2023 | ISSUE 7

THE ONSIDE

ONci's Credit Intelligence Magazine for Commercial Banking Leaders

PATHWAY TO NET ZERO

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Fifth Third Bank: Excelling at Climate Risk Management

Winner of Celent Model Risk Manager 2023 Award for Responding to Emerging Risks

ON Climate has enabled Fifth Third Bank to develop climate scenario analysis capabilities, quantify climate risk in its commercial loan portfolio, support the bank's climate leadership through disclosure, and more - earning the 2023 Celent Model Risk Award.

Read more about the award-winning partnership

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INSIDE THE ONSIDE

RISHI KHOSLA

"OakNorth continues to be defined by one simple goal: to create better outcomes for its customers."

OAKNORTH CONTINUES TO BE DEFINED BY one simple goal: to create better outcomes for its customers. Our laser-focus on this underpins everything we do, including helping our customers to navigate challenges of all sizes and thrive in spite of them – including one of the greatest challenges of our time: the climate crisis.

That is why I'm proud that we published our inaugural TCFD report earlier this year, ahead of any regulatory requirements to do so, taking the opportunity to reaffirm our commitment to net zero.

Our software, ON Climate (part of OakNorth Credit Intelligence) played a crucial role in helping us do this, enabling us to conduct an accurate analysis of climate impact on our entire UK bank portfolio in just one week. This analysis also meant we could set an ambitious target of reducing 60% of the scope 3 financed emissions from our UK bank loan book by 2030, down from a 2022 baseline. We've now embedded climate analysis across our lending lifecycle, integrating conversations on climate strategy with both new and existing customers.

With the help of our Director of Sustainability and ESG Strategy, Matt Bullivant, who is the focus of this issue's cover feature, and through platforms such as the ON Climate Consortium, we are helping to shape industry best practice, and demonstrate that sustainability and growth can go hand in hand.

We are proud to be supporting other leading financial institutions such as PNC and Fifth Third on their climate journeys, and will continue to work with them and others to turn this challenge into a significant opportunity.

We hope you enjoy this latest issue of the ONside and if you have any feedback about our magazine, please email onside@oaknorth.com

ONside@onci.com

SB 253

CALIFORNIA'S LANDMARK CLIMATE BILL & WHAT IT MEANS FOR YOUR BANK

On October 7th, 2023, California Governor, Gavin Newsom, signed the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261). Taken together, these bills will require private and public companies with over $500M in revenue to conduct scenario analysis to assess climate related risk and companies with over $1B to publicly disclose Scope 1-3 carbon emissions data.

This is an important development in that these bills pre-empt SEC (Securities and Exchange Commission) climate disclosure requirements which were expected to apply only to public companies and to exclude Scope 3 emissions. It remains to be seen what impact this will have on federal reporting requirements. These regulations apply to all companies doing business in California, a state that is on track to be the 4th largest global economy (as SB 253 notes in its opening paragraph). As a result, many out-of-state companies with over $500M in revenue and business interests in California will be impacted, regardless of whether the SEC changes its impending disclosure requirements.

The state still has a lot of work to iron out the regulatory details, including oversight bodies, specific reporting requirements, guidance, and frameworks. And Governor Newsom has already alluded to the fact that the bills will see some minor alterations through amendment. However, key elements of the regulations are clear cut, and unlikely to change.

What does this mean for banks

2026

- Report scope 1 and scope 2 emissions
- Report climate risk impact using TCFD / ISSB pillars - which includes the need to run climate scenario analysis

2027

- Report scope 3 emissions (including financed emissions)

How can ONci (OakNorth Credit Intelligence) help?

