INTRODUCTORY NOTE ON

Expectations for Real-economy Transition Plans

GFANZ
Glasgow Financial Alliance for Net Zero

Acknowledgements

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AXA (Workstream co-chair)
BancoEstado
BBVA
Brunel Pension Partnership
Industry Tracker (Advisor)
CDP (Advisor)
Deutsche Bank
Institutional Investors Group on Climate Change (Advisor)
La Banque Postale
London Stock Exchange Group (Workstream co-chair)
Mitsubishi UFJ Financial Group
Montanaro Asset Management
Moody's
Morgan Stanley
NatWest (Workstream co-chair)
PricewaterhouseCoopers
Principles for Responsible Investment (Advisor)
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Purpose of this note

To finance the transition of the global economy to net zero, there needs to be effective dialogue and associated flows of data between users and providers of capital. Disclosure of real-economy transition plans plays a central role in enabling this exchange. The Glasgow Financial Alliance for Net Zero (GFANZ), representing 500+ financial institutions, has established the Real-economy Transition Plans workstream to support the development and implementation of credible transition plans by companies in the real economy.

This note aims to introduce the work that GFANZ is doing to support and accelerate the development of real-economy transition plans, by providing clarity around the expectations of financial institutions for the disclosure of transition plans, leveraging existing tools and frameworks. This workstream seeks to help companies understand how to navigate the existing transition plan guidance landscape and bring together real-economy transition plan frameworks. To this end, GFANZ is working to outline the components of existing transition plan guidance that financial institutions find relevant when making decisions (preliminary list of components can be found in Table 1).

Table 1 (preliminary): Components of a real-economy transition plan relevant for disclosure[1]

Note: this list of components is subject to review based on feedback and consultation expected to be taken during June/July 2022. Furthermore, the application of these components is expected to vary based on the size and complexity of the company and its transition plan (further guidance will be provided to help companies prioritize their reporting).

			DISCLOSURE & DATA COLLECTION			TARGET-SETTING & VALIDATION		ASSESMENT TOOLS		
THEME	**COMPONENT**	**KEY ELEMENT**	**TCFD**	**CDP**	**ISSB**	**SBTI**	**TPI-CP**	**ACT**	**CA 100+**	**TPI-MQ**
Foundations	Objectives and priorities	• Objectives and over-arching strategy								
		• Just transition								
Implementation strategy	Activities and decision making	• Business planning and operations								
		• Financial planning								
		• Sensitivity analysis								
	Policies and conditions	• Transition-related policies								
		• Nature-based impact								
	Products and services	• Products and services								
Engagement strategy	Value chain	• Engagement with clients/ customers and suppliers								
	Industry	• Engagement with industry peers								
	Government and public sector	• Engagement with government and public sector								
Metrics and targets	Metrics and targets	• GHG metrics								
		• Sectoral pathways								
		• Carbon credits								
		• Business and operational metrics								
		• Financial metrics								
		• Nature-based metrics								
		• Governance metrics								
Governance	Roles, responsibilities and remuneration	• Board oversight and reporting								
		• Roles and responsibilities								
		• Incentives and remuneration								
	Skills and culture	• Skills and trainings								
		• Change management and culture								

TCFD is typically used as reference for climate-related disclosures

1 Abbreviations used in the table: Task Force on Climate-Related Financial Disclosures (TCFD), International Sustainability Standards Board (ISSB), Science Based Targets initiative (SBTi), Transition Pathway Initiative Carbon Performance (TPI-CP), Assessing Low Carbon Transition (ACT), Climate Action 100+ (CA100+), Transition Pathway Initiative Management Quality (TPI-MQ).

