



Banking on the climate transition

Why it pays to be a first mover



As Australia mobilises towards a greener future, financial institutions are facing increased pressure to support and accelerate the system-wide transition to a net zero economy.

The race to net zero provides a once-in-a-generation commercial opportunity for those who choose to lead – but will require rapid and transformational change to capture.

Leveraging insights from across the global banking sector, industry research, interviews with business leaders and policymakers, globally and in Australia, we analyse how banks have approached the decarbonisation opportunity. We then bring the business case to life for executives through deep-diving on three high-emitting Australian industry sectors.

Finally, we outline the key steps required by banks to protect, grow and expand their competitive position and market share – through both the continued investment in green finance and, more importantly, the rapid scaling of their transition financing capabilities.

Australia's climate challenge

Australia is behind in its journey to decarbonise. Rapid change is required to play our role in limiting the impacts of climate change.

09th highest global emitter

With the 9th highest emissions per capita in the world, and despite recent progress, Australia still needs to reduce total emissions by 32% or 137 Mt CO₂-e to meet our 2030 target – current projections put us on track to achieve only a 17% reduction.

55th Global Climate Change Performance Index

Australia's bottom quartile ranking is due to our current GHG emissions, comparatively low use of renewable energy and energy use per capita. Recent performance in engaging on the international policy stage, however, has shown some signs of improvement.¹

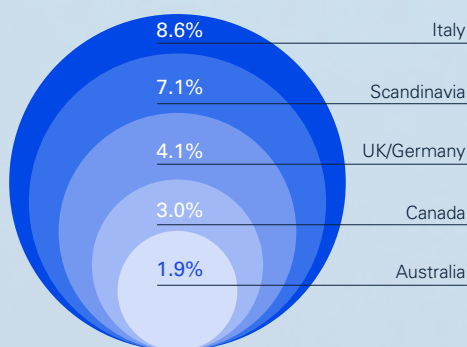
Contributions from selected hard-to-abate sectors



Transition finance: first mover ambition matters

Traditional profit pools are under pressure from intense pricing competition, rising costs of deposits and wholesale funding – therefore banks must look to new profit pools. Incumbents who fail to act quickly on green and transition finance opportunities risk losing market share to fast-moving competitors such as foreign ADIs and specialist finance providers.

Global banks have a higher level of sustainable finance as a proportion of total lending⁴



- Compared to global banking peers, Australian banks continue to lag in terms of acting on these financing opportunities. Their response to climate change is currently anchored in risk management, missing the commercial opportunity of transition.
- Local financiers who fail to act quickly on these emerging opportunities risk losing out to global players and other fast-moving competitors – those with proven capabilities to meet this burgeoning market demand.

¹ Climate Change Performance Index 2023

² Emissions are largely due to electricity consumption (Scope 2).

³ Largely due to emissions from the combustion of fuel to generate electricity for public use.

⁴ KPMG analysis; new and incremental sustainable finance relative to total lending in 2022. Figure reflects the leading bank in each country / region.

The sizeable opportunity

Australia will need to attract and invest close to \$1.5 trillion by 2030 and \$7 trillion by 2050⁵ across high-emitting sectors like energy, industrials, mobility, manufacturing and agriculture.

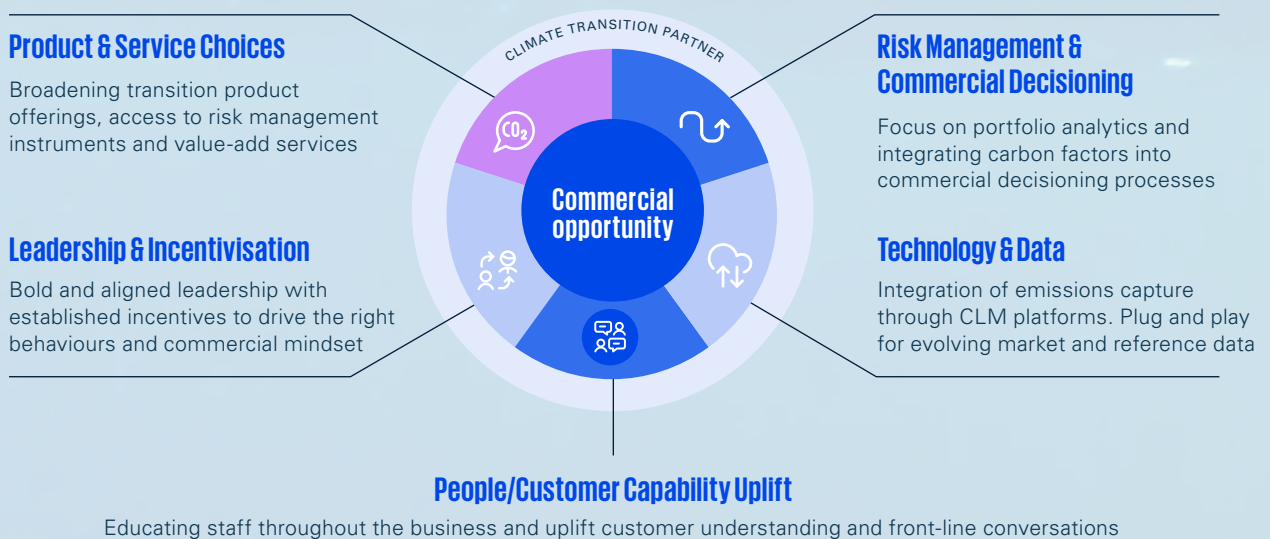


**The good news:
It's a rewire, not a rebuild.**

To seize the commercial opportunity of becoming Australia's 'transition bank of choice' – leaders will need to invest in making a number of **targeted changes**, **rewiring established foundations** to cater for these new definitions of success. But the rewire will impact every part of the enterprise.

Success factors of global leaders

- 1 Embedded in corporate strategy
- 2 Executive remuneration scorecards designed to achieve environmental and commercial outcomes
- 3 Market development mindset in collaboration with policymakers
- 4 Advanced risk capabilities to monitor and manage high-emitting sectors
- 5 Significant investment in internal capability uplifts
- 6 Development of new revenue streams through value-add transition services



⁵ Net Zero Australia (2023), *Final Modelling Results – Charting Pathways to Net Zero*.

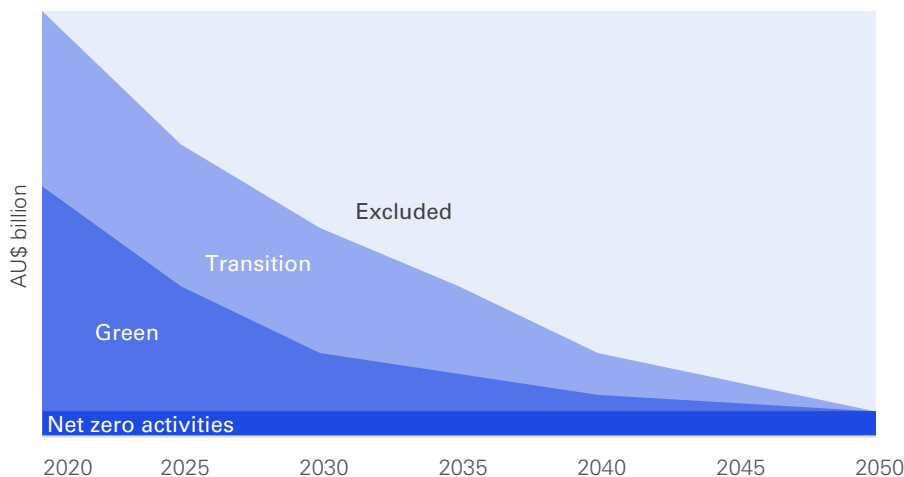
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01. Forging a path to net zero

Decarbonisation is an enormous, system-wide challenge required to counter the worst impacts of climate change, but it presents a once-in-a-generation economic opportunity.

Figure 1: Categories of funding for net zero activities⁶



“Globally, we are seeing some great examples of banks that have been able to take the reins and spearhead successful transition finance initiatives in their own still-evolving markets. These organisations will have a significant competitive advantage as decarbonisation efforts accelerate in the months and years ahead.”

STEVE JACKSON

National Sector Leader,
Banking & Capital Markets
KPMG Australia

Across all sectors, organisations are coming to grips with the scale and pace of transformation required to achieve the goals of the Paris Agreement and keep global warming well below 2°C (and pursuing efforts to limit it to 1.5°C). While Australia’s transition to a net zero economy seems inevitable, the investment community – shareholders, wealth funds and banks – will help set the pace of change and play a critical role by raising and directing capital to support this transition to a low-carbon economy.⁷

Our analysis shows that, compared to global peers, Australian banks continue to lag in terms of acting on decarbonisation financing opportunities. While this paper acknowledges some of the broader sociopolitical and other drags on Australia’s progress over the last two decades, the Australian financing system has taken a largely ‘wait and see’ approach to the climate transition, preferring to move in line with regulations, policy changes and

competitors rather than ambitiously being a first mover in the market. However, since the May 2022 change of government, the political sentiment around climate change and sustainability has shifted – further evidenced by the resources allocated to the national sustainable finance agenda in the 2023 Federal Budget, including the establishment of a sovereign green bond program and the development of a sustainable finance taxonomy.

In our conversations with clients across all sectors of the economy, we find business leaders bracing for a wave of rapid change as policymakers seek to catch up and deliver on Australia’s international obligations. Three-quarters of Australian CEOs say they have faced greater pressure over ESG-related transparency and accountability from regulators, investors, employees and customers in the past 12 months.⁸

To achieve a net zero economy by 2050, recent research estimates that Australia will need to attract and invest close to **\$7 trillion of capital** across high-emitting sectors like energy, industrials, mobility, manufacturing and agriculture, with the bulk of these funding arrangements likely to be finalised **within the next 5-10 years**.⁹ This pool of *sustainable finance* will encompass both *green finance*, which is allocated exclusively to environmentally beneficial projects, as well as *transition finance* to help businesses in all sectors meet more ambitious sustainability targets and transition business models from ‘brown’ to ‘green’.¹⁰

⁶ Australian Sustainable Finance Institute (2023), *Designing Australia’s sustainable finance taxonomy*.

⁷ KPMG (2023), *30 Voices on 2030: The ESG Revolution*.

⁸ KPMG (2022), *KPMG CEO Outlook 2022 – Australia*.

⁹ Net Zero Australia (2023), *Final Modelling Results – Charting Pathways to Net Zero* and Australian Sustainable Finance Institute (2023), *Designing Australia’s sustainable finance taxonomy*.

¹⁰ For this report, we have relied on the Australian Sustainable Finance Institute’s definitions of sustainable, green and transition finance. See Glossary on page 35.

Top challenges facing the banking sector in responding to the climate challenge

- 1 Historic politicisation of causes and implications of global warming resulting in previous governments being unable – or unwilling – to enact meaningful climate policies.
- 2 A lack of consensus on critical frameworks and methodologies – including comprehensive Australian and sector-specific transition pathways and targets.
- 3 No singular Australian sustainable finance taxonomy to support transparent and credible sustainable economic activities.
- 4 Incomplete and inaccurate emissions data across Australian business sectors.
- 5 Meeting rapidly evolving stakeholder demands (including new and evolving reporting and disclosure requirements) and the increased scrutiny and risk associated with greenwashing.
- 6 Complexity of managing actions to drive climate, social and economic outcomes to achieve a just transition.

While early sustainable funding initiatives have focused predominantly on the provision of green finance, demand for transition finance has yet to be substantially addressed.

Over the next decade, banks will need to do far more than simply fund renewables or divest from fossil fuels. **Australia's economic transition calls for a more sophisticated approach,** with financiers who can support their customers at every stage of the decarbonisation journey through more advanced credit-decisioning and

risk pricing capabilities, innovative products and ecosystem solutions alongside robust, transparent and consistent performance assessment metrics. Given the inherent complexities in providing transition finance, banks **will need to build sustainability into all parts of the value chain** if they are to successfully participate in this high growth market.

“In five years time, divestment will be a strong theme. I believe this will mean that we end up with specialist financing towards the second half of the decade, to meet the need for transition finance. This market will be big. It will be served by financiers with the risk management capabilities to be able to handle the risk of stranded assets and extract value from those opportunities.”

