PACTA for Banks brings climate scenario analysis to financial institutions

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In response to the systemic risk climate change poses, financial institutions around the world are increasingly considering the climate impacts of their investments. As these institutions seek to mitigate their environmental risks and meet investor expectations on climate change, climate scenario analysis can be an important tool for analyzing financial holdings.

That's where the 2° Investing Initiative (2DII) comes in. 2DII is an international nonprofit think tank working to align financial markets and regulations with the Paris Agreement goals. To help financial institutions understand how their investments contribute to climate change, 2DII has extended its flagship Paris Agreement Capital Transition Assessment (PACTA) methodology to the corporate lending sector with its new PACTA for Banks toolkit.

Developed in partnership with leading European universities and backed by the UN Principles for Responsible Investment, PACTA was first released in 2018, offering investors a tool to analyze bond and equity portfolios. PACTA for Banks builds on this, providing financial institutions with resources to measure the alignment of their corporate lending portfolios with climate scenarios across a set of key climate-relevant sectors and technologies.

By providing banks with insights into the climate alignment of their corporate clients' capital stock and expenditure plans, the PACTA for Banks toolkit represents a major step forward in climate scenario analysis for lenders. The toolkit was developed over the course of six years, and it has been tested by 17 global banks and over a dozen academic institutions. 2DII provides the materials for free to any interested organization. 2DII will hold a webinar on October 13 to explain how PACTA for Banks works. In the meantime, this article provides an overview of key features.

About PACTA for Banks

Risks posed by climate change come in two forms: **physical risks** (such as rising sea levels, storms, and wildfires) and **transition risks** associated with the shift to a low-carbon economy. While these risks can trigger significant disruption in financial markets, they remain outside the traditional time horizon of loan repayment forecasting and collateral analysis. PACTA for Banks is designed to help banks assess the alignment of their corporate lending practices with climate scenarios. For instance, banks can use PACTA for Banks to evaluate the effects of climate change on their assets and loans, analyzing risks ranging from EU regulations of carbon-intensive industries to how inclement weather may threaten loan collateral.

Three core components comprise the PACTA for Banks methodology: physical asset-level data, financial exposures, and climate scenarios. This methodology assesses physical assets (such as steel or power plants) linked to financial assets (such as loans, bonds, and shares) and analyzes the alignment of these assets with climate scenarios.

PACTA for Banks consists of:

- **PACTA for Banks software**. 2DII has created a software package for banks to use free of charge. It is open source and publicly available online. The package includes datasets, tools to match financial portfolios to asset-level data from market-intelligence databases (eg, power plant capacities), and a utility that uses climate scenarios to assess whether a financial portfolio aligns with overarching climate goals.
- **PACTA for Banks methodology and supporting documents.** These materials explain the PACTA methodology in detail. It describes necessary inputs and the different options for allocating the macro carbon budgets (scenarios) to microeconomic actors (portfolio managers and clients) and for allocating the physical asset-level data to financial instruments such as loans. Finally, it provides the mathematical formulas behind each metric.
- **PACTA for Banks training materials**. This is a set of practical user guides provided by 2DII to guide a bank through installing the relevant software, preparing the loan book and running the PACTA for Banks Software.
- **PACTA for Banks free data set**. 2DII, in cooperation with Asset Resolution, can provide a free asset-level data set for a bank to use, subject to a user license agreement.

Next steps for financial institutions

Financial institutions seeking to integrate PACTA for Banks into their lending decisions and analysis of climate risks should consider the following steps:

- Evaluate stakeholder expectations on climate change and climate-related risks.
- Identify loan portfolio and real estate holdings subject to increased climate change risks.
- Conduct a preliminary climate related audit on loans subject to climate risks.
- Evaluate existing loan agreements and investments to determine whether they align with the company's climate goals and risk appetite.
- Attend 2DII's webinar on October 13 to determine whether and how the PACTA for Banks toolkit can help your organization achieve its climate goals (you can review the agenda and RSVP by following this link).

Conclusion

Climate change has swiftly become a central issue in financial decision making. The PACTA for Banks toolkit can help inform lending decisions of financial institutions as well as integrating climate change mitigation strategies. In turn, this can help financial institutions meet stakeholder expectations regarding climate change and the environment.

For further information regarding PACTA or PACTA for Banks, please contact the authors or your regular DLA Piper relationship lawyer.

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