- **GET ORGANIZED:** Identify scope 3 emission gaps, and track current baseline and future emissions trajectory for your loan book using ONci financed emissions
- **ALIGN INTERNAL STAKEHOLDERS:** Start educating your board and management teams regarding climate-related risks using ONci climate insights
- **PREPARE EXTERNAL REPORTS:** aligned with TCFD / ISSB pillars using ONci climate scenarios covering
- **BUILD A STRATEGY:** Portfolio level climate risk forecasts, transition risk assessment and impact of climate on financials, report financed emissions in line with PCAF, and understand climate risk drivers

PATHWAY TO NET ZERO

How OakNorth leveraged ON Climate to publish its first ever TCFD report and set ambitious net zero targets

THE GROWING NEED TO ADDRESS CLIMATE CHANGE HAS profound implications for businesses across all sectors. As extreme weather events become more frequent and regulations on carbon emissions tighten, companies must adapt to a rapidly changing environment – as must the commercial banks that lend to them. One crucial aspect of this adaptation is finding ways to integrate climate risk mitigation and disclosure into their financial strategies.

Many readers may be aware that the Financial Stability Board created the Task Force on Climate-related Financial Disclosures (TCFD) in 2015 to develop a set of disclosure recommendations for use by companies in providing decision-useful information to investors, lenders, and insurance underwriters about the climate-related financial risks and opportunities that companies face. Since then, a growing number of banks have begun making commitments that align their lending and investment portfolios on pathways to net zero.

OakNorth in the UK is one such bank - it published its first ever TCFD report in August, so we sat down with its Director of Sustainability and ESG Strategy, Matt Bullivant, to discuss the report, and how ON Climate helped it set ambitious targets for net zero.

> The reality is that we were only able to set the ambitious targets we have thanks to the insights we were able to derive from ON Climate.

MATT BULLIVANT, OAKNORTH DIRECTOR OF SUSTAINABILITY AND ESG STRATEGY

Q: Many thanks for taking the time to speak with ONside, Matt. To kick us off, why did OakNorth want to publish a TCFD report?

A: As a neobank that's unconstrained by age and complexity, that's never lent to businesses directly engaged in fossil fuel production, and that has developed technology to support financed emissions reporting, we wanted to demonstrate our leadership and ambition regarding sustainability. So, we decided to publish our first ever TCFD report this year – ahead of any regulatory requirements to do so. We also set a number of punchy targets with regards to net zero, alongside estimates covering our entire Scope 1, 2, and 3 emissions types; something many other banks have only tackled partially to date.

Q: What are the targets OakNorth has set itself?

A: We were able to set ourselves a number of ambitious targets thanks to the data and analytics capabilities provided by ON Climate:

- **Achieve net zero for all Scope 1, 2 and 3 emissions**, including those we finance, by 2035. This is well ahead of the industry (which is typically 2050) and national targets.
- **Reduce 60% of the Scope 3 financed emissions from our loan book by 2030**, down from a 2022 baseline. Most banks are targeting 50% for selective portfolios, rather than their entire financing activity like we are.
- **Achieve net zero for all Scope 1, 2 and 3 emissions of our UK supply chain**, including purchased goods and services, by 2028.
- **Maintain carbon neutrality for Scope 1 and 2 emissions.** In 2019, we became one of the first banks to achieve this by reducing emissions and the use of carbon offset credits, and have maintained this status since.
- **Ensure all new CRE deals have a path to at least an EPC rating of B by 2030**. Today, 83% of OakNorth-funded property investments have an EPC rating of C or above.
- **Support at least 75% of our C&I customers in adopting a net zero target of their own**.

Q: One of the targets you mention is for all new CRE deals to have a path to at least an EPC rating of B by 2030. For those who may not be familiar, what is an EPC rating, and how will OakNorth support its CRE customers in this?

A: An EPC is an Energy Performance Certificate showing how energy-efficient a building is based on a rating from A (very efficient) to G (inefficient). It also provides information on what the EPC rating could be if the owner were to make suggested improvements to its insulation, energy, and heating components. OakNorth can provide the business with the capital needed to fund these improvements or, for a new build, ensure they invest in the right materials and architectural designs to ensure this efficiency from the outset. We're also looking at how borrowers can optimize their energy use and potential retrofit beyond the basic indications on an EPC.

Q: How have your efforts been supported by ON Climate?

