levels), before reducing to 0.16% in 2025, 0.11% in 2030, 0.06% in 2040 and 0.03% in 2050. Assuming 70% utilisation, we expect our coal sector loans to reduce to 0.11%, 0.08%, 0.04% and 0.02% of our total loans in 2025, 2030, 2040 and 2050 respectively. Note that these targets exclude loans to Eskom. We have set an internal cap on coal sector financing" (2021 TCFD report p. 16).

9 Absa's gas sector loans "are expected to exceed oil by 2027. We expect our total exposure to the gas sector (including limits) to increase from 2021's 0.51% to peak at 0.83% in 2030. Thereafter, we target a material reduction to 0.52% in 2040 and 0.32% by 2050. Assuming 70% utilisation, we expect our gas loans to increase materially (off a very low base) to 0.58% in 2030, before falling to 0.37% and 0.22% respectively in 2040 and 2050" (2021 TCFD report p. 16).

Africa is particularly vulnerable to the physical impacts of climate change and many African countries are also vulnerable to transitional risks and have low capacity to adapt to the impacts of a changing climate.

Absa's standards do not reveal any understanding of or engagement with climate science or the urgency of taking climate action. Instead, the standards emphasise the alleged importance of coal and gas to Africa's energy future, emphasising the need to "balance" climate considerations with Africa's development needs. Absa has not engaged at all with the overwhelming scientific consensus that action taken this decade will determine whether or not we are able to achieve the goals of the Paris Agreement – and limit the worst impacts of the climate crisis.

Absa also does not appear to have considered the growing body of evidence that developing fossil fuels – particularly oil and gas assets – is neither necessary nor desirable for Africa to improve its energy security, create jobs, or alleviate poverty.[10] The bank also fails to consider the long history of the failure of fossil fuels to bring economic prosperity to Africa, and ignores the significant time and cost implications of developing new fossil fuel reserves, all of which can be avoided with the mass deployment of renewable energy.

It is not controversial that rapid, extensive scaling up of renewable energy generation is the most cost-optimal energy pathway, presenting significant economic benefits and opportunities for African energy security, given its abundance of solar and wind resources.

The Oil and Gas Standard states that "[a]lthough there is a strong global trend to move away from using fossil fuels in power generation, Africa remains reliant on coal in the short term. Indications are that there will be a continued demand for natural gas and oil and it could become one of the largest growth regions for liquefied natural gas (LNG), because of our vast natural gas resources and this being seen as a transition fuel, growing faster than the rest of the world, especially LNG projects under construction." Absa provides no evidentiary basis for these sweeping claims.

Absa's poor understanding of the landscape of climate action is also illustrated by the fact that the bank's standards misname and confuse key terms and acronyms. For example, it refers to "Nationally Determined Contributions", a requirement under the Paris Agreement, as "National Development Commitments" and at other points appear to confuse South Africa's Nationally Determined Contribution with the "National Development Plan", which is a different policy document altogether.

End

[10] See for example, https://www.iisd.org/publications/report/south-africa-no-need-for-gas; https://www.iisd.org/publications/natural-gas-finance-clean-alternatives-global-south; https://www.tips.org.za/research-archive/sustainable-growth/green-economy-3/itemlist/tag/Renewable%20energy; https://meridianeconomics.co.za/our-publications/hot-air-about-gas-an-economic-analysis-of-the-scope-and-role-for-gas-fired-power-generation-in-south-africa/; http://priceofoil.org/content/uploads/2021/10/Skys-Limit-Africa-Report-2021.pdf; and https://www.banktrack.org/download/locked_out_of_a_just_transition_fossil_fuel_financing_in_africa/07_md_banktrack_fossil_fuels_africa_rpt_hr_1.pdf