KAY SWINBURNE

Vice Chair of Financial Services at KPMG UK and former Member of European Parliament

Change is accelerating for Australia's finance sector firms

The federal 'Climate Election' in May 2022 was a major turning point for Australia's decarbonisation ambition. Driven by increasingly visible impacts of climate change, warnings from the scientific community and positive examples from overseas jurisdictions, Australians voted overwhelmingly for change.¹¹

Finance sector firms will be directly affected by:

- **Stronger mandatory disclosure obligations.** The Australian Government is considering a mandatory climate-related financial reporting regime. This is likely to be initially aligned with the current Taskforce on Climate-related Financial Disclosures (TCFD) recommendations, with the scope to incorporate upcoming International Sustainability Standards Board (ISSB) standards.¹² Banks and large, listed entities could be required to produce compliant reports as early as FY2024-25.
- **Greater regulatory scrutiny of climate risk exposure.** APRA, the RBA and Treasury have been undertaking climate scenario analysis and modelling to assess the financial impacts of climate change. APRA has issued Prudential Practice Guide CPG 229 to help regulated entities manage the risks and opportunities that may arise from a changing climate.¹³
- **Greater regulatory scrutiny of climate-related claims.** ASIC has issued anti-greenwashing guidance for firms offering or promoting sustainability-related products.¹⁴ The Australian Government has set aside a further \$4.3 million in 2023-24 to strengthen ASIC's investigations and enforcement action against greenwashing and other sustainable finance misconduct.
- **Increasingly ambitious national and corporate emissions reduction targets.** As part of the landmark Climate Change Act 2022, the Australian Government has set a National Emissions Reduction Target of 43% by 2030, off 2005 levels, and net zero by 2050.¹⁵ While the initial target fell short of private sector ambitions, future interim goals and targets are likely to be more ambitious. Organisations will need to ensure their decarbonisation strategies are aligned with government ambitions and the global Science-Based Targets Initiative (SBTi).
- **The development of an industry-wide sustainable finance taxonomy.** The Australian Sustainable Finance Institute is working with government, regulators and industry participants to develop a system for defining 'green' or 'transition' economic activities. The introduction of a standardised classification system will support banks' ability to develop sustainable finance products and collect and share the data they need to assess customer eligibility, and enable fairer, more accurate comparisons of banks' sustainability performance.
- **The maturation of green, sustainable and transition finance frameworks in overseas jurisdictions.** Australia's Green Bonds market was worth almost \$25 billion in 2022, and demand from investors is growing.¹⁶ However, there is still no industry-wide standard to assure investors that local issuers are playing by the same rules. In contrast, the EU Green Bonds (EuGB) standard will be based on the region's established taxonomy regulation regime. The UK Government is also looking to regulate ESG ratings providers, to allay investors' fears of greenwashing.
- **Growth of the UN-convened Net Zero Banking Alliance (NZBA),** which now covers more than 120 financial organisations worldwide including Australia's five largest banks, and over 40 percent of global banking assets. NZBA members commit to work towards achieving net zero emissions from their lending and investment portfolios by 2050 or sooner, set regular intermediary targets focused on high-emission priority sectors, and report on their progress annually.¹⁷

Finance sector firms will be indirectly affected by:

- **Tighter emissions caps on high-emitting facilities.** The government has passed new laws to strengthen the Safeguard Mechanism, which limits the emissions produced by Australia's biggest industrial sites. Stricter limits will affect operating costs of businesses in the electricity, mining, manufacturing, oil and gas production, transport and waste sectors. Significant capital investment will be needed for many of these facilities to meet national emissions reduction targets.
- **Near-term business risk for bank's customers due to evolving buyer expectations and requirements.** We are already seeing state government sustainable procurement policies precluding certain businesses from tendering for services due to the rapid embedding of environmental sustainability objectives in procurement practices. As an example, some construction businesses have already reported being locked out of public sector projects due to their inability to meet baseline Scope 3 and social procurement requirements.

¹¹ IPCC (2022), *AR6 Climate Change 2022: Impacts, Adaptation and Vulnerability*.

¹² KPMG (2023), *'Get ready for global sustainability standards'*, Treasury (2022), *'Climate-related financial disclosure'*.

¹³ APRA (2021), *Prudential Practice Guide CPG 229 Climate Change Financial Risks*.

¹⁴ ASIC (2022), *'How to avoid greenwashing when offering or promoting sustainability-related products'*.

¹⁵ Parliament of the Commonwealth of Australia (2022), *Climate Change Bill 2022*.

¹⁶ Responsible Investment Association Australasia (2022), *Responsible Investment Benchmark Report Australia 2022*.

¹⁷ Net Zero Banking Alliance (2021), *'Commitment Statement'*.

The business case for change

To date, Australian banks have, on the whole, prioritised their traditional deposits and lending businesses, believing this to be the safest way to deliver sustainable value to shareholders. However, recent financial results show that margins from these traditional markets are under pressure from both intense pricing competition in the home loan

“Too many in corporate Australia have viewed sustainability through the lens of risk and compliance, often overlooking the upside business case of getting this right. Let’s be clear: this is the biggest commercial opportunity of our lifetimes. With fast-emerging clarity on the Australian direction of travel, banking leaders will need to better understand the opportunity, investment and internal transformation required to seize the opportunity.”

BEN KILPATRICK
ESG Industry Co-Lead,
Financial Services
KPMG Australia

market, and a significant increase in interest expense driven by the rising cost of deposits and wholesale funding.¹⁸

The need for banks to **identify new profit pools** and to **capture early market share**, takes on a new and heightened importance. Finance that supports organisations to transition to low-carbon or carbon-positive business models is a key requirement, one that will benefit those bold enough to make the first substantial move in the local market.

It is a different story in more mature climate-focused markets and economies such as the UK and EU where banks like Intesa Sanpaolo, Barclays, Banco Santander, Nordea and others are already proving the business case for change. Banks with the sector knowledge, technology and operating processes in place to deepen customer relationships and support them throughout the transition will be best placed to lead in the times ahead. Based on our observations in Australia and overseas, we expect banks to play one of the below three roles as the local sustainability landscape matures (Figure 2).

SPOTLIGHT: TRANSITION RISKS FACING ALL BUSINESSES AND SECTORS

Australian CEOs have become increasingly concerned about the policy, legal, technology and market changes driven by the global transition of more climate-friendly economies. **Eighty-six percent of Australian CEOs believe climate change will be ‘a huge threat to growth’,** and 46 percent say they would invest up to a quarter of revenue in programs to become more sustainable.¹⁹

With the growing global and local momentum – our view is that should local financiers **fail to act quickly** on the emerging opportunities, they **risk losing market share to global and other fast-moving competitors** – those with already proven and developed capabilities to meet the market demand. High-emitting sectors in particular will be open to specialist financiers or global banks that are better able to meet their transition financing needs, and do so at a scale that is economically viable.

Figure 2: Bank archetypes in the provision of sustainable finance



RULE FOLLOWER

Meets prudential responsibilities by managing exposure to businesses and assets impacted by climate risks.

Ensures compliance with ESG regulations, including by setting decarbonisation targets and managing emissions across their lending portfolios accordingly.



RISK MANAGER

Takes a screening approach to mitigate risks and target opportunities.

Offers green loans, bonds and other products to climate-friendly businesses and projects.

Sets a carbon budget and reduces exposure to heavy-emitting customers and projects accordingly.



TRANSITION PARTNER

Takes an impact-driven, engagement approach to enable transformation across the economy.

Develops technologies, processes and strategies to mobilise sustainable project funding.

Works with all customers – including those in carbon-intensive industries – to accelerate and achieve carbon reduction.

¹⁸ KPMG (2023), *Major Australian Banks Half Year Results 2023*.

¹⁹ KPMG (2022), *KPMG CEO Outlook 2022 – Australia*.

02. Slow, steady, and missing out

In 2021, Australia ranked 17th of 32 countries in KPMG’s Net Zero Readiness Index, behind South Korea, Japan, most European nations, and the USA.²⁰ When we look globally to jurisdictions that are further progressed along their decarbonisation journey, we see major banks playing a significant role in the reallocation of capital to sustainable economic activities.

Major banks like Barclays, Natwest and Nordea have set world-leading ESG targets – which encompass not only climate objectives but also broader environmental, social and governance considerations – and are already well underway to meeting their 2030 and 2050 goals. For these organisations, decarbonisation has become not only an environmental imperative but also a core element of their commercial strategy.

Australian banks provide less sustainable finance than global peers

The level of new sustainable finance provided by local Australian banks in 2022 is well below global market leaders, with major banks issuing approximately \$44 billion in loans across renewable energy, land remediation, waste management, green buildings and other sustainable asset categories. By comparison, European bank Intesa Sanpaolo provided approximately \$65 billion in new sustainable lending and earned close to \$5.9 billion in total sustainable revenue.²¹

Australia’s low level of sustainable finance is in stark contrast with its relatively high need for change. Compared to global peers including Canada, France, Scandinavia, the United Kingdom and United States, Australia’s contribution to sustainable finance is well below other markets (see Figure 3). This is despite the fact, that as a nation, we have one of the highest levels of emissions per capita with 15 tonnes emitted per person per year.²² To play our role, therefore, in meeting our global emissions reduction obligations – greater levels of capital allocation and financing will be required.

Sustainable finance also represents a smaller share of total lending for Australian banks compared to global leaders. In 2022, green and sustainability-linked loans accounted for only 0.3–1.9 percent of total loans, issued by ANZ, CBA, NAB, WBC and Macquarie Bank – significantly less than leaders operating in international markets.

“Many of the larger Australian financial institutions feel they are world-class in terms of their ESG performance and initiatives. However, when we benchmark them, they would not end up in the top international group. There’s a good reason for that: if you focus on ESG policies and practices and training, yes, large firms tend to have done a good job of the process part, but going beyond ESG and making a positive impact measured against the United Nations SDGs is what the leading institutions worldwide are focused on. Matching that is much more complicated.”

KETAN PATEL

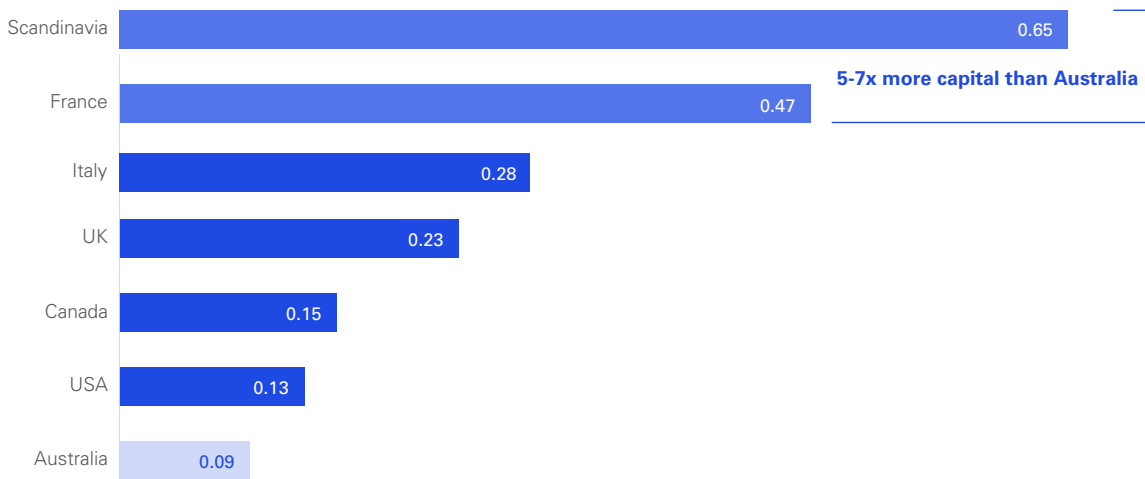
Chairman and Advisory Council Chair
Force for Good

²⁰ KPMG (2021), *Net Zero Readiness Index*.

²¹ KPMG analysis, Corporate Knights (2022), *‘Which banks are financing the clean energy transition?’*

²² World Bank (2020), *‘CO2 emissions (metric tons per capita) – Australia’*

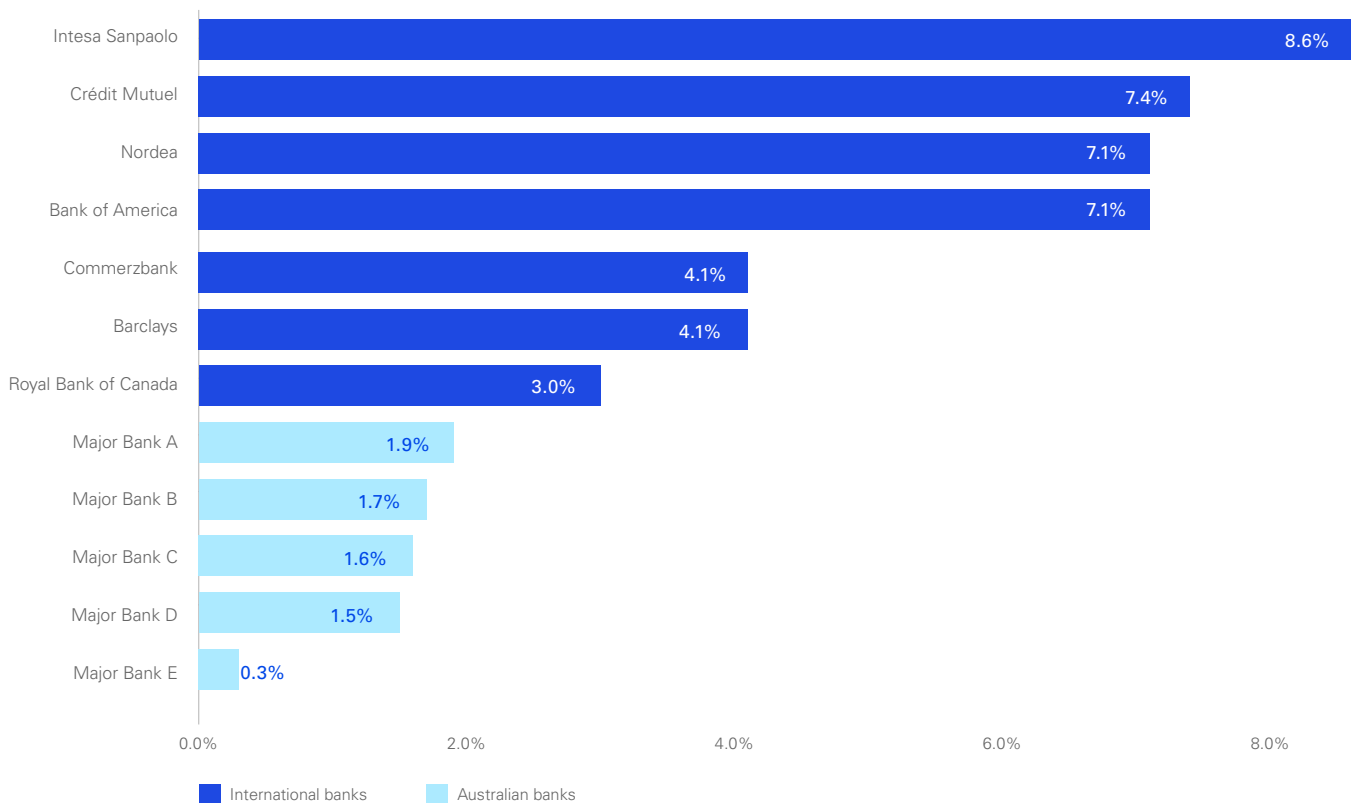
Figure 3: New sustainable finance provided by the top five banks in each country/region relative to total emissions



Source: KPMG Analysis; Our World in Data – Total Emissions (2021) and publicly available Annual reports and/or Sustainability reports (2021/2022).