Background

Companies around the world are facing increased levels of engagement from financial institutions regarding their climate ambitions and associated transition strategies. This provides an opportunity for companies that can articulate credible targets and transition plans to better access finance, investment, and other financial products/services.[2]

Net-zero commitments are influencing asset allocation by financial institutions with significant implications for the real economy. Companies' access to capital is increasingly impacted by their climate targets and strategies.[2]

Through the Net-zero Alliances, all types of financial institutions, including asset managers, asset owners, auditors, banks, data providers, exchanges, insurers, investment consultants, and rating agencies, have committed to setting net zero targets.[3] To achieve these GHG emission reduction targets, financial institutions are changing the criteria and requirements for the provision of finance, investment, and other financial products/services. As a result, financial institutions are changing how they make decisions, which has a direct impact on companies in the real economy:

- Financial institutions will increasingly be considering climate-related constraints (e.g., carbon budgets, portfolio coverage) which will influence financing, underwriting, and provision of other financial services to companies that have credible climate transition plans in place.
- Access to capital and insurance will increasingly be contingent on performance against climate-related metrics (e.g., CAPEX in net-zero assets, GHG emissions reductions).
- This transition is taking place across asset classes, including active and passive investments, and is having an increasingly material influence on global investment and finance flows. The alignment of capital allocation with GHG emissions intensity/reductions will impact companies of all sizes and across all industries globally.[4]

This requires supporting and financing companies across all industries in developing and executing credible, high ambition, transition plans.

Key implications for companies

Companies across all industries, and of all sizes, that do not have credible transition plans may face higher costs of financial products and services (e.g., higher costs of capital) as well as potential constraints on access to financial products and services (e.g., constrained insurance capacity). In contrast, companies with credible transition plans may increasingly be able to access products and services with preferred terms and products and services tailored to low-carbon business models.

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2 Roughly 44 percent of financial institutions are now assessing if their clients/investees are aligned to the ambition set on the Paris Agreement — CDP: Now for Nature, The Decade of Delivery, March 2022, p. 14.

3 The alliances are: The Net Zero Asset Managers initiative, the Net-Zero Asset Owner Alliance, the Net-Zero Banking Alliance, the Net Zero Financial Service Providers Alliance, the Net-Zero Insurance Alliance, the Net Zero Investment Consultants Initiative, and the Paris Aligned Investment Initiative.

4 Examples from UN-PRI: Integrating climate change in passive investments: A developed markets equity strategy and TPI climate transition index — aligning a global equity portfolio with the climate transition | Case study | PRI (unpri.org).

What is the role of financial institutions in supporting the real-economy transition?

As financial institutions integrate net-zero targets into their financial strategies, it is important that these strategies account for their impact in the real economy and that they lead to actual GHG emissions reductions. Doing so also supports the implementation of ambitious Nationally Determined Contributions (NDCs).

Simply divesting or withdrawing financing from high-emitting/hard-to-abate sectors may inhibit the real-economy transition. High-emitting/hard-to-abate sectors and companies need financial products and services to successfully transition to a low-carbon future. Sequencing of finance to prevent economic volatility and shocks is crucial in the transition — where displacement of high-emitting assets by zero-carbon assets and infrastructure needs to be orderly to support continuity of services and support local communities.

Financial institutions can help accelerate GHG reductions in the real economy by financing and supporting:

- Development and scaling of climate solutions to replace high-emitting technologies, products, and/or services
- Companies that are already aligned to a 1.5 degree C pathway
- Transition of real-economy companies according to transparent and robust net-zero transition plans in line with 1.5 degree C aligned sectoral pathways[5]
- Accelerated managed phaseout — via early retirement, retrofitting, or redevelopment — of high-emitting physical assets[6]

To achieve these objectives, financial institutions are increasingly making significant changes to their strategies and decision-making processes. These includes more:

- Alignment and tracking of financial activities with net-zero outcomes (e.g., through GHG carbon intensity reductions, GHG budgets, portfolio coverage approaches, climate solutions finance, managed phaseout finance)
- Development of new products and services to support the transition
- Frequent and in-depth assessments of companies based on companies' transition plans
- Structural alignment of their investment/lending/financing portfolios to achieve their net-zero trajectory

To enable these changes, financial institutions need information from companies, which can best be provided in the form of real-economy transitions plans. Such transition plans describe companies' objectives, actions, progress, and accountability mechanisms to reach net zero.

