CLIMATE ENERGY FINANCE

CBA's oil and gas policy ratchets up shift of finance away from fossil fuels and meets the minimum global standard

Commonwealth Bank of Australia (CBA) follows global bank HSBC's previous minimum standard and sets a benchmark for its domestic Australian competitors

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Note: This is CEF's interim response to CBA's FY2023 reporting, addressing the key shift in its O&G policy in the global context with a focus on HSBC's policies. Our full analysis of CBA's disclosures is forthcoming.

KEY POINTS

- *CBA, Australia's biggest bank by market capitalisation, this week released a landmark fossil fuel financing policy (pp 6-7) that rules out project finance for new (greenfield) oil and gas (O&G) extraction and for expansions of existing (brownfield) O&G extraction.*

- *CBA will require fossil fuel clients to commit to verifiable transition plans by 2025 encompassing Scope 1, 2 and 3 emissions and aligned to a Paris Agreement "well below 2 degrees" pathway. Where client transition plans do not meet CBA's expectations, the bank may end the relationship, as the chair previously flagged at 2022's AGM, potentially impacting financing for majors like Santos and Woodside that lack credible transition plans.*

- *The shift brings CBA into closer alignment with leading international counterparts, such as HSBC, which has also ruled out financing of greenfield O&G and will decline corporate finance to clients without credible transition plans.*

- *However, CBA's policy does allow for funding of liquified natural gas (LNG) infrastructure, and for financing of fossil fuel clients where the Australian Government or regulator has deemed that supply from a certain asset or client is necessary for energy security, a caveat open to abuse given the climate crisis unfolding in real time (e.g. Hawaii), and the Federal Government's failure to yet align fully with the climate science.*

- *We call on the remaining Big 4 domestic banks to also raise their decarbonisation ambition in light of CBA's progress, and of Australia's outsized contribution to climate chaos as a top 3 export petrostate alongside Saudi Arabia and Russia.*

- *The extreme weather events of the Northern Hemisphere summer, and the advent of "global boiling", underline the urgent imperative to cease financing of fossil fuels.*

1. CONTEXT

Urgent action is needed to shift economies away from fossil-based energy to clean energy: as United Nations Secretary General, Antonio Guterres, last month declared in the face of unprecedented global temperatures, the 'era of global boiling' is upon us. Australia has an outsized role to play in the global energy transition given we are a major exporter of the world's fossil energy, third only behind Russia and Saudi Arabia. We also have a once in a lifetime opportunity to shift from petrostate to electrostate, ushering in the green economy of the future.

If the climate crisis weren't enough reason to act, last year, CEF estimates fossil fuel multinationals in Australia reaped $150bn in gross profit at a time when the rest of the nation was thrust into a cost of living crisis. Christiana Figueres, former Executive Secretary of the United Nations Framework Convention on Climate Change (UNFCC), cautions that fossil fuel companies have not shown they are willing to change at the speed and scale required. Instead of investing their war superprofits to decarbonise and position for the energy transition by abating emissions and pivoting to renewables, we've seen continued delay tactics that accelerate climate chaos.

O&G majors will inevitably see their access to new finance drying up, as has happened to the coal sector, as globally significant financial institutions pivot to financing the emerging green global economy in alignment with their net zero emissions pledges.

CBA's new policy is a case in point.

2. CBA's NEW POLICY - A COMPARISON WITH HSBC

HSBC is a British bank of similar market cap to CBA. While continental Europe banks previously set the global standard in ambition in restricting new fossil fuel finance, HSBC's 2022 Energy Policy was a flagship development for the global banking sector, especially given HSBC's status as a Global Systemically Important Bank (G-SIB) operating within a resource driven economy such as the UK, where the release of oil and gas licences is touted by the government as key to energy and economic security.

Domestically, CBA is among the first of our globally significant banks to implement a policy with the ambition to limit finance that expands the supply of oil and gas. This is a huge step for a nation that is the world's top 3 LNG exporter, and has the potential to move the benchmark for our region's financial institutions – i.e. Asian & Japanese banks.

We compare HSBC's and CBA's policies in the following sections.

i. Upstream O&G

HSBC will no longer provide new finance[1] or new advisory for the specific purposes of new O&G fields. The policy classifies new O&G fields as those with a final investment decision after 31 Dec 2021, which aligns to the release of the International Energy Agency's (IEA) Net Zero Roadmap. The policy also restricts new finance to O&G exploration, appraisal, development and production pertaining to unconventional fields[2] or those in environmentally and socially critical areas.[3]

CBA's policy commits to providing no project finance[4] to new (greenfield) or expanded (brownfield) O&G extraction projects, including reserve-based lending. By including brownfield projects in its remit, CBA's policy takes a step further than HSBC's, elevating the new minimum standard for the region in ensuring that the supply of O&G is not expanded.

ii. O&G related infrastructure (upstream and midstream)

HSBC will no longer provide upstream finance for the specific purposes of related infrastructure whose primary use is in conjunction with new O&G fields. This implies restrictions only to upstream infrastructure at extraction sites and not mindstream infrastructure that enables the O&G value chain such as processing. Dutch multinational ING leads here, expanding its policy into midstream finance by committing to adopt by the end of 2023 a "net zero by 2050'-aligned methodology for midstream oil and gas infrastructure such as pipelines, liquified natural gas terminals and storage facilities".