Notes: (1) Analysis is based on \$bn in new sustainable lending provided by the top five leading banks (by market capitalisation) in each geography in 2022 and the total emissions for each nation or region. (2) See overview of sustainable finance categories for each bank in the Glossary. (3) Scandinavia is comprised of Sweden, Denmark and Norway – countries have been grouped for more accurate comparison due to country size, total emissions and scale of banking sectors.

Figure 4: New sustainable finance as a percentage of total lending in 2022



Source: KPMG Analysis; sustainable finance and balance sheet lending exposures derived from individual bank Annual reports and Climate/Sustainability report (2022). Foreign banks have been selected based on having the highest percentage compared to other banks in the same jurisdiction.

It should be noted that identifying easily comparable statistics from across all banks (both globally and locally) is a challenge. The analysis performed as part of this report identified a wide range of economic activities deemed to be ‘sustainable’ – and the format in which these were reported varied greatly (e.g. including or excluding new lending and/or re-financing, different historic time reporting series (cumulative views vs single year reporting) and inclusion of facilitated lending and/or ESG advisory amounts. If nothing else, the analysis supports the case for greater standardisation to support comparability for investors and customers alike.

Attributes of a leading organisation

	AMBITION	ACCOUNTABILITY	ACHIEVEMENT
	<ul style="list-style-type: none"> Clear and transparent sustainability-linked objectives outlined in the 2022-2025 Business Plan. 	<ul style="list-style-type: none"> 15% of CEO and Managing Director remuneration is directly linked to ESG metrics. 	<ul style="list-style-type: none"> Global leader with ~\$65bn (AUD) in new sustainable lending in 2022.
	<ul style="list-style-type: none"> \$1.5tn (AUD) in sustainable and transition finance by 2030. 	<ul style="list-style-type: none"> Best performer in industry-wide ratings and standards for ISS Quality Score Environment and FTSE Russell ESG Rating. 	<ul style="list-style-type: none"> ~\$30bn (AUD) in sustainable financing provided in 2022.
	<ul style="list-style-type: none"> Clearly lays out strategic focus areas to support 2050 net zero ambitions. Highlights key enablers to achieve targets and metrics. 	<ul style="list-style-type: none"> Detailed criteria for investment in and/or financing provided to customers across high-emitting sectors. 	<ul style="list-style-type: none"> Net zero since 2020 and ranked #1 in renewable energy financing. Fossil fuels account for 0.7% of total lending.
	<ul style="list-style-type: none"> Facilitate more than \$320bn (AUD) in sustainable financing by end of 2025. 	<ul style="list-style-type: none"> Detailed sustainability objectives and targets (2050) with comprehensive metrics and benchmarks. Will no longer issue a standalone Sustainability Report, with performance and outcomes to be covered as part of their audited Annual Report. 	<ul style="list-style-type: none"> ~\$40bn (AUD) in sustainable financing provided in 2022.
	<ul style="list-style-type: none"> Multiply Corporate and Institutional Bank Green Revenues by 1.7x by 2024. 	<ul style="list-style-type: none"> Assigns a 7-level 'Green Weighting Factor' to align lending activities with Paris Agreement commitments. 	<ul style="list-style-type: none"> First bank in the world to actively measure and manage the climate impact of its financing portfolios. Green Weighting Factor tool recognised by the IPCC (AR6 WG3) in 2022.

How Australian banks compare

	nab	ANZ	Westpac	Commonwealth Bank	MACQUARIE
	<ul style="list-style-type: none"> Smaller 2025 and 2030 sustainable finance targets. Largest sustainable finance target of \$100bn (AUD). Incomplete transition sector pathways and targets. Limited ESG metrics known to be linked to Executive and Board remuneration scorecards. ~\$44bn (AUD) provided collectively in new sustainable finance in 2022. 				

Case study

Barclays: going beyond the framework to drive ESG performance and meet targets

British multinational Barclays has set itself clear and ambitious ESG targets that define not only the sustainable funding levels it seeks to provide, but also its maximum exposure to high-emissions activities.

Between 2022 and 2030, Barclays plans to provide a total of \$1.5 trillion (AUD) in sustainable and transition financing, which includes \$160 billion in green finance and \$280 billion in social, environmental and sustainability-linked financing facilitated. The bank is currently on track to meet this target by 2027.

Recognising that high-emitting sectors need significant financing to pivot their technology and infrastructure, Barclays has

developed a Sustainable Finance Framework that enables more granular eligibility assessments. This framework has been based on international practices by the Climate Bonds Initiative, International Capital Markets Association, Loan Market Association and regional taxonomy systems.

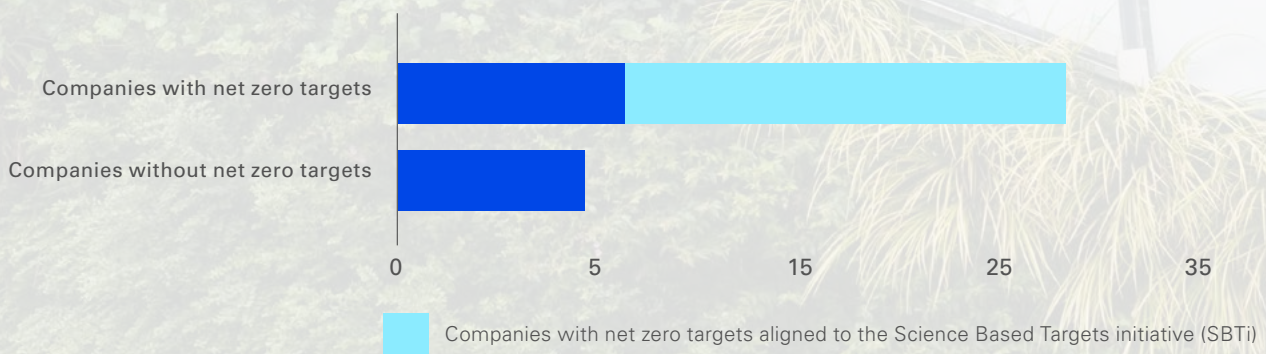
As shown in the following infographic, Barclays is actively monitoring progress towards net zero not only internally but also when it comes to

organisations that they bank with. Barclays track emissions per \$1 million invested, revenues generated from clean-energy by investee companies, as well as exposure to fossil fuels. Our research indicated that a similar degree of transparency is seldom found in the reports of the local banking players in Australia.

96% fewer carbon emissions per \$1m invested than the wider market

45% of Barclays investee companies are generating revenues from clean-energy solutions

0% exposure to fossil fuels



Source: Barclays Sustainable Portfolio Management Report 2022

Demand will grow rapidly as Australian climate policy catches up

With the convergence of global leaders on the 1.5°C ambition, demand for sustainable lending is projected to increase significantly as global decarbonisation efforts accelerate. This will be particularly acute in Australia as we look to play catch-up. In a 2022 survey of Australian industry leaders, almost 6 in 10 said they were ready to deal with implementing their environmental priorities, but there was an expectation that banks and regulators would drive change.²³

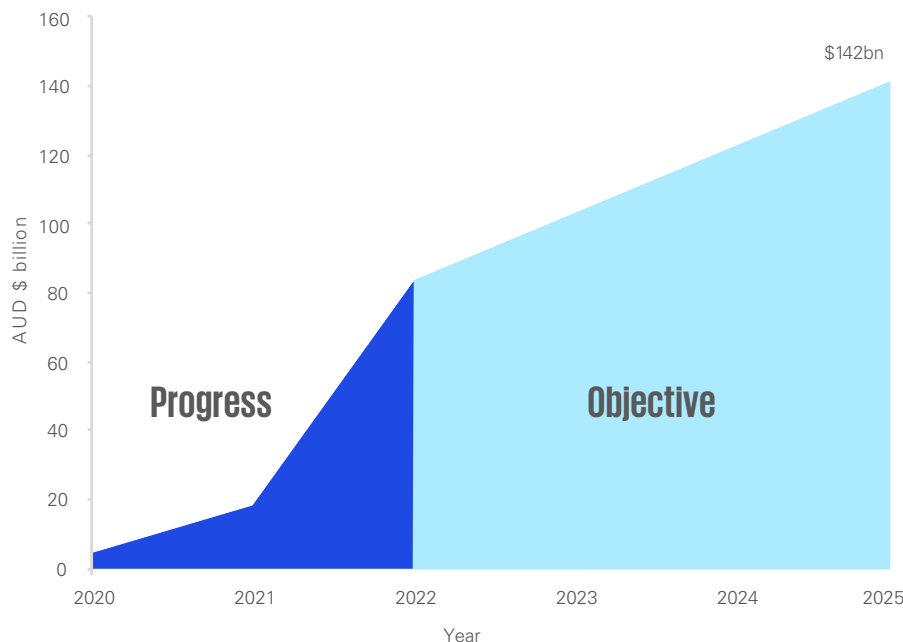
Since the introduction of the European Union’s action plan on sustainable finance in 2018 and the regulations and frameworks that have followed, banks in the region have set increasingly ambitious targets for funding green and transition-related economic activities.

In the case of Intesa Sanpaolo, which is comparable in size to Australia’s Commonwealth Bank, the bank’s provision of sustainable finance has skyrocketed over two years to reach almost \$65 billion in new lending in 2022.²⁴ In support of Italy’s National Recovery and Resilience Plan (2021-2026), Intesa Sanpaolo has committed to providing \$650 billion in medium/long-term lending for projects across green, circular and ecological transition, transport, infrastructure and regeneration.²⁵ Of this, Intesa Sanpaolo have committed to deliver a combined target of \$142 billion in new lending across renewable energy and green mortgages as part of their 2022-2025 Business Plan. By comparison the leading Australian major provided approximately \$15.3 billion of new and incremental financing for sustainable industries and asset types in 2022.²⁶

“It’s clear that domestic banks have an important opportunity to take leadership roles in financing the transition for heavy emitting sectors, to accelerate the pathway to net zero for Australia and seize the commercial opportunity this presents for our economy as a whole.”

SIMON MCKEON
Chair
Australian Industry Energy Transitions Initiative

Figure 5: Rapid growth of sustainable finance from Intesa Sanpaolo, 2020-2025



Source: KPMG Analysis; Intesa Sanpaolo - Support to ESG transition.

Note: \$142 billion represents Intesa Sanpaolo’s 2022-2025 Business Plan target as part of Italy’s National Recovery and Resilience Plan (2021-2026). Reported figures have been converted from Euros to Australian dollars.

²³ KPMG (2022), *30 Voices on 2030: The ESG revolution*

²⁴ Intesa Sanpaolo (2021), *Over €400 billion to support Italy’s Recovery Plan*.

²⁵ Intesa Sanpaolo (2021), *Over €400 billion to support Italy’s Recovery Plan*.

²⁶ Commonwealth Bank of Australia (2022), *2022 Climate Report*.

03. Market share up for grabs in high-impact sectors

A number of global banks are already in discussions about expanding their Australian operations to capture what they have identified as sizeable opportunities in green and transition finance.

Our view is that unless significant progress is made locally, incumbents may find themselves losing out in sectors where they traditionally have had the advantage.

For example, agribankers may lose their more sustainable farming customers to alternative financiers that are able to offer lower prices or more innovative products that reflect the reduction in risk associated with sustainability improvements. For example, Rabobank is a key cooperative partner to the Bega Circular Valley and provides access to finance, knowledge and

sustainability networks.²⁷ This would have a two-fold effect on the bank: the erosion of their legacy business; and increased exposure to higher emitting, less sophisticated customers and associated reputational and stranded asset risks.