5 GFANZ: Guidance on Use of Sectoral Pathways for Financial Institutions. 2022.

6 GFANZ: The Managed Phaseout of High-emitting Assets. 2022.

What is the objective of the GFANZ Real-economy Transition Plans workstream?

The users and providers of capital need to work together to achieve economy-wide GHG emissions reductions. The Real-economy Transition Plans workstream aims to facilitate the transition to a net-zero economy by supporting the development and implementation of credible transition plans by companies, including small and medium-sized enterprises (SMEs) in the real economy. As a first step, GFANZ will publish a report on Expectations for Real-economy Transition Plans in fall 2022 which will be a practical guide for real-economy companies to understand what financial institutions view as relevant information when assessing transition plans. This report will draw on the input to the consultation on the GFANZ Financial Institution Net-zero Transition Plans report. The GFANZ Real-economy Transition Plans workstream will also be publishing sector briefs that go into greater detail for three high-emitting/hard-to-abate sectors: steel, aviation, and oil and gas.[7]

<u>This workstream aims to help scale and connect existing standards and initiatives, as opposed to creating new ones.</u> These reports will clarify the use of existing climate transition planning standards, assessment frameworks, and engagement initiatives. Harnessing and connecting existing initiatives is the fastest route to driving action globally. The global investment community has already become well-connected on company climate engagement through CA100+, engaging with the largest companies from the sectors with the highest carbon intensities.

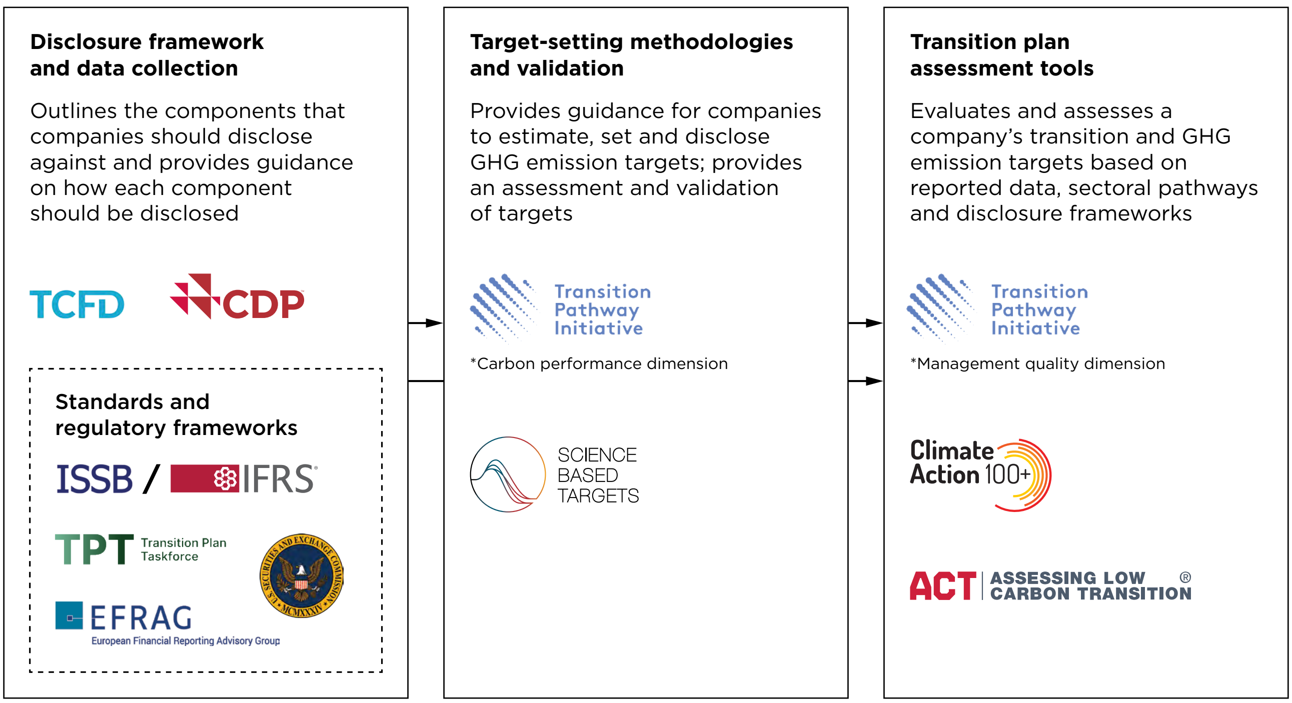
HELP COMPANIES UNDERSTAND HOW TO NAVIGATE THE EXISTING TRANSITION PLAN GUIDANCE LANDSCAPE