A: ON Climate enabled us to conduct an accurate analysis of climate impact on our entire loan portfolio in just one week. This is notable as other banks can typically only do this for a few sectors, as they don't have the data coverage across their book. As it follows the Partnership for Carbon Accounting Financials (PCAF) guidelines and methodology when calculating GHG emissions, we're able to view the total financed emissions in our loan book at both the portfolio and individual borrower level, to PCAF data quality scores 3 and 4. It is also helping us identify transition financing opportunities within our existing loan book, ensuring we can take immediate action by understanding transition drivers and strategies.

The reality is that we were only able to set the ambitious targets we have thanks to the insights we were able to derive from ON Climate.

Q: How are you incorporating sustainability into conversations with borrowers?

A: As a commercial bank, we've embedded climate analysis across our lending lifecycle, integrating conversations on climate strategy with both new and existing borrowers. These happen during onboarding and at regular intervals throughout our relationship with borrowers to help us understand what steps they've taken with regard to decarbonization. For example, we use a borrower questionnaire to integrate conversations on climate strategy and regular questions within our engagement and onboarding processes for both new and existing customers.

By advocating the merits of committing to net zero, and in many cases commercial returns for doing so, we're already beginning to see customers making such commitments or working on their own targets and transition plans, and are supporting them by providing the capital needed for these capex / opex requirements.

Q: Is sustainability something your borrowers are looking at more?

A: We're increasingly financing customers with leading climate and decarbonization strategies. In fact, over 20% of our current loan facilities support businesses that place sustainability at the core of their business model. I'm delighted with the progress we've made in measuring our Scope 3 emissions during the last year, and the conversations we're already starting to have with our customers and suppliers, while providing education, tools, and advocacy on how to reduce climate impact and where we can support and help finance the transition. This may only be the beginning of what we hope to achieve, but our climate related disclosures now form an important milestone in that journey.

Q: How are you sharing best practice with the wider industry?

A: As regular participants in industry-led forums, events, trade bodies, and working groups focused on a wide array of themes in sustainable finance, we actively contribute to collaborative efforts ranging from guidance on regulatory reform to solutions for enabling commercial growth and opportunities. For example, we played an instrumental role in developing the latest PCAF standards, database and methodologies for calculating scope 3 financed emissions for European buildings, published last month.

Through our memberships with Bankers for Net Zero, the Net Zero Banking Alliance, Tech Zero, Innovate Finance, UK Finance, and the ON Climate Consortium, we hope to continue sharing best practices with other commercial banks, as well as building on our team's expertise and understanding of climate change risk and financial disclosures.

OakNorth Bank has set ambitious targets with support from ON Climate

2028
Achieve net zero for all Scope 1, 2 and 3 emissions of our UK supply chain, including purchased goods and services

2030
Reduce 60% of the Scope 3 financed emissions from our loan book

2030
Maintain carbon neutrality for Scope 1 and 2 emissions

2030
Ensure all new CRE deals have a path to at least an EPC rating of B by 2030

2035
Achieve net zero for all Scope 1, 2 and 3 emissions, including those we finance

Support at least 75% of our C&I customers in adopting a net zero target of their own

CLIMATE RISK MITIGATION AND FINANCIAL RESILIENCE:

Leveraging fintech for sustainable commercial lending strategies

BUSINESSES WORLDWIDE ARE facing an increasing level of climate-related risks stemming from rising incidences of extreme weather events, including floods, forest fires and cyclones. As these instances of extreme weather become more frequent and governments enact stricter regulations on carbon emissions, they have the potential to significantly impact a bank's loan book and its overall financial performance.

At the core of financial resilience lies sustainable lending practices, which include evaluating and mitigating climate risks in lending decisions, promoting sustainable investments, and aligning financial products with sustainability objectives. By incorporating sustainability into lending practices, banks can reduce their exposure to climate risks and support the transition to a more sustainable economy.