CBA's policy is narrower in its exclusions, restricting project finance to new distribution pipelines dedicated to new upstream O&G, new Floating Production Storage and Offloading (FPSO) for upstream oil, and new oil ships or new gas vessels for midstream distribution.

However, an obvious area of necessary focus – and the one which makes the most difference in context of Australia's position as a world leading exporter of LNG – is restricting finance to LNG facilities, both new facilities and extensions or expansions to existing ones, especially where such investments would facilitate greenfield or brownfield gas. For example, the Papua LNG JV led by TotalEnergies will bring new LNG trains online that will process gas for export from new gas fields.

CBA should make it clear that it will not finance infrastructure, such as LNG processing facilities, related to the expansion of gas supply, consistent with the climate science.

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[1] HSBC's policy explicitly defines "new finance" as including the refinancing of existing finance facilities.
[2] HSBC's definition of unconventional O&G includes ultradeep offshore O&G, shale oil, extra heavy oil
[3] HSBC's definition of environmentally and socially critical areas includes Amazon Biome, Arctic and Antarctic, Ramsar Wetlands and UNESCO World Heritage Sites.
[4] We understand CBA considers its commitments on new financing arrangements to include both origination of new loans and renewal of existing loans.

iii. Corporate finance and client transition plan expectations

HSBC will provide no new corporate finance or advisory where HSBC determines the client's overall operations are substantially in O&G exploration, appraisal, development, and production pertaining to unconventional O&G, or projects in environmentally and socially critical areas, or related infrastructure.

The bank's policy also specifies a pathway to engage with O&G clients whose operations are substantially in new O&G fields and related infrastructure, to determine their appetite, ability and plans to decarbonise in line with HSBC's efforts to meet its NZ50 Target (refer to HSBC Energy Policy 2022 for full transition plan criteria). While HSBC establishes repercussions for its O&G clients who do not produce timely transition plan guidance after repeated requests, or for those whose plans are inconsistent with HSBC's climate commitments, the bank's engagement efforts are not time-bound. This could allow misaligned O&G companies to continue their climate destructive operations well into this crucial decade.

CBA's stance on corporate finance also includes a major loophole – the bank will continue to offer corporate finance for new O&G clients who derive 15% or more of their revenue from the sale of oil or gas where the client has publicly committed to the goals of the Paris Agreement, and after an assessment of the environmental, social and economic impacts. The bank requires Paris-aligned transition plans (refer to 2023 Climate Report, p.77) by 2025 across Scopes 1, 2 and 3 from these clients. This level of ambition is a sign that the times are moving and reflects the bank's restrictions on O&G project finance from two years ago (p.30). We note Woodside has no scope 3 alignment, where scope 3 represents over 90% of Woodside's total emissions.

CBA will use the Climate Action 100+ framework criteria (Figure 1) to assess transition plan alignment. A weakness here is that alignment will be assessed against the "well below 2 degrees Celsius" aspect of the Paris Agreement goal rather than the more rigorous "pursue efforts to limit the temperature increase to 1.5°C above pre-industrial levels." We know that every increment of warming increases the likelihood of devastation as the effects of climate change continue to worsen, disproportionately impacting those who have done the least to drive it, such as our Pacific neighbours.

CBA begins its transition plan assessment and client engagement in FY2024 with an aim to complete by early 2025, and flags its intention to end the relationship with companies who don't meet CBA's environmental standards (p.6). This aligns with comments from CBA's Chair at the 2022 AGM, who indicated that companies without transition plans by 2025 would be unbankable.

CBA's stance has the potential to impact financing of clients such as Santos, Woodside, Exxon and Beach Energy that have repeatedly failed to commit to credible transition planning. For example, Santos has proven unwilling to transition to the new economy by continuing to invest in O&G expansion, publicly denying the climate science, engaging in misleading conduct relating to its "clean energy" claims, as well as a host of other egregious social and environmental acts that would surely not pass the sniff test at CBA. The tide against laggard O&G majors is already turning, with, for example, the Church of England Pensions Board last month making the decision to divest from Shell and other O&G majors due to their lousy decarbonisation commitments and their failure to change despite repeated engagement, exemplifying Christiana Figueres' comments linked above.

We expect to see CBA take action to end its relationship with the worst-polluting companies by this time next year.

Figure 1.