While new transition finance opportunities will emerge across all sectors of the economy, this report analyses three key sectors where banks are likely to have a major impact on emissions reduction efforts: **agriculture**, **commercial real estate** and **energy**.

“The biggest international corporates will certainly leverage their global banking relationships if they are not getting the support they need from their local banks. Accessing global capital pools and deploying them regionally will become an increasingly critical part of the transition. We have already seen this trend becoming more evident at events like COP27.”

NOELEEN COWLEY

Head of Financial Services Consulting and Financial Services Lead Partner for ESG
KPMG UK

²⁷ Bega Circular Valley, *How will partners be involved?*

Agriculture sector

The agriculture sector is responsible for approximately 17 percent of Australia's greenhouse gas emissions. Agricultural businesses are under pressure to decarbonise and support the decarbonisation of their broader supply and value chain, while also improving productivity to underpin industry growth targets.²⁸

Based on our research of forecast industry growth targets (\$100 billion farm gate GVP target), projected emissions, abatement initiatives and associated costs, we estimate the Agriculture (farm gate) sector would require an additional \$30 billion in capital by 2030. Sector investment will support Australian agriculture businesses by improving farming practices, adopting new technologies and improving carbon sequestration to progress towards net zero transition by 2050.

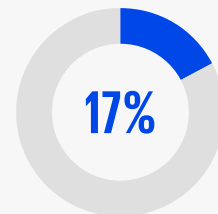
Farmers face significant physical and economic challenges from climate change. A 2021 report by Farmers for Climate Action found that climate-

related risks – including the loss of productive capacity, natural disasters, and health impacts – could cost Australia's agriculture sector more than \$5 billion a year. Agricultural exports, which account for 70 percent of sector output, are likely to be affected by global regulatory changes that will require more extensive sustainability and carbon performance and reporting, and potential expansion of emissions related tariffs at some time in the future.²⁹

To meet their ESG responsibilities and manage transition risks, we expect agricultural businesses to seek green and transitional financing to invest in land use or farm systems change. This will be largely driven by: 1) measurable, and tradeable positive ESG outcomes such as the creation of carbon, biodiversity or other tradable credits; 2) increasing market requirements for more sustainable products; 3) the production of raw materials for markets such as biofuels or construction; and 4) improving the resilience of farms against the physical risks of climate change.

Across the Tasman, Aotearoa Circle's launch of the Sustainable Agriculture Finance Initiative (SAFI) has made steady progress by providing guidance on sustainable agricultural risks, opportunities and practices to reduce emissions and accelerate funding to New Zealand's agricultural sector.³⁰

Farm systems changes will include improved livestock management, fertiliser use, adoption of renewable energy, and ESG measurement and reporting capabilities. Our conversations with agriculture sector organisations indicate that appetite for these sustainable farming investments is growing, particularly as a new generation of farming business operators emerge.



of Australia's greenhouse gas emissions

\$30bn

needed to improve Agriculture farming practices, technology and carbon sequestration to abate emissions by 2030

80%

share of lending currently provided by Australian banks³¹

"There is a lot of money in ESG – hundreds of billions of dollars of capital is being deployed into this space every year just to meet the Intergovernmental Panel on Climate Change targets. This wall of money incentivises companies to embrace ESG and creates opportunities for new revenue streams."

HUGH KILLEN

Former CEO

Australian Agriculture Company (AACo)

²⁸ Department of Climate Change, Energy, Environment and Water (2022), *Quarterly Update of Australia's National Greenhouse Gas Inventory: September 2022*

²⁹ Ibid.

³⁰ Centre for Sustainable Finance NZ (2021), *Sustainable Agriculture Finance Initiative*

³¹ KPMG proprietary analysis

In total, Australia's agricultural businesses are expected to require investment of \$240 billion to \$417 billion by 2030 to meet industry growth forecasts.³² Banks that actively make finance available for companies leading this sustainable transformation will be best placed to take advantage of the industry's growth over the next decade.

Australian banks account for more than 80 percent of agricultural lending, with ANZ, CBA, NAB and WBC issuing almost \$120 billion in loans to the sector currently.³³ The sector has also matured in its consideration and approach to capital financing and ESG, which is demonstrated by increased investment and participation by private equity organisations competing for traditional banking sector market share. Linking the availability and pricing of finance to the customer's own performance against climate-related and sustainability

metrics continues to be an effective method of incentivising and enabling transition. The Commonwealth Bank's agreement with Queensland-based Stockyard Group is one example of a sustainability-linked loan facility that tied pricing to key ESG performance metrics including the reduction of Scope 1 and 2 emissions and improved animal welfare outcomes.³⁴ Since that 2021 agreement, we have continued to see an increase in more readily accessible sustainable finance products offered by banks to the mass market.

While the agricultural sector currently lacks standardised metrics for on-farm data, banks could leverage an increase in data to create value and set themselves apart from competitors. Syncing on-farm data with banks will require significant investment, but the benefits that could emerge from such innovation would bolster trust and confidence in banking lending solutions.

"In the next 20-30 years, all agricultural businesses will need to achieve net zero. All farm sector financing will be sustainability-linked."

ROBERT POOLE

Consumer Goods & Food Sector Leader
KPMG Australia

For banks, speed will be key to capturing and growing market share in agricultural transition finance. Banks that are able to win over early ESG adopters with better product or service offerings will benefit from stronger loan books, particularly as climate-related risks grow, and will be better equipped to support new customers with products, services and advice on the transition to net zero.

³² ANZ (2022), *Greener Pastures 2*.

³³ KPMG analysis of major banks' 2022 annual reports and Australian Banking Association (2022), *Agribusiness Report 2022*.

³⁴ KPMG, National Farmers Federation (2022), *The time is now*.

Commercial Real Estate sector

Commercial real estate is responsible for 10 percent of Australia's greenhouse gas emissions, primarily due to electricity, and smaller gas consumption.³⁵ The sector currently has a total of \$415 billion in commercial property loans, of which 76 percent is provided by local banks.³⁶

There is currently over 859 million square metres of commercial floor space in Australia. With floor space expected to increase 1.5-fold by 2050 to meet projected demand for offices, retail and wholesale trade, factories and other facilities, it is critical that energy efficiency within the sector improves.

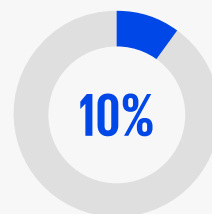
Accurate ratings provided by National Australian Built Environment Rating System (NABERS) that measure the energy efficiency of office buildings are driving the development of new capacity to meet environmental standards, for example by incorporating onsite renewable power and more energy-efficient systems.

But the largest green and transition finance opportunity will be in retrofitting existing buildings to accelerate the sector's contribution to lower carbon emissions. With over 80 percent of Australian buildings expected to still be in use by 2050, the nation will need to retrofit up to 3.5 percent of existing stock each year to meet net zero targets: over three times the current rate of 1 percent.³⁷

Transition funding will be needed for projects such as:³⁸

- Installation of more efficient heating, ventilation and air-conditioning systems within office buildings. A recent upgrade within a Sydney office building cost \$33,000 with an expected 31 percent reduction in energy use.
- Upgrade of a chiller system in an office building, with previous projects costing \$350,000 for an expected 40 percent reduction in energy use.
- Upgrade of a compressed air system in a processing plant, with previous projects costing \$50,000 for an expected 23 percent reduction in energy usage.
- Installation of a building management system in a mixed-use office and retail space, with previous projects costing \$200,000 for an expected 10 percent reduction in energy usage.

Based on recent decarbonisation efforts by commercial real estate operators, we expect \$655 million to be spent on retrofitting offices and retail buildings, and an additional \$729 million on retrofitting hotels in 2023 – accounting for about a third of commercial floor space across Australia. Retrofit costs for those three categories alone are expected to reach a total of almost \$2 billion per annum by 2050.



of Australia's greenhouse gas emissions

80%

of buildings will need to be retrofitted across Australia by 2050

\$105bn

opportunity for green refinance, including \$9 billion for retrofit costs up to 2030³⁹

³⁵ Department of Climate Change, Energy, Environment and Water (2023), 'Commercial Buildings'.

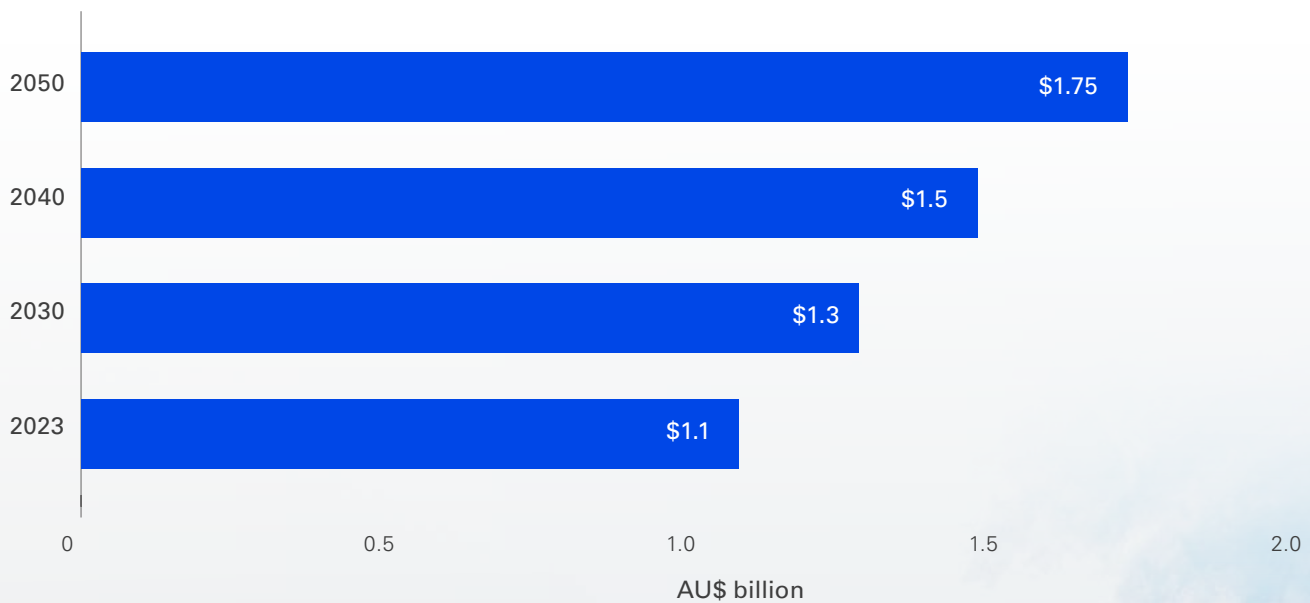
³⁶ Sydney Morning Herald (2022), 'Commercial property lending peaks despite rate rises, pandemic'.

³⁷ JLL (2023), 'Retrofits: The better way to decarbonise real estate' and KPMG (2023), 'ESG in the Real Estate Industry'.

³⁸ NSW Office of Environment & Heritage (2014), 'Energy Efficiency and Renewables Finance Guide'.

³⁹ KPMG Analysis; CBRE (2022), 'Green Finance'.

Figure 6: Estimated annual costs for reducing emissions from existing offices, retail buildings and hotels in Australia



Global statistics indicate that transition finance is underutilised in the Australian commercial real estate sector currently. Green loans account for just 3 percent of the \$330 billion market for commercial real estate debt in Australia, compared to 12-15 percent in the US and Europe.⁴⁰

According to a 2022 report by CBRE, there could be a \$10-15 billion annual opportunity up until 2030 for green refinancing in Australia, if sustainable finance levels grow to meet those in the US.⁴¹

This figure includes opportunities across retrofitting, development and renewable energy improvements. More will be needed not only from the majors but also from alternative lenders to drive the levels of decarbonisation needed across the economy.

⁴⁰ KPMG analysis based on Australian Energy Market Operator (2022), 2022 Integrated Systems Plan for the National Electricity Market.

⁴¹ CBRE (2022), *Green Finance*.

