
Understanding banks' disclosure of emissions reduction targets

January 2025

Introduction / Regulatory Background

AFME's members are preparing to publish their first CSRD reporting in accordance with the ESRS for FY2024. This briefing note explains why intensity-based emissions reduction targets are most appropriate for setting science-based targets for banks' financing and highlights challenges which banks face in reporting such targets under the sector-agnostic ESRS.

Many banks have set intensity-based emissions reduction targets for their financing in line with international guidance. This gives rise to challenges for banks in reporting under CSRD, particularly under the ESRS requirements for the disclosure of GHG emission reduction targets in absolute terms (*Disclosure Requirement E1-4 – Targets related to climate change mitigation and adaptation; AR 23*), which go further than the corresponding ISSB standard¹ and are at odds with banks' industry practice for setting emissions reduction targets for Scope 3 financed emissions.

This note is intended to elaborate on the reasons why many banks, in line with industry guidance, do not deem absolute financed emissions reduction targets to be appropriate or useful and, accordingly, why the ESRS should provide sufficient flexibility for banks to report emissions reduction targets in intensity terms.

Absolute and intensity-based emissions reduction targets

Intensity-based financed emissions metrics measure the efficiency of emissions relative to a unit of economic output or activity, for example, CO₂ per megawatt-hour of electricity generated or per kilometre driven. Absolute-based financed emissions metrics are a measure of the proportion of total emissions that a bank may be deemed to be responsible for. According to the Partnership for Carbon Accounting Financials (PCAF) Standard², this is calculated as the product of an asset's total emissions and some attribution factor.

Banks' approach to target setting

Banks set absolute emissions reduction targets when these targets are decision-useful for strategic planning and communicating with investors. Banks generally have absolute targets for their own-account activities (Scope 1, 2, and 3, excluding financing), for example.

However, in accordance with the approaches developed by the UN-convened Net Zero Banking Alliance (NZBA) and the Science Based Targets Initiative (SBTi), amongst others, banks do not typically set absolute emissions reduction targets for most of their financing activity. They have instead developed targets in terms of physical GHG emissions intensity. For example, SBTi's Sectoral Decarbonization Approach (SDA)³ for Scope 3 financed emissions requires financial institutions to set physical emissions intensity targets in line with sector specific decarbonisation pathways, without the need for absolute targets, and the NZBA guidelines⁴ allow banks to set either absolute emissions or sector-specific emissions intensity targets. Banks' Pillar III disclosures of indicators of climate change transition risk are also made in sector-specific intensity values.⁵

¹ See the [ESRS-ISSB Standards Interoperability Guidance](#), pg 23. "There is no requirement to always disclose an absolute target, however the entity must disclose whether the target is absolute or intensity based (see paragraph 33(g) of IFRS S2)."

² See [Part A of the PCAF Standard](#)

³ See the SDA in chapter 5, "Approaches to Setting Scope 3 Portfolio Targets", in the SBTi's September 2024 "[Financial Sector Science-Based Targets Guidance](#)"

⁴ See the additional guidance for "Guideline One" in the NZBA's March 2024 "[Guidelines for Climate Target Setting for Banks](#)"

⁵ See Template 3, [Commission Implementing Regulation \(EU\) 2022/2453 of 30 November 2022](#) amending the implementing technical standards laid down in Implementing Regulation (EU) 2021/637 as regards the disclosure of environmental, social and governance risk

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There are a number of reasons why intensity-based targets for banks may be more appropriate than targets based on absolute financed emissions, which we discuss below.

Intensity-based targets better align with the objective of reducing real-world greenhouse gas emissions

Intensity-based emissions reduction targets can help support the transition to a net-zero economy by avoiding the “paper decarbonisation” that could be incentivised by absolute financed emissions reduction targets.

Absolute-Based Targets

Absolute-based emissions reduction targets could encourage a ‘narrow’ approach whereby, in order to achieve such reductions, a bank or investor simply reduces its financing to, or investment in, high emitting sectors, such as the transport or industrial sectors, and reallocates it to lower emitting sectors, for example, services sector. This approach, however, might not be appropriate for a ‘whole of the economy’ transition, as high emitting sectors are often the very sectors most in need of the transition finance required to drive real-world emissions reductions.

Intensity-Based Targets

Intensity-based metrics, on the other hand, directly measure carbon efficiency tailored to specific sectors, and therefore are not affected by production levels or company size; when pursuing reduction targets, banks are incentivised to finance less carbon intensive technologies within a specific sector. This includes the companies in the high emitting sectors most in need of transition finance.

Intensity-based targets are effectively used by banks as strategic steering tools

Intensity-based metrics are also more useable for banks when supporting clients’ unique transitions and comparing companies of different sizes. As such, the disclosure of these targets more accurately reflects banks’ actual decision-making processes.

The denominator of an intensity-based metric is free to be altered. This means that they can be adapted to measure emissions relative to the most meaningful metric to measure against, for example, CO₂ per kilometre driven or CO₂ per megawatt-hour of electricity generated. This allows banks to tailor metrics to specific sectors and companies.

In addition, the standardised nature of intensity-based metrics allows for comparability of companies of different sizes as well as company changes in size over time. This standardisation also gives intensity-based metrics much greater temporal stability since they are less affected by short term fluctuations in factors such as production levels or economic conditions (see section below).

As a result, intensity-based metrics allow banks to support each client’s unique transition to lower emissions by focusing on their most relevant emissions sources, regardless of how each company might change in size over time and regardless of how external factors affect short-term production levels. The same can be said for comparing different companies within the same sector.

Translating intensity-based targets to associated absolute financed emissions values is unlikely to be meaningful to users

Finally, the disclosure of absolute financed emissions values as translated from intensity targets (*Disclosure Requirement E1-4 – Targets related to climate change mitigation and adaption; AR 23*) is unlikely to be meaningful since their calculation is based on too many assumptions and, for investors, gauging progress towards such values is highly challenging.

While a particular entity may be able to make reasonable estimates about its own operations, a financial institution is not so well placed because it would have to make estimates about future emissions reductions for every asset in its portfolio.

In order to translate an intensity target to an absolute financed emissions value, total emissions must be estimated either directly or by multiplying the intensity target by projected output. This is then multiplied by the attribution factor. For example, if a bank sets an intensity-based target for the energy sector in terms of CO₂ per megawatt-hour generated, in order to convert it to an absolute financed emissions value, they would need to estimate how much energy would be generated by all of the energy companies in the portfolio over the target period as well as how much of that they would finance.

A company's output and emissions vary with production levels, and these depend on a wide variety of external market factors. This is similarly the case for the attribution factor, which is calculated using parameters like enterprise value, property value, or GDP, as well as the proportion of the financing a bank provides. The combination of these sources of uncertainty makes absolute financed emissions estimates extremely unpredictable, and any prediction will inevitably rely on a large number of significant assumptions.

Additionally, when investors interpret the associated absolute value as a target, leading up to date of the target, they may find it too difficult to gauge progress. This is because an asset's emissions and the attribution factor can exhibit a great amount of short-term volatility due to fluctuations in production levels and economic conditions, for example.

If financial institutions are unable to make sufficiently accurate estimates of their portfolio's future absolute financed emissions, then associated absolute values are unlikely to be meaningful and relevant to users, and therefore unlikely to meet the qualitative characteristics of information requirements described in *ESRS 1 Appendix B*. Even in a scenario where accurate estimates could be made, when viewed as targets by investors, the problem of short-term volatility would persist.

Disclosure users, investors and standard-setters should take the above considerations into account when analysing banks' emissions reduction targets for their Scope 3 financing.