Engagement and guidance frameworks are already in use today to support the development of real-economy climate-related strategies and transition plans. Though there is much commonality between these, there are also some differences. This workstream aims to help real-economy companies understand the expectations of financial institutions when navigating existing guidance, including: 1) how companies can best leverage each initiative, and 2) how financial institutions use the information that each initiative provides.

7 The priority sectors were selected based on the materiality of emissions and the extent to which involvement from GFANZ is expected to be additive given the level of consensus and the existing landscape of transition plan guidance.

For example, the Task Force on Climate-Related Financial Disclosures (TCFD) and CDP are often used as a framework for disclosure and data source, respectively. The Science Based Targets initiative (SBTi) and the Transition Pathway Initiative Carbon Performance (TPI-CP) are leveraged for science-alignment of targets. The Assessing Low Carbon Transition (ACT), Transition Pathway Initiative Management Quality (TPI-MQ) and Climate Action 100+ (CA100+) are referenced as assessment tools that evaluate the credibility of transition plans (Figure 2).

Figure 2: Transition plan initiatives classification



In addition to these initiatives, governments and regulatory bodies are starting to include transition plans in mandatory disclosure requirements.[8] GFANZ is actively collaborating with these regulatory bodies to ensure that financial institutions' expectations are in line with the latest developments of mandatory transition plans and aims to drive global consistency between initiatives. The work delivered through the Real-economy Transition Plans workstream is intended to also serve as a guide for the development of new regulatory frameworks.

8 Examples include the International Sustainability Standards Board (ISSB) — part of International Financial Reporting Standards (IFRS), the European Financial Reporting Advisory Group (EFRAG), the US Securities and Exchange Commission (SEC), and the UK Transition Plan Taskforce (TPT).

CONSOLIDATE INFORMATION THAT FINANCIAL INSTITUTIONS FIND RELEVANT IN REAL-ECONOMY TRANSITION PLANS

GFANZ is working to identify the components of existing transition plan guidance that financial institutions find relevant when making decisions (Table 1). Moreover, GFANZ is planning to outline the specific guidance across initiatives that is considered useful for financial institutions' decision-making processes. GFANZ hopes that these expectations provide transparency and clarity for companies so that they are better prepared when formulating their transition plans. This work can provide insights to existing initiatives to influence their work as they develop new guidance and tools as well. GFANZ is also supporting the development of guidance on transition planning specific to the managed phaseout of high-emitting assets through their early retirement.[9]

This workstream aims to facilitate productive dialogues and better equip companies for engagement with their financial partners and investors. Also, by providing companies with a pan-sector view of transition plan expectations, companies can better understand — and where appropriate address — the key elements that are most relevant to financial institutions. The Expectations for Real-economy Transition Plans report will provide further detail on each transition plan component, including detailed references to existing transition plan guidance that companies can leverage for each component.

Immediate and well-planned action from financial institutions and real economy companies is necessary to reduce GHG emissions, stave off the worst impacts of climate change, and ensure a successful transition. Together, GFANZ members can enable the capital flows that can fund the business changes, projects and products that will deliver the transition to a more climate secure and resilient world.