Energy sector

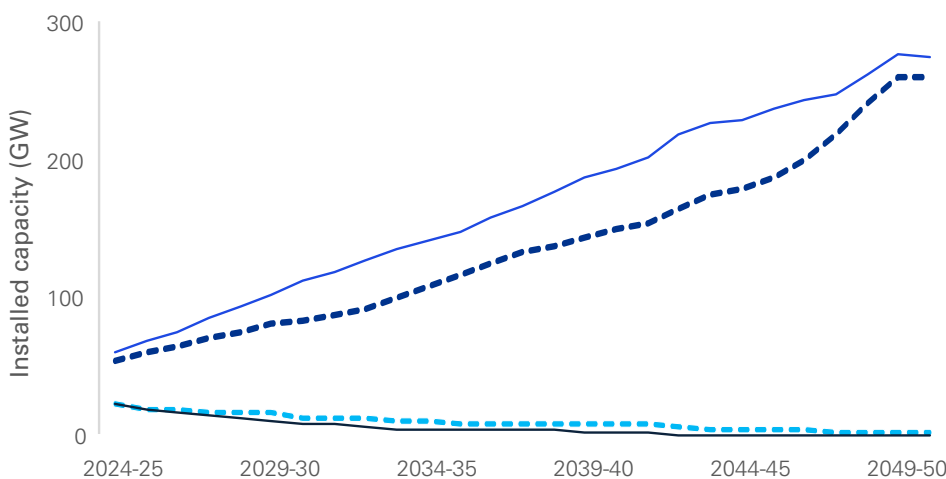
The energy sector is critical to Australia meeting its net zero objectives. As of 2021, fossil fuels accounted for 71 percent of electricity generation in the country, but this proportion is falling fast. As Origin Energy CEO Frank Calabria has explained, 'The reality is the economics of coal-fired power stations are being put under increasing, unsustainable pressure by cleaner and lower-cost generation, including solar, wind and batteries.'⁴²

By 2030, the Australian Government expects renewable energy to meet 82 percent of the nation's electricity needs.⁴³ An enormous investment will be required to transform Australia's predominantly coal-powered electricity grid to one powered majority by renewables. Federal and state governments have introduced

significant measures to drive this change, including the development of a capacity investment scheme to underwrite new renewable energy generation and storage, significant regulatory changes and finance to facilitate transmission infrastructure, and state-based measures.⁴⁴

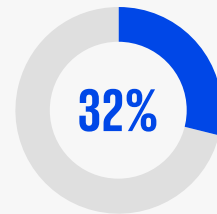
As Climate Change Minister Chris Bowen told the October 2022 AFR Energy & Climate Summit, Australia will need to install 40 7-megawatt wind turbines every month, and 22,000 500-watt solar panels every day, to meet its 2030 target. 'We know we need to work with every sector in our economy and every part of our community to make sure we strike the right balance,' he said at the time.

Figure 7: Australian Energy Market Operator (AEMO) projected change in fossil fuel and renewable energy generation assets 2024 to 2050 (GW)



KEY

- Subtotal fossil fuels – step change
- Subtotal renewable energies – step change
- - Subtotal fossil fuels – progressive change
- - Subtotal renewable energies – progressive change



of Australia's greenhouse gas emissions are contributed by the Energy sector largely due to emissions from the combustion of fuel to generate electricity for public use

> \$100bn

needed to finance new renewable energy generation by 2030

\$2-3bn

worth of fossil fuel electricity generation assets at risk by 2030

⁴² Origin Energy (2022), 'Origin proposes to accelerate exit from coal-fired generation'.

⁴³ Department of Climate Change, Energy, the Environment and Water, 'Government backs next-generation renewable technology'.

⁴⁴ Australian Federal Government (2023), 'Budget 2023-24'.

'It won't be a *whole-of-government* effort, it won't be a *whole-of-governments* effort – it will be a *whole-of-economy* effort which will see us achieve net zero.'

One of the key challenges Australia, its supply chain and financing partners will face is that to fulfil this extraordinary demand in such a short space of time will bring in complex intersectional risks with aspects such as modern slavery issues across the supply chain that will deliver these real assets.⁴⁵

Based on AEMO projections, we expect the energy sector to require over \$100 billion by 2030 to fund new renewable electricity generation facilities, and \$270-300 billion by 2050.⁴⁶ Energy firms will rely on a mix of funding sources, including internal funding, large global financiers, superannuation funds, governments and local banks.

Funding arrangements for new generation facilities are already being negotiated, and banks will need to act now to compete in this market.

By 2035, around half of the required renewable generation assets are projected to have entered the National Electricity Market (NEM). Finance for these major infrastructure projects will need to occur well in advance.

Meanwhile, stranded fossil fuel assets will present a \$2-3 billion risk by 2030, when around half of these assets are expected to have retired from the NEM. By 2050, when the bulk of black and brown coal is decommissioned, the amount rises to an estimated \$4-5 billion.

Case study

Closures, reflecting the acceleration in the energy transition

In 2017, when AGL announced its intention to shut down its ageing Liddell coal power station, the Federal Government of the time threatened intervention. Policy and market conditions have shifted significantly in the six years since.

As well as the Liddell power station, AGL has now brought forward the closure of its Torrens Island gas power station to 2026, and the closure of its Bayswater and Loy Yang A coal power stations to 2033 and 2035 respectively – in the latter case significantly ahead of its predicted lifespan. AGL wrote down the value of Loy Yang A by \$700 million after announcing its decision to close the facility a decade ahead of schedule.⁴⁷

AGL's announced early closures are indicative of how quickly conditions are changing in the global race to

net zero. Energy sector companies are facing growing pressure from governments, investors, consumers and businesses to decarbonise, increasing the risk of stranded assets as the market evolves.

In a statement to the NSW Environment Protection Authority in November 2022, AGL said it had committed to repurposing its large thermal generation sites into low-carbon industrial Energy Hubs. 'Our industrial Energy Hubs at Loy Yang, Torrens Island and in the Hunter will bring together renewable energy production and storage with

energy-intensive industries, centred around a shared infrastructure backbone,' the company wrote.

The Liddell power station, previously responsible for an estimated 1.4 percent of national emissions, was permanently closed in April 2023.⁴⁸ The facility will be replaced with a 500-megawatt (MW), two gigawatt-hour (GWh) grid-scale battery onsite, and the firm is exploring other generation options including renewable energy, battery and pumped hydro opportunities.⁴⁹

⁴⁵ KPMG and Responsible Investment Association Australasia (2021), 'Human rights and climate change'; The Guardian (2022), 'Evidence grows of forced labour and slavery in production of solar panels, wind turbines'

⁴⁶ KPMG analysis based on Australian Energy Market Operator (2022), '2022 Integrated Systems Plan for the National Electricity Market.'

⁴⁷ AGL (2022), 'Outcomes of review of strategic direction and FY23 earnings guidance'.

⁴⁸ Liddell was estimated to account for 7.5 megatonnes of emissions in 2015-16, when national emissions were 534.7 megatonnes. Department of Environment and Energy (2016), 'Quarterly Update of Australia's National Greenhouse Gas Inventory: June 2016' and The Conversation (2017), 'The true cost of keeping the Liddell power plant open'.

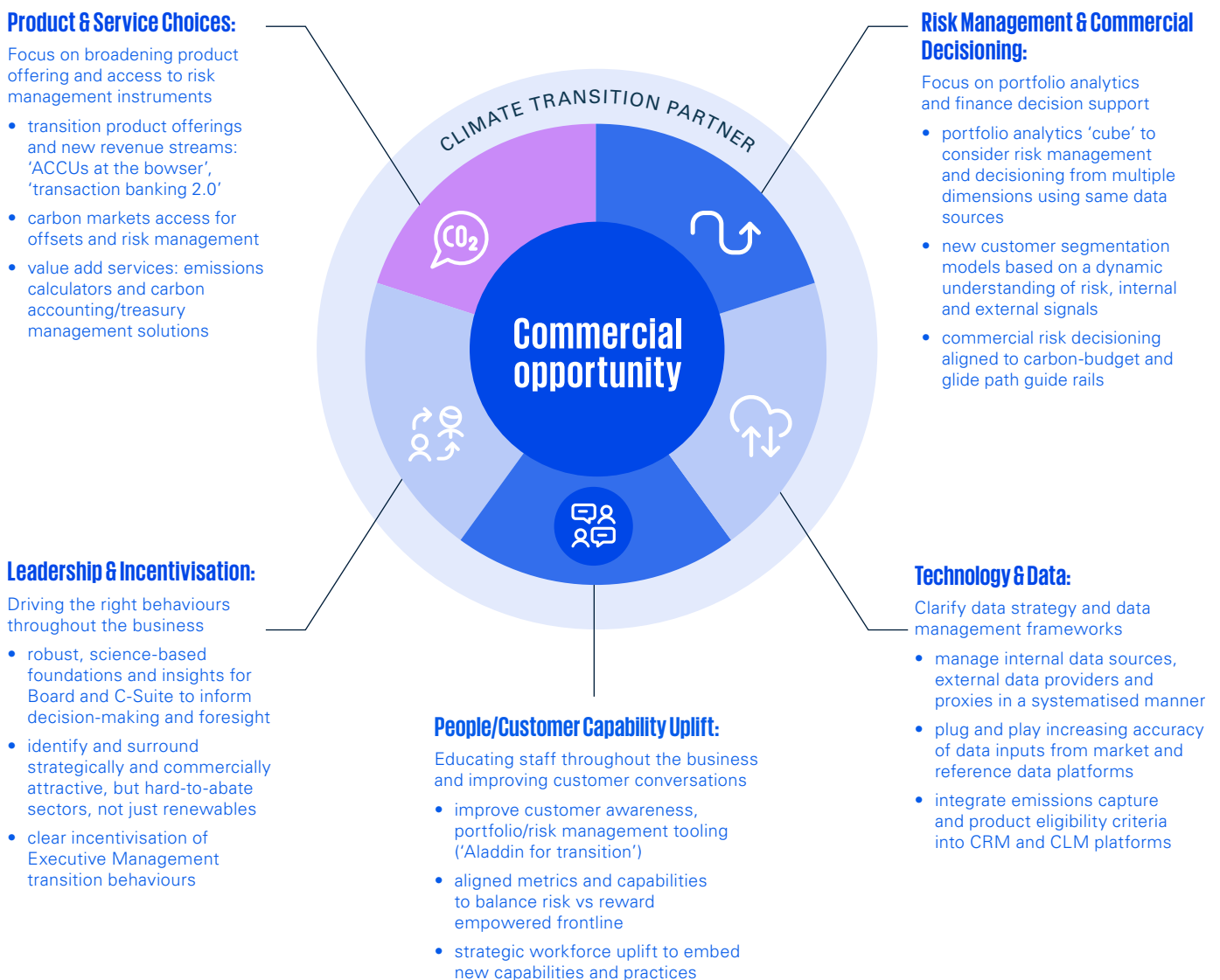
⁴⁹ AGL (2023), 'Half-Year Results Presentation'.

04. Rewiring the bank for transition finance readiness

To compete in both the green and transition financing markets, Australian banks will need to embark on urgent, enterprise-wide transformation to embed sustainability into all their lending and financing decisions.

Local banks, to date, have not been able to make the case for transformational change due to competing priorities, regulatory uncertainty and insufficient understanding of the quantifiable business case to act.

Figure 8: Adopting a targeted, test and learn approach to the transformation | Rewiring existing capabilities to service transition finance needs



As decarbonisation efforts accelerate across all sectors of the economy and the science clock continues to tick, the time for change is now. As outlined in this report, our view is that while climate risk – through physical, transition and liability risks – poses a new and material financial risk for the banks to quantify, analyse and mitigate; an **equally sizeable risk exists around the commercial implications of losing market share and new profit pools derived from funding the economic transition** in Australia. The positive news, however, is that banking is well-placed to transform to meet the once-in-a-generation challenge – and opportunities – that decarbonisation presents, when compared to other sectors. Leading banks already have many of the foundations needed to provide the financing required in a way that achieves a win-win-win for the planet, their customers, and their shareholders:

- expert commercial decision-making
- sound risk management and governance capabilities
- advanced data and analytical capabilities, including the ability to quantify and price externalities into their propositions.

The challenge will be how quickly can they industrialise and scale this to all the sectors they serve. Their traditional credit-based decisioning, based off decades of learned and quantified experience, will need to evolve to consider these new consideration sets – in an environment where even the scientific fact base continues to evolve.

To build on these strengths, banks will need to undergo an accelerated, enterprise-wide ‘rewiring’ of systems and processes in five key areas to develop the comprehensive green and transition financing capabilities for the decade ahead:

- **product and services**
- **risk management**
- **leadership and incentivisation**
- **technology and data**
- **people and customer capability.**

We expect these transformation efforts to be an iterative multi-year, often test-and-learn reality as policy, regulation and global business conditions continue to evolve, with a complex set of interdependencies to be considered.

Investment in capability uplift and strategic partnerships will be essential in enabling organisations to successfully navigate this pathway.

SPOTLIGHT: AUSTRALIA GOES GLOBAL FOR CAPITAL RAISING TO FUND SUSTAINABLE ACTIVITIES

In March 2023, NBN Co became the first Australian Government Business Enterprise to issue Green Bonds in Europe. It raised AU\$2.1bn from European Green Bond issuance in debt capital markets. The capital raise was designed to fund green projects that support its energy efficiency focus – in line with the government’s commitment to net zero by 2050.

BNP Paribas, Citi, Deutsche Bank and HSBC acted as lead managers for the offering.