Consequently, banks must prioritize staying well informed about the evolving climate science landscape and policy changes, and continuously evaluate and refine their strategies as new information becomes available and the understanding of climate change evolves. However, regulators have constantly stressed the inadequacy of tools currently available to banks for conducting a comprehensive climate-related risks evaluation. Fintech companies, who are at the forefront of leveraging technology and data, can bridge this gap by improving the precision and granularity of climate risk assessments.

> “ Climate risks are no longer a peripheral concern but a central aspect of lenders' risk management strategy. Fintechs can offer innovative solutions to integrate sustainability into commercial lending practices, enabling banks to build financial resilience.
>
> **YUGAL YADAV, SENIOR DIRECTOR OF PRODUCT - CLIMATE CHANGE RISKS & OPPORTUNITIES AT ONCI**

Fintech firms leverage extensive datasets, both conventional such as financial risks and exposures and non-traditional such as climate models and hazard forecasts, and employ advanced analytics and machine learning techniques to deliver climate intelligence solutions. In addition, fintech firms provide highly localized weather data and predictions as well as solutions to calculate carbon footprints. This data-centric approach provides lenders with up-to-date information on borrowers' environmental vulnerability and empowers them to navigate and mitigate climate risks.

By leveraging fintech solutions, banks can boost their climate risks understanding, refine risk management strategies, and align their loan book consistent with sustainable objectives. Consequently, lenders are constantly deciding between Buy, Build, or Partner to enhance their financial resilience and effectively handle all facets of climate change risks.

One example is our ON Climate solution that is enabling some leading US lenders to address the growing regulatory demand to evaluate, measure, and report on climate-related risks and financed emissions. ONci's climate scenarios stress-test portfolios over various timeframes, including policy target terms. This helps banks assess portfolio performance across different periods and determine the right-mix of borrower profiles consistent with their strategic risk goals. These scenarios are applied at borrower level across the loan book, enabling banks to perform a bottom-up portfolio impact assessment and providing them with actionable intelligence to shape their loan exposure to be more resilient.

In conclusion, climate risks are no longer a peripheral concern but a central aspect of lenders' risk management strategy. Fintechs can offer innovative solutions to integrate sustainability into commercial lending practices, enabling banks to build financial resilience. As the fintech industry continues to evolve, we can expect the emergence of even more sophisticated tools and strategies, which will further expedite the transition to a low-carbon economy. Commercial banks that embrace these innovations today will be better positioned to thrive in the face of future challenges related to climate change.

ON CLIMATE APPLICATION TO ANALYZE TRANSITION RISK & IMPACTS FOR EACH YEAR UP UNTIL 2050

THE RECENT MONTHS SAW ONCI ANNOUNCE ON Climate's latest product advancement. This means customers will be able to analyze transition risks and impacts for each year up until 2050, in accordance with the time horizons analysis suggested by the US Federal Reserve in their pilot climate scenario analysis.

This advancement comes at a critical time, with transition risks arising from the process of adjustment towards a low-carbon economy, with a range of factors influencing this adjustment. These include climate-related developments in policy and regulation, the emergence of disruptive technology or business models, shifting sentiment and societal preferences, or evolving evidence, frameworks, and legal interpretations.

The new update, which is a market first, will also enable commercial lenders to:

- **Align transition risk scores with loan tenures** to understand climate impact at loan expiration dates for potential refinancing conversations
- **Report financed emissions** trajectory on an annual basis to stakeholders
- **Create emission abatement curves** on an annual basis for TCFD reporting
- **Understand and extract** transition risk-adjusted impacted financials at annual time horizons for credit risk analysis

Learn more about the latest ON Climate enhancement

"Businesses of all sizes across the globe are facing an increasing level of climate-related risks from a growing number of extreme weather events, including floods, forest fires, and cyclones.

These climate-related financial risks, including both physical and transition dangers, have the potential to dramatically impact a bank's loan book and overall performance, while also affecting several key sectors of the economy.