> **E&S Framework Transition Plan expectations**
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> Subject to Australia having a secure energy platform, we will expect certain *clients* to have published Paris-aligned *Transition Plans* by 2025, requiring that the plans include their *Scope 1, 2 and 3 emissions*. This applies to existing oil and/or gas producing or metallurgical coal mining *clients* who derive 15% or more of their revenue from the sale of oil, gas or metallurgical coal, or power generation *clients* who generate 25% or more of their electricity from coal, and to whom we provide *corporate or trade finance*, or *bond facilitation*.
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> During the year, the Bank has been considering an appropriate process to engage with *clients* and frameworks to assess their *Transition Plans*. We intend to adopt a framework, which leverages and adapts the high level Climate Action 100+ framework criteria to assess alignment of *Transition Plans* with the 'well below 2°C' goal of the *Paris Agreement*. Our adapted framework will include criteria such as net zero ambition, targets, strategy, governance and disclosure.
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> CBA considers Climate Action 100+ to be a widely recognised framework that is also referenced by the Glasgow Financial Alliance for Net Zero and *NZBA*. Given the complexity involved in this assessment, CBA has engaged an external party to help assess our *clients' Transition Plans*, as required. This process of assessment and *client* engagement will commence in the 2024 financial year, with a view to completing the process by the beginning of 2025.

iv. Capital market activities

In addition to direct lending, HSBC commits to no longer providing upstream finance through capital markets, for the specific purpose of new O&G fields and related infrastructure whose primary use is in conjunction with new fields. HSBC defines this as arranging or underwriting of capital markets transactions to clients, but also includes the provision of financial or investment banking advisory services to clients. However, there is no mention of restricting bond finance to new O&G, a gap which France-based European bank BNP Paribas does address in its policy.

As with its corporate finance criteria, CBA is starting to edge into setting limits on capital markets activities, stating it will only offer bond facilitation for new O&G clients who derive 15% or more of their revenue from the sale of oil or gas where the client has publicly committed to the goals of the Paris Agreement, and after an assessment of the environmental, social and economic impacts. We expect to see greater scrutiny on facilitated emissions as new standards for facilitated emissions enter the global domain.

3. CONCLUSION

To date, the global banking sector's financing policies, such as those of HSBC, ING and BNP Paribas, have far outstripped the ambition of Australia's key financial institutions in shifting finance away from fossil fuels, providing a benchmark to which the domestic sector should have long since responded. Whilst the Australian economy is heavily exposed to the fossil fuel economy of old, with all the political inertia and obfuscation this entails, it is critical leading financial institutions provide the clarity of direction Australia must take, particularly noting the massive investment, employment and export opportunities opening up for Australia from the global energy transition.

CBA has now meaningfully stepped up. There is still significant room for improvement – principally, as discussed above, CBA should restrict finance to new or expansions of LNG facilities, especially where it facilitates new or expanded gas; enhance its stance on providing corporate debt that subsidises the balance sheet of companies that are misaligned to the transition (we expect these measures to ratchet up from next year when CBA has completed its transition plan assessments and engagement); and put in place formal measures for ending facilitation of capital markets where those activities expand the supply of fossil fuels.

However, especially in the context of a history of inadequate action on climate by the banking sector, CBA's new-found leadership on decarbonising finance is a potential game changer that signals a long overdue ratcheting up in ambition towards aligning with the climate science, leaves its competitors amongst the Big 4 to follow, and sets a minimum domestic benchmark which its peers will now be under pressure to move toward.

Our analysis of CBA's FY2022 reporting showed its reductions in oil and gas exposures meant that it had successfully met and exceeded its 2030 emissions reduction targets under the Net Zero Banking Alliance (NZBA), and that it had gotten its energy exposure trend right, reducing exposures to coal, oil and gas while increasing exposures in renewables. CBA's most recent shift confirms it is possible to reform fossil fuel financing to better align with the urgency of the risks and opportunities relating to the economy-wide decarbonisation now underway.

Its competitors' continued bankrolling of the climate catastrophe driven by O&G – Westpac, NAB and ANZ, have, for example, played a key enabling role in the financing of Woodside's mega gas project Scarborough-Pluto 2 – is untenable. We again call on CBA's peers to lift their game in light of CBA's progress.

The ambition shown by CBA also throws into the spotlight continued federal and state government policy and funding support for Australia's program of major gas expansion, the subject of growing and widespread community dissent, and indefensible against the backdrop of the IEA's 2021 declaration that there can be no new fossil fuels if we are to retain a liveable planet.

In this context, CBA's play looks a lot like business demonstrating leadership on climate which our government has abdicated.

CBA's disclosures released this week kicked off the FY2023 reporting season, to be followed by its peers in the coming months. CEF will continue to review and publish analyses of the Big 4 banks' FY2023 climate financing across key indicators relevant to the transition, building on the series of analyses we commenced in 2022.

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