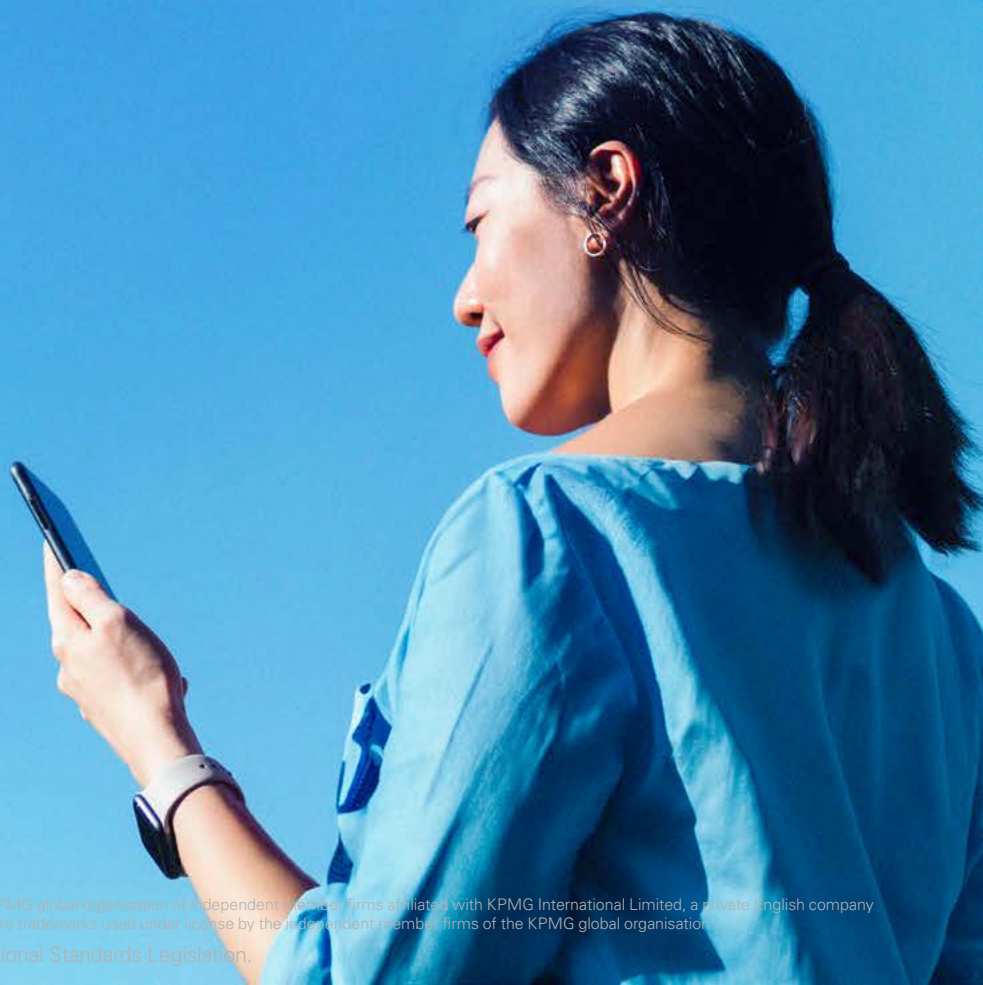
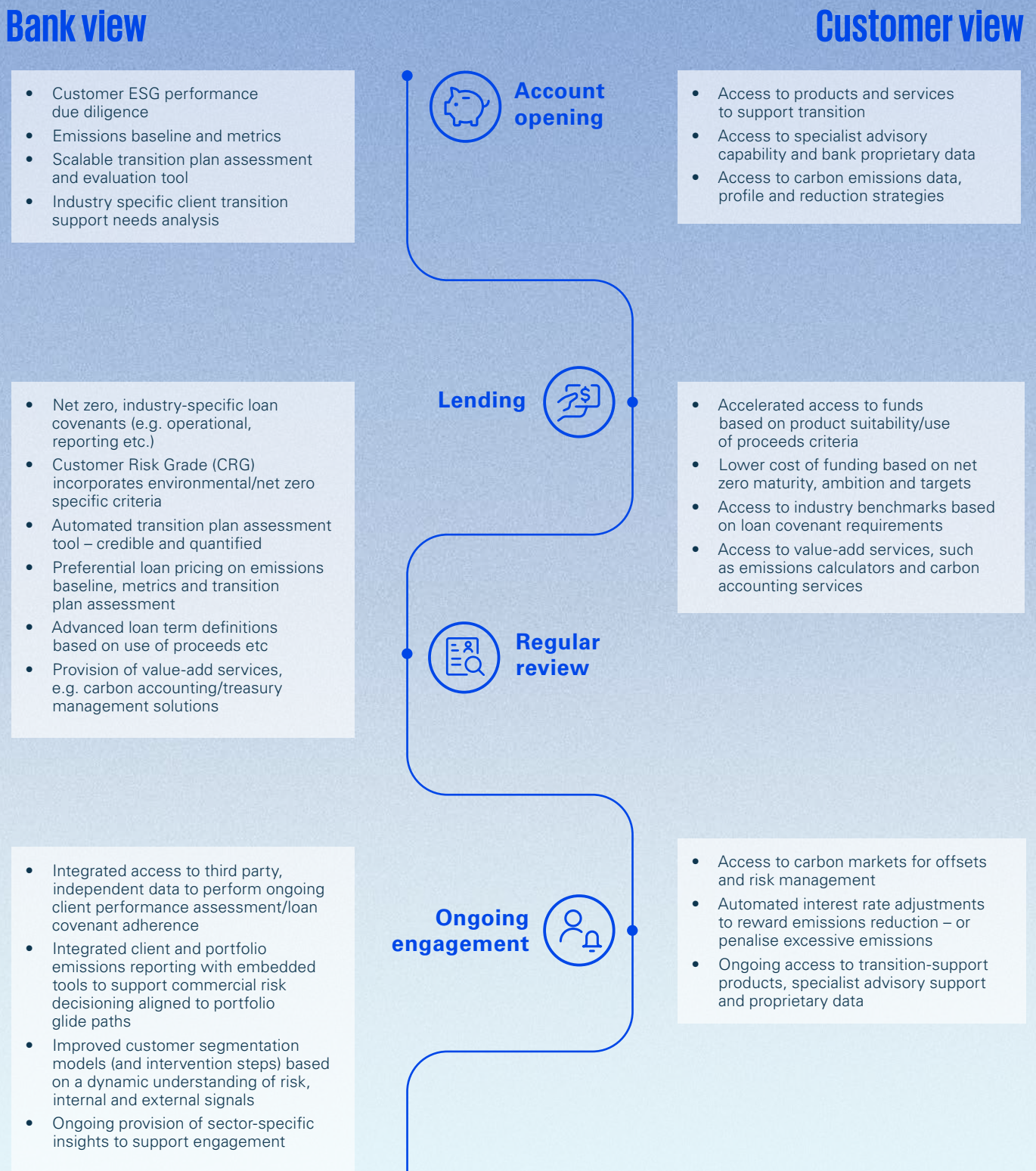


Figure 9: Transition finance in the lending journey



Underpinned by increasing level of independently verifiable data sources (e.g. satellite data, third party aggregators)

Products and services

While the market for green bonds and renewable financing has grown rapidly in the past five years, leading financiers are now shifting their focus towards the much larger transition financing opportunity.

New sustainable debt instruments and debt capital markets are emerging to support a wider range of decarbonisation efforts, in a wider range of economic sectors. Chief among them are sustainability-linked loans (SLLs): performance-based instruments that tie interest rates to the achievement of defined sustainability outcomes.

Transition finance products are emerging not only from banks but also from asset managers, infrastructure funds, institutional investors, private equity and venture capital funds. Some of these will require banks to modify their lending policies – enabling shorter loan periods, aggregating project portfolios to increase ticket size, and playing a structuring role to earn incremental fees. But financiers need to be prepared for the increased volatility that these changes will bring.

Ultimately, we **expect climate considerations to become embedded into all lending and investment decisions over the long term**. In the interim, bankers and credit risk officers will need to upskill to capture transition finance opportunities from emissions reduction efforts in hard-to-abate sectors such as steel, cement, new energy transmission and distribution infrastructure to green mortgages, residential solar and EVs. Leading banks are also looking to develop new revenue streams through value-add ‘transition services’. These include advisory, emissions calculators and assessment tools, trade finance and transaction banking solutions. As an example, Levi Strauss & Co’s 2022

sustainable supply chain financing arrangement with HSBC offers interest rate discounts to suppliers that meet the clothing brand’s environmental and social standards.⁵⁰ Similarly, Santander has partnered with Sonae to offer suppliers preferential discounts based on ESG ratings from global sustainability rating platform EcoVadis.⁵¹ Carbon markets will also be a significant opportunity for banks. Carbonplace, which has been jointly developed by nine global banks, is one example of a carbon marketplace that will enable customers to mitigate the effects of hard-to-abate emissions, while allowing others in sectors such as agriculture to effectively commercialise their assets. Leading financiers are also building carbon tracking capabilities, carbon trading desks and related products such as carbon credits, indexes, funds and certificates, to help corporate customers purchase and use offset solutions.

To support this evolution in product and services to better serve the economic need, **banks will need to continue to lobby and support other actors to build the critical ‘rules of engagement’ for Australia** – for example, the development of industry-wide definitions of sustainability terms and taxonomies and new government standards, such as energy ratings for all residential properties. This will enable the banks to evolve their credit-decisioning criteria in way that drives the right outcomes and build new ways of looking at project economics towards more long-term thinking.

Risk decisioning

Banks need more advanced risk management and commercial decisioning capabilities to participate in the transition finance market.

“At the moment, green financing products are very small in terms of the value in the marketplace. These are the bright shiny products that retail ESG investors will want. But the reality is, the bulk of funding for the next decade is going to be in transition financing. Ultimately, society needs transition financing. It’s actually where banks can make the biggest difference, working with customers to truly transform their businesses.”

KAY SWINBURNE

Vice Chair of Financial Services at KPMG UK and former Member of European Parliament

While many currently err on the side of caution with environmental policies that simply exclude high-emitting sectors, customers or projects, **market leaders are weighing up each deal against their strategies, carbon budgets, and ‘bigger picture’ impact on emissions transition pathways**. This more nuanced approach is enabling leading financiers to support more challenging decarbonisation initiatives with higher commercial returns in the short run.

Enabling these more complex decisions will require a significant evolution in commercial decision-making frames of reference. Banks will need to develop ways of verifying customers’ transition plans and monitoring progress in line with suitable financing terms, as well as a better understanding of how credit risk is affected by customers’ achievement of their sustainability targets.

⁵⁰ Levi Strauss & Co (2022), ‘Financing supplier sustainability with HSBC’

⁵¹ Santander (2022), *Santander launches first Sustainability-linked Supply Chain Finance in Portugal*

Banks will need five key elements in place to enable new transition finance products and services:



An ecosystems approach

Leveraging both strategic and niche partners who can support banks' points of differentiation and accelerate solution and market development. This can and should extend to cross-sector partnerships.



Transition finance specialists

Who can 'spot the opportunities' by understanding how policy changes can turn previously unattractive opportunities into commercially viable ones, where rapid scaling can occur at pace.



Enhanced customer segmentation models

Based on a dynamic understanding of risk factors and opportunities of your customers' performance against climate KPIs.



Greenwashing mitigation

In product development, advertising, terms and conditions, product disclosure statements and other documents. Organisations will need to manage this risk against a fast-evolving regulatory environment to avoid extensive future remediation and reputational damage.



Climate ambition embedded within the broader corporate strategy and incentives

To help embed sustainability objectives throughout the organisation. Bank leaders and staff at all levels should be incentivised to innovate beyond the status quo, and actively look for solutions that accelerate decarbonisation.

A number of capabilities and analytical tools will need to come together to collectively inform:

- **Strategy setting and capital allocation**, including the use of scenario modelling and stress-testing to determine expected losses (e.g. defaults or wholesale credit losses for key high-emitting sectors), and risk-weighted asset projections to inform capital allocation while accounting for climate risk.
- **Portfolio mix considerations**, for example, avoiding concentration risk in any sector or portfolio.
- **Risk appetite setting and measurement** as market conditions continue to evolve.
- **Credit risk decisioning for transactions** including the expertise needed to understand the new economics of any given deal, particularly as governments introduce incentives to support new technologies and sector advances.

These new capabilities will require advances in how banks use limited historical data for long-term forecasting and new ways of looking at project economics, credit and market risks as technologies and commercial models continue to evolve.

Banks will also need to manage risks associated with 'greenwashing' – including the potential of reputational damage and financial remediation – by ensuring decisions are made and reported in a way that is fair, consistent and clearly aligned to the bank's risk appetite and long-term decarbonisation strategy.⁵²

⁵² KPMG (2023), 'The crackdown on greenwashing'.

SPOTLIGHT: NATIXIS EMPLOYS GREEN WEIGHTING FACTOR TO EMBED ENVIRONMENTAL IMPACT INTO CREDIT APPROVALS

French corporate and investment bank Natixis in 2019 introduced a Green Weighting Factor to reflect the environmental impact of their lending in their risk-weighted assets.⁵³

The mechanism is based on a detailed, two-tiered sector-based methodology that assigns each financial transaction an environmental rating, based on a seven-level colour scale from dark brown to dark green. Risk weighted assets are reduced by up to 50 percent for green deals and increased by up to 24 percent for brown deals.