With our latest product release, banks will be able to mitigate, manage and track climate risks from this year up to 2050, while also quickly identifying sectors and borrowers that have the greatest climate risk and create effective transition strategies – helping borrowers confidently navigate the unique climate transition situations within their industry."

YUGAL YADAV, SENIOR DIRECTOR OF PRODUCT - CLIMATE CHANGE RISKS & OPPORTUNITIES AT ONCI

RECAP REPORT

CLIMATE CONSORTIUM

Views from the US' top climate thought leaders in commercial lending

ONci recently hosted a special edition of its Climate Consortium with a group of leading executives from some of the largest and most successful US commercial banks. The discussion focused on a variety of interesting topics, including the best approach to identifying transition risk in commercial loan books, how best to build a climate-confident team, and preparation ahead of the FED's Climate Scenario Analysis (CSA) exercise.

Some of the key insights and takeaways are included below.

IDENTIFYING TRANSITION RISK

The session started with the attendees discussing how best commercial lenders can identify transition risk within their loan books, with many of them continuing to be heavily reliant on public and third-party data providers, while simultaneously attempting to gather extra data directly from customers.

With regards to data, all participants agreed that every one of their customers is different. Meaning in order to effectively examine the effects of transition risk, sourcing granular data at an individual borrower level and taking a forward-look view around how these businesses could be impacted is critical. Furthermore, as the level of borrower emissions disclosure increases (i.e. the data improves), banks' scenario analysis needs to evolve too.

To give an example and as we have seen from extreme weather events across the US over recent times, climate risks are highly uncertain and non-linear in their propagation and can affect multiple risk categories simultaneously.

PREPARATION AHEAD OF THE FED'S CSA EXERCISE

The FED's CSA exercise is the first of its kind and is designed to learn about the risk-management practices and challenges and some of the largest banking institutions, and to enhance the ability of both large banking organizations and supervisors to identify, measure, monitor, and manage climate-related financial risks. Attempting such an exercise by commercial lenders can be done in multiple ways, with one panelist advocating that the best way to approach the exercise is through a pilot scheme, as opposed to putting an entire portfolio through the process.

A key ambition for the participating banks discussed during this section of the session was how to make their processes towards the exercise more streamlined and automatic. A desire that the ON Climate solution can help towards, with the product designed to help banks run the CSA exercise for the two recommended scenarios - Current Policies and Net Zero 2050.

BUILDING CLIMATE-CONFIDENT TEAMS

Given the unknown and new-found nature of climate risk analysis, there's no one right way to building a good climate scenario analysis team. With this in mind however, the participants did agree that commercial lenders should consider this a learning experiment, only bringing in team members who show intellectual curiosity, and who are willing to ask questions that will move the project forward. Furthermore, the panel added that it is vital lenders choose to involve internal talent from other keys parts of the business e.g. credit underwriting, especially during the initial stage of the project, to help gather differing perspectives.

The group also highlighted that front-line team members will be the ones dealing with customers, including having conversations with them about transition risk and the changes they can and should be making to their business models to address these. Therefore, banks need to be coaching these teams to have transition-related conversations with clients, providing them with the right questions to ask for different industries and sub-sectors, and using the data from these discussions as one of several inputs to help inform decision-making.

GENERATING INTERNAL BUY-IN

More customers are wanting their banks to be more proactive in terms of providing them with detailed, forward-looking data on their performance and the state of their credit. The group agreed that external advisors need to deliver value throughout the entire lending journey.

Request an invite to a future ON Climate Consortium

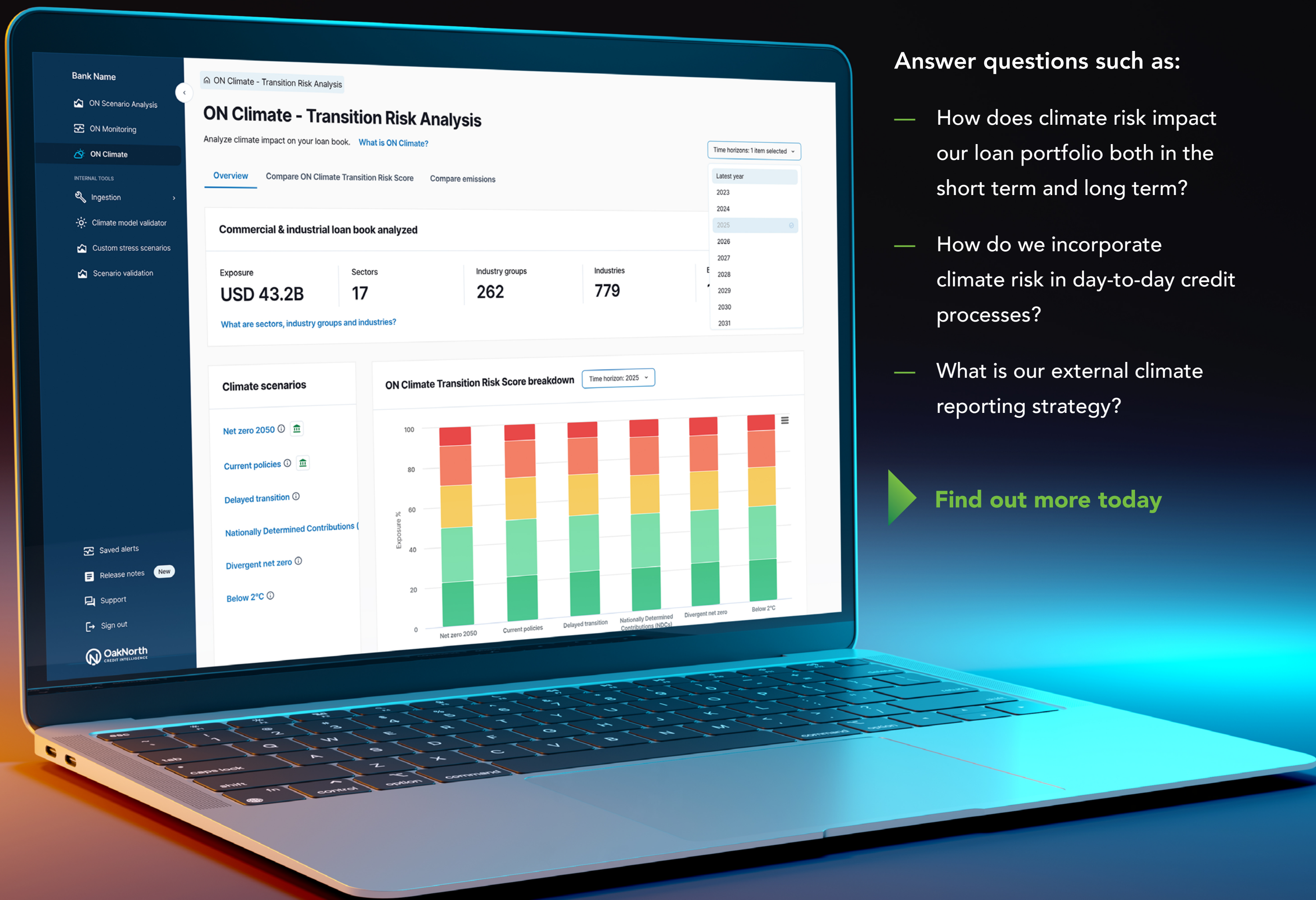
OakNorth
CREDIT INTELLIGENCE

Now available in ON Climate

How can your bank incorporate climate risk into its day-to-day credit processes?

Aligned with the latest guidelines from the US Federal Reserve, banks can now assess climate risk impact (financed emissions and transition risk) on their loan portfolio annually, from 2023 to 2050, at a borrower, industry, sector, and portfolio level.

Lend smarter. Lend faster. Lend more.



Answer questions such as:

- How does climate risk impact our loan portfolio both in the short term and long term?
- How do we incorporate climate risk in day-to-day credit processes?
- What is our external climate reporting strategy?

Find out more today