“We are committed to increasing the ratio of green assets on our balance sheet [to align to a decelerating global warming trajectory of +1.5 degrees by 2050], by using our Green Weighting Factor mechanism.”⁵⁴

HONG MY NGUYEN

Head of Green & Sustainable Investment Solutions, Natixis Corporate & Investment Banking

Leadership and incentivisation

Bold leadership will be needed for banks to drive the transformational change required for the climate transition, and to communicate their activities and objectives to customers, stakeholders and staff. This will be complex – as transition finance (i.e. financing to assist organisations to decarbonise) will be more challenging to communicate to certain stakeholder groups.

Our conversations with industry leaders have highlighted the challenge in taking a bolder approach to transition financing, as any public statements about corporate climate initiatives tend to quickly attract public accusations of greenwashing. While we believe this challenge will diminish as the market matures, it has dampened potentially important attempts at a test-and-learn approach, where banks have sought to develop processes and systems to play the transition partner role within specific target sectors.

To counter this, **global leaders take an active advocacy role in advising government and policy-makers on the settings that will incentivise or discourage capital flows for decarbonisation**, while also investing in internal efforts to make the most of existing frameworks. Being bold here will help strengthen the economic case for decarbonisation – and develop the economically viable markets that create a triple win for the planet, businesses and investors alike.

To drive the transformational changes required within banks, sustainability will need to be clearly embedded into staff performance metrics. While 80 percent of ASX 100 companies now have ESG targets in their bonus calculations, many of these are described in qualitative and less objective terms. In contrast, **1 in 4 European Union banks have in place a remuneration structure linked to climate targets, as defined by the European Central Bank.**⁵⁵ These performance targets are critical to how executives balance their fiduciary duty to achieve financial returns to shareholders with the delivery of longer-term environmental and social outcomes.

⁵³ Groupe BPCE (2019), ‘*Natixis rolls out its Green Weighting Factor*’

⁵⁴ The Banker (2022), *Natixis delivers green-flavoured structured product opportunities*

⁵⁵ European Central Bank (2022), *Walking the Talk*.

SPOTLIGHT: INTESA SANPAOLO EMBEDS ESG TARGETS INTO EXECUTIVE INCENTIVES

At Intesa Sanpaolo, clear ESG targets have been embedded into executive incentive systems, accounting for 15-20 percent of performance ratings for Intesa’s middle managers, functional heads, Managing Director and CEO.

Executives are assessed against targets such as the year-on-year increase in customer lending volumes for green and transition finance products, and promoting awareness at all levels of the organisation of emerging risks including climate change.

Intesa overtook UniCredit as Italy’s largest bank in 2021 and is one of the best-performing companies on Borsa Italiana, with its stock price up 23 percent in the six months to March 2023. It has a network of over 3,600 branches and opened its first in Australia in 2020.

Data and technology

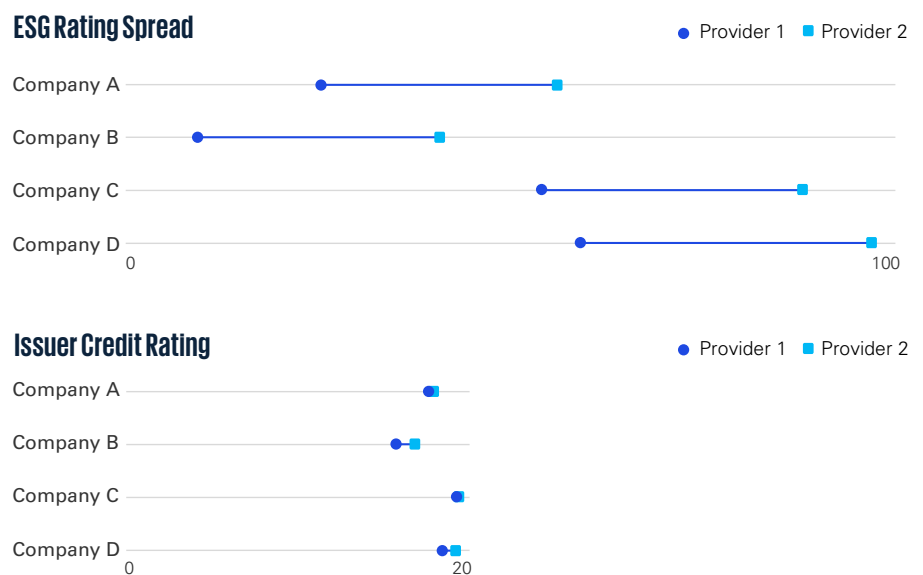
From a performance perspective, it is already well understood that existing ESG specialist rating agencies have been unable to provide a reliable and consistently agreed approach to evaluating a companies’ ESG performance.⁵⁶ This provides a real challenge to financiers, whose existing decision frameworks are built on dealing with robust and reliable credit ratings – built on decades of quantitative experience, where correlation even across different rating agencies is far greater.

The challenge is equally pervasive when it comes to banks understanding their financed emissions – with analysis showing there can be significant discrepancies between players using granular, company-specific emissions data and those who rely on industry data and proxies for baseline estimates. This has an impact on data-led decisions when it comes to portfolio management, capital allocation and lending decisions.⁵⁷

In the coming years, enabled by increased requirements for all sectors to uplift emissions reporting⁵⁸, **we expect lenders to be collecting new climate data across all stages of the customer journey**, and leverage this along with uplifted existing data to:

- integrate data into the value chain, enabling, for example, differentiated customer onboarding processes, differentiated credit risk and commercial drivers for rate setting
- monitor emissions reductions alongside financial performance of assets and financed projects
- develop closer links between customer activities and emissions reduction progress, and bank targets and achievements
- better understand Scope 3 financed emissions by transitioning from estimation factor data to real, granular customer data.⁵⁹

Figure 10: Material discrepancies in ESG ratings compared to more consistent credit ratings



Source: KPMG adapted image from Dimensional Fund Advisors (2021), ‘Do ESG Ratings Get High Marks?’.

⁵⁶ ScientificBeta (2020), ‘Scoring against ESG? Avoiding the pitfalls of ESG scores in portfolio construction’.

⁵⁷ KPMG (2023), ‘Harnessing ESG data to achieve your decarbonisation goals’.

⁵⁸ In December 2022 Treasury released its consultation paper on Climate-related Financial disclosures for Corporate Australia. KPMG’s response to this consultation paper can be found here: [Climate-related financial disclosure \(kpmg.com\)](https://www.kpmg.com/au/en/issuesandinsights/articlespublications/2022/12/12-climate-related-financial-disclosure).

⁵⁹ Scope 3 financed emissions are emissions that may be attributed to a financial services provider because of the customers or activities that it funds. They account for a vast majority of finance sector emissions.

Better, more reliable customer data will become available as standards emerge.⁶⁰ To effectively collect and use this data, banks will need to:

- adapt their existing data governance processes and frameworks so they may be applied to externally provided data (including data from customers and third parties)
- enhance their data management practices to accurately track new and existing ESG data flows
- define the data technology architectures for capturing, managing and provisioning Scope 3 emissions data
- integrate the data models and systems managing Scope 3 emissions data into existing core data models and operational systems, to enable this data to be used in business value chains and decision-making.

Banks that are able to leverage relationships with specialist ESG fintechs and other partners will have a clear advantage in building the data and technology capabilities needed for the provision of sustainable finance.

People and customer capability

Local banks have made visible commitment to the climate agenda, including the investment in building specialist teams across the enterprise in areas such as frontline bankers, risk management and reporting and disclosures. This includes:

- partnerships with research and academic providers to deliver point-in-time ESG upskilling across targeted areas and audiences

- targeted operating model changes to ensure appropriate focus and enterprise-wide alignment to deal with the complex waves of change anticipated
- deployment of targeted tools to assist customer decisioning – such as carbon emission tracking applications for retail customers.

Our observation on these investments, however, remains the challenge to rapidly scale and seize the opportunity, while continuing to operate within measurable risk tolerances. **With the transformation required impacting front, middle and back office, we observe several potential gaps** in the current approach:

1. **Data and analytics** – bridging the gap between deep technical data expertise with sustainability or ESG centres of excellence. This includes how complex scenario modelling and stress-testing – and the insights this provides – feeds into the decision-making apparatus of the bank.
2. **Technology** – understanding the strategic intent and priorities of the organisation and how the external technology and data vendor landscape might best support this, including how and where investment is required to uplift and integrate existing systems.
3. **Operations** – ensuring operational processes are designed in a way that is efficient and scalable, and leverage data and automation levers to support scale, especially across the high-volume areas of business and retail banking propositions.

4. **Risk, including credit risk and second line** – uplifting risk frameworks and risk reporting to recognise what is, in climate risk, a complex risk type that continues to evolve.
5. **Compliance focus on greenwashing mitigation** – vetting and monitoring at a firm, product and transaction level.
6. **Finance** – fast becoming the new custodians of sustainability reporting – to better integrate into financial reporting processes and build equivalent control frameworks, current and future assurance activities, but also Carbon Planning (Financed emissions) and impact to Pillar 3 reporting.

And beyond these:

- **Related policy owners** – to understand how the shift in market need will impact either sector or domain functional policies and how these will need to morph to meet the commercial opportunity within accepted risk tolerances.
- **Enterprise process owners** – core strategic processes such as investment prioritisation to ensure appropriate consideration of ROI in an area that continues to evolve.
- **Broader, enterprise-wide and aligned capability uplift program** – from Board through to role-specific training programs to ensure all members of staff and the board are aligned with the organisation's sustainability objectives and long-term goals.

⁶⁰ The Australian Sustainable Finance Institute is developing an industry-standard sustainable finance taxonomy. Development will continue in partnership with the Australian Government and regulators throughout 2023. Australian Sustainable Finance Institute (2023), *Designing Australia's sustainable finance taxonomy*.

05. How we can help

What if there was a way to stay in front of evolving regulations, opportunities and best practices and take advantage of commercial opportunities as the economy transitions to net zero?

KPMG works shoulder-to-shoulder with leading banks across the globe – and the corporates they serve – to devise and execute plans to enable the transition financing capabilities needed to support decarbonisation.

With a global network of specialists in climate change, decarbonisation and net zero transition, as well as deep expertise in business operations, technology, policy and industry sectors, we are uniquely positioned to bring together the experience and expertise needed to embed sustainability into an organisation's core business strategy and deliver on its transformation goals at speed.

KPMG in Australia supports clients with:



Access to global insights

On leading practices, trends and potential roadblocks. We leverage the latest industry knowledge, alliance partnerships, and deep experience with organisations like yours around the world, to help you achieve your targets faster.



A systems-based approach

With KPMG financial services specialists working closely with expert colleagues in key economic sectors such as energy, agriculture, commercial real estate and industrial to help banks understand how to best support their customers' decarbonisation journeys and sector-specific challenges.



World-leading climate change, sustainability and social impact expertise

To help banks understand material risk exposures, how to measure, report and monitor these, and how to interpret the growing complexity of policy, regulatory and key stakeholder needs.



Market-leading sector-specific capabilities and pre-configured assets

Including customisable target operating model (TOM) frameworks, transformation blueprints and prioritised roadmaps and risk frameworks (e.g. greenwashing risk management). These provide a clear path for banks to enhance the capabilities needed to identify and decision transition finance opportunities while monitoring, managing and reporting on underlying climate change financial risks.



Proprietary tools and modelling suites

To accelerate the development and deployment of new products and capabilities to meet the needs of multiple stakeholders, be they customers, investors or regulators.

KPMG's decarbonisation solution suite for financial services providers

We offer a range of industry-leading solutions and services to help clients capture and accelerate sustainable finance opportunities.

Decarbonisation Transition Pathways	<p>Bringing together our deep climate change and sustainability expertise with our financial risk modelling to develop or assure robust, leading practice aligned methodologies and quantified modelling through:</p> <ul style="list-style-type: none"> • counterparty data consolidation and emissions apportionment • portfolio target setting – considering segmentation, metrics, reference pathways (e.g. IEA, SBTi, CSIRO/Climateworks) and targets • model review and verification – baseline calculation, tracking to roadmap and tracking to reference pathway.
ESG Learning Pathways	<p>KPMG's ESG Learning Pathways is a targeted learning program that is delivered in conjunction with experts from Climateworks Centre, Monash Sustainable Development Institute (MSDI), and KPMG Banarra to enhance ESG competency across your whole organisation from board and C-suite all the way through to a scalable, whole-of-enterprise foundational capability.</p>
KPMG Financed Emissions Data Solution	<p>Our Scope 3 financed emissions data management framework helps banks address the data challenges of using their customers' emissions data.</p> <p>The solution includes an advanced Kimball data model for capturing GHG data and is built on the backbone of our best-in-breed Advanced Data Management Framework, which brings together leading data quality and governance disciplines, frameworks (e.g. DAMA-DMBOK), reference models (e.g. Data Management Maturity model of CMMI) and project assets to help you get the most from your data, faster.</p>
ESG Target Operating Model and Sustainable Lending Transformation	<p>KPMG's ESG Target Operating Model is an end-to-end blueprint that incorporates six critical design layers: functional processes, people, service delivery model, technology, performance insights and data, and governance. With the use of leading practices and maturity models, we enable clients to make critical decisions using strategically applied processes, technologies and tools.</p> <p>KPMG's Sustainable Lending Transformation practice leverages our deep understanding of retail, business and institutional lending processes (e.g. origination, credit-decisioning) to inform changes required to: develop and execute on new products and services; scale key products to meet underserved market demand; and to move towards dynamic pricing.</p>
KPMG Analytics: ClimatIQ and Climetric	<p>Climate IQ is a comprehensive, multi-industry risk management tool that evaluates key KPIs to address key questions around a company's exposure to climate change, to help formulate strategic decisions in line with business needs and regulatory requirements.</p> <p>Climetric performs portfolio-wide climate risk stress-testing to quantify the impact of multiple physical and transition risk scenarios on a portfolio's credit quality and key financial metrics. The tool leverages internationally accepted climate scenarios and a modularised and adaptable methodology.</p>
Risk Governance and Management	<p>We offer a suite of tools to quickly and efficiently implement robust climate risk processes and controls, including:</p> <ul style="list-style-type: none"> • greenwashing identification across firm-based, product-based, client-based and transaction-based risk drivers • maturity model, based on COSO 13 • ESG controls framework to accelerate control uplift work • pre-configured process maps covering TCFD key metrics and over 50 other ESG metrics • TCFD and ESG 'SOX-style' leading practice risk and control matrix (RACM) and associated controls.
ESG Strategic Alliances	<p>We collaborate with Microsoft, Salesforce, ServiceNow, IBM, Oracle, Workday and other strategic alliance partners and understand their ESG solutions on a deep, technical level. By leveraging these partnerships and our operational expertise, we work with clients to deliver technology and data solutions that meet business needs, including integrating with key platforms.</p>

Case studies

Enabling a major Canadian mutual bank to deliver on its climate commitments

In 2022, a major Canadian mutual bank reached out to KPMG for assistance with mapping out a path to meet its net zero commitments.

The bank had publicly promised to reach net zero in three sectors by 2040. In the interim, it faced a dilemma: an overly ambitious carbon budget would preclude it from important transition finance opportunities, while overly weak decarbonisation targets would leave it open to public accusations of greenwashing.

We worked with the bank to create appropriate 2030 targets that would balance stakeholder expectations with the reality of supporting sectors in early stages of the climate transition. This work was supported by an initial benchmarking exercise, which we performed to help the bank understand what its peers had done and how their targets had been perceived.

Along with the interim targets, we also delivered a communications plan to help the bank manage stakeholders and a high-level roadmap of the changes it would need to implement to deliver on its objectives.

Developing a Climate Investment Framework for a US\$100 billion private equity fund

In 2022, KPMG worked with a large, US-based private equity firm to develop a Climate Investment Framework for its new investing platform.

The client had committed to deploying US\$100 billion in energy transition and decarbonisation investments by 2030. It sought KPMG's support to address two key concerns: to reduce the risk of greenwashing, and to strengthen its understanding of key risks and considerations when investing in companies within the nuclear, liquid natural gas and biomass sectors.

We conducted a detailed review of the firm's proposed Climate Investment Framework, comparing it against market expectations, industry standards and peer activity. Through our review, we identified areas of improvement for the framework and existing asset classifications, and also devised detailed standards for nuclear, liquid natural gas and biomass investments.

Our findings were delivered in an in-depth report that outlined how the proposed framework would align with the firm's existing screening, segmentation and processes; relevant environmental risks and considerations; and advice on the firm's draft marketing materials and fund documentation.

Supporting the UK's largest insurer on their ESG journey

KPMG has supported the UK's largest insurer over the last two years across a number of their impacted business units and functions to assist on their ESG transformation journey.

This has included:

- definition of the group's climate reporting manual and methodology, and assistance in defining ESG metrics, business requirements and data sources to support the implementation of a group ESG reporting data model
- documentation of end-to-end ESG process, controls framework and performance of readiness reviews for a number of various ESG reporting requirements

- collaboration with selected technology vendor to design, integrate and deliver the end-to-end climate and ESG data management solution
- ongoing regulatory horizon scanning and discussions – to inform go forward strategy and focus
- supporting the design of the group ESG COE.

Our work delivered:

- Streamlined the number of metrics reported and the

disclosure itself, leading to clearer reporting and efficiencies in delivery

- Clarity over accountability led to improved oversight, increased standardisation, better quality data and enhanced reliability of controls
- Ultimately led to key metrics and disclosures being "reasonably assured" by external audit and wider areas being internally assured, giving comfort to Audit Committee and investors.

Analysing climate-related risks in a major bank's agribusiness portfolio

KPMG assisted a major bank with portfolio analytics for their agribusiness loans to identify relationships between credit quality and weather events.

We have developed a climate risk stress-testing model which measures physical risk and transition risk impacts on loan portfolios for a range of climate scenarios.

Our model has the capability to analyse the impact of the mitigation and no-mitigation scenarios on a

borrower's credit risk. This enables us to calculate the cost of inaction, which could guide banks in targeting appropriate products and services for their customers.

Our framework is based on the widely used Meriton model to understand the risk of a borrower.

We use information inputs from the customer level, transition scenarios and Australia-specific industry information. The methodology leverages the most relevant tools for quantifying climate-related transition risk and combines them into a holistic approach.

A blockchain-based platform to support green financing across the sugar supply chain

Since 2017, KPMG has worked with the Queensland sugar industry and a major Australian bank to develop an incentive and reward mechanism for growing and sourcing sustainable sugar.

The partnership leverages KPMG Origins, a blockchain-based platform for recording products' sustainability credentials and tracking them as they move through the supply chain. This platform enables the bank to quickly validate and issue

green loans to cane growers for implementing more environmentally friendly practices, as well as to the mills, refineries and marketers that seek to source sustainable sugar.

Our work has simplified the reporting process for the sugar industry, reduced the risk of greenwashing, and enabled the bank to create sustainability incentives for its customers, including Green Financing Loan Interest Discounts.

Glossary

TERM	DEFINITION	SOURCE
Sustainable finance	Capital flows into economic activities that contribute to sustainability objectives including climate change mitigation, climate change adaptation, and the promotion of resource resilience and/or the transition to circular economy. Green finance and transition finance are two categories of sustainable finance.	Designing Australia's sustainable finance taxonomy , Australian Sustainable Finance Institute (2023)
Green finance	Capital flows into economic activities that are aligned with sustainable finance objectives.	Briefing: Green and sustainable finance , European Parliament (2021)
Transition finance	Capital flows into economic activities on a pathway to aligning with sustainable finance objectives.	Guidance on Transition Finance , OECD (2022)

Bank definitions of sustainable finance

As there is no global, industry-standard definition of sustainable finance, comparing banks' sustainable finance targets and progress to date can be challenging. In this report, we have relied on new lending data and definitions from Annual Reports, Climate/Sustainability Reports or market updates. Where possible, key figures utilised in this report exclude green bonds, facilitated loans, advisory loans and social lending for analysis purposes.

WBC	Includes committed lending exposure to green buildings, renewable energy projects, low carbon transport, adaptation infrastructure, forestry, waste, low carbon infrastructure, energy efficiency, green businesses, water, land remediation and other.	Westpac Group 2022 Sustainability Supplement
ANZ	Includes renewable energy infrastructure, energy efficiency, green building, waste, water, low carbon transport, environmental markets, information and communication technology, and affordable housing.	ANZ 2022 Annual Report
CBA	Includes new lending exposure across renewable energy, low carbon transport, low carbon commercial buildings, energy efficiency, green residential buildings, pollution and waste management, and sustainability-linked loans.	Commonwealth Bank 2022 Climate Report
NAB	Includes new lending for green commercial buildings, specialised lending, corporate and securitisation finance for applicable projects, asset finance, green term deposits and lending to support development of 6-star residential properties (excludes green bonds and advisory, underwriting and arranging activities).	National Australia Bank Climate Report 2022
Macquarie	The amount of AU\$bn invested, committed or arranged in green energy assets is made up of lending and equity committed/invested by Macquarie, MAM and GIG across renewable energy technologies (solar, wind, hydro or geothermal energy); emerging green technologies (green hydrogen, carbon capture, utilisation and storage and renewable natural gas); waste-to-energy and bioenergy assets; energy efficiency (smart meters, lighting, biomass boilers and ground and air source heat pumps); low carbon transport (EVs) and supporting infrastructure (battery storage and EV chargers).	Macquarie Net Zero and Climate Risk Report 2022
Barclays	Includes loans across green mortgages, energy efficiency, renewable energy, green transport, sustainable food, agriculture and forestry, waste management and greenhouse gas emission reduction.	Barclays ESG 2022 Reporting Framework

HSBC	Financial service or offering for sectors including renewables, energy efficiency, green buildings, waste management, land use and transportation.	HSBC Holdings plc Annual Report and Accounts 2022
Intesa Sanpaolo	New lending and loans disbursed to support the ecological transition, green and circular economy.	Support to ESG transition
Standard Chartered	Lending across green/transition project export finance; sustainable PEF; financing solutions and leveraged and acquisition finance; sustainable linked loans; transition finance; green mortgages; business banking SME; and micro finance (excl. green/transition bonds, social bonds and M&A advisory).	Standard Chartered Sustainable Banking Report 2022
Lloyds	Green mortgage lending, EV and plug-in hybrid electric vehicles and renewable energy.	Lloyds Banking Group Environmental Sustainability Report 2022
NatWest	Lending in areas including but not limited to renewables, wind, homes, green buildings, electric vehicles.	BMO Financial Group 2022 Sustainability Report
Bank of Montreal	Loans to sustainable clients and projects in sustainable agriculture, clean transport, waste management, green buildings, general green, low-carbon energy.	BMO Financial Group 2022 Sustainability Report
Scotiabank	Financial products or service that integrates ESG criteria and may consist of financial instruments such as labelled use of proceeds loans, sustainability-linked loans.	Scotiabank 2021 ESG Report
National Bank of Canada	Includes the use of green loans, sustainable loans and transition loans predominantly for use for clean energy, green buildings and transportation.	National Bank 2022 TCFD Report
Royal Bank of Canada	Green loans for sustainable land management, clean transportation, sustainable water management, terrestrial biodiversity, green buildings, climate change and adaptation, circular economy.	Royal Bank of Canada Climate Report 2022
TD Bank	Sustainable finance includes loans to forestry, mining/minerals, oil and gas, power and energy, chemical and industrial, other.	TD 2022 ESG Report
Citibank	Lending to circular economy, clean technology, energy efficiency, green buildings, renewable energy, sustainable agriculture, water quality and conservation.	Global ESG Report 2022
JPMorgan	Loans and financial activity for sustainable transportation, renewable energy, energy efficiency, water management, green buildings, mixed use.	JPMorgan Chase & ESG Report 2022
Wells Fargo	This includes financial products and services that support clients or client activities that promote environmental sustainability. Categories include renewable energy, energy-efficiency, green buildings, and clean transportation.	Wells Fargo's Sustainable Sustainable Finance Progress 2022
Bank of America	Financial solutions for renewable energy, energy efficiency, clean transportation, water and sanitation, sustainable agriculture, and carbon capture and sequestration.	Bank of America CDP Climate Change Questionnaire 2022
Morgan Stanley	Low-carbon financing over green categories including but not limited to green mortgages, renewables, circular economy, and sustainable agriculture.	Morgan Stanley 2021 Sustainability Report
Handelsbanken	Green loans to remaining sectors including renewable energy financing, green mortgages and transition finance to high-emitting sectors.	Handelsbanken Annual and Sustainability Report 2022

Danske Bank	Green loans to support climate transition including clean transportation, renewable energy, green buildings, climate change adaption, sustainable water and water management, pollution prevention and control.	Danske Bank Sustainable Finance 2022
Nordea Bank	Sustainable lending portfolio includes green buildings, renewable energy, pollution, water management and clean transportation.	Nordea Annual Report 2022
Swedbank	Sustainable lending and sustainability-linked lending for renewable energy, energy efficiency, green buildings, pollution prevention, clean transportation, sustainable water, and water management.	Swedbank Annual and Sustainability Report 2022
SEB	Includes but not limited to green and sustainable loans and household mortgages.	SEB Annual and Sustainability Report 2022
BNP Paribas	Green lending related to renewable energy, energy efficiency, green buildings, transportation, water management, pollution.	Energy Transition and Climate Action 2022
Crédit Agricole	Financing the energy and climate transition with renewables, green loans, EV, and others.	Crédit Agricole 2022 Full Year Results
Société Générale	Sustainable finance includes lending and financial activity in renewable energy, green buildings, low-carbon transport, water management, pollution prevention and circular economy.	Société Générale Integrated Report 2021-2022
BPCE	Loans outstanding for energy renovation, renewable energy, and green mobility.	Group BPCE Green Investor Presentation 2022
Crédit Mutuel	Outstanding loans granted to projects that contribute to the climate and energy transition including green buildings, renewables, low carbon transport.	Non-financial performance statement 2022 statement

Currencies

The following exchange rates are used throughout the report:

- 1 EUR = 1.6 AUD
- 1 GBP = 1.8 AUD
- 1 USD = 1.5 AUD
- 1 CAD = 1.1 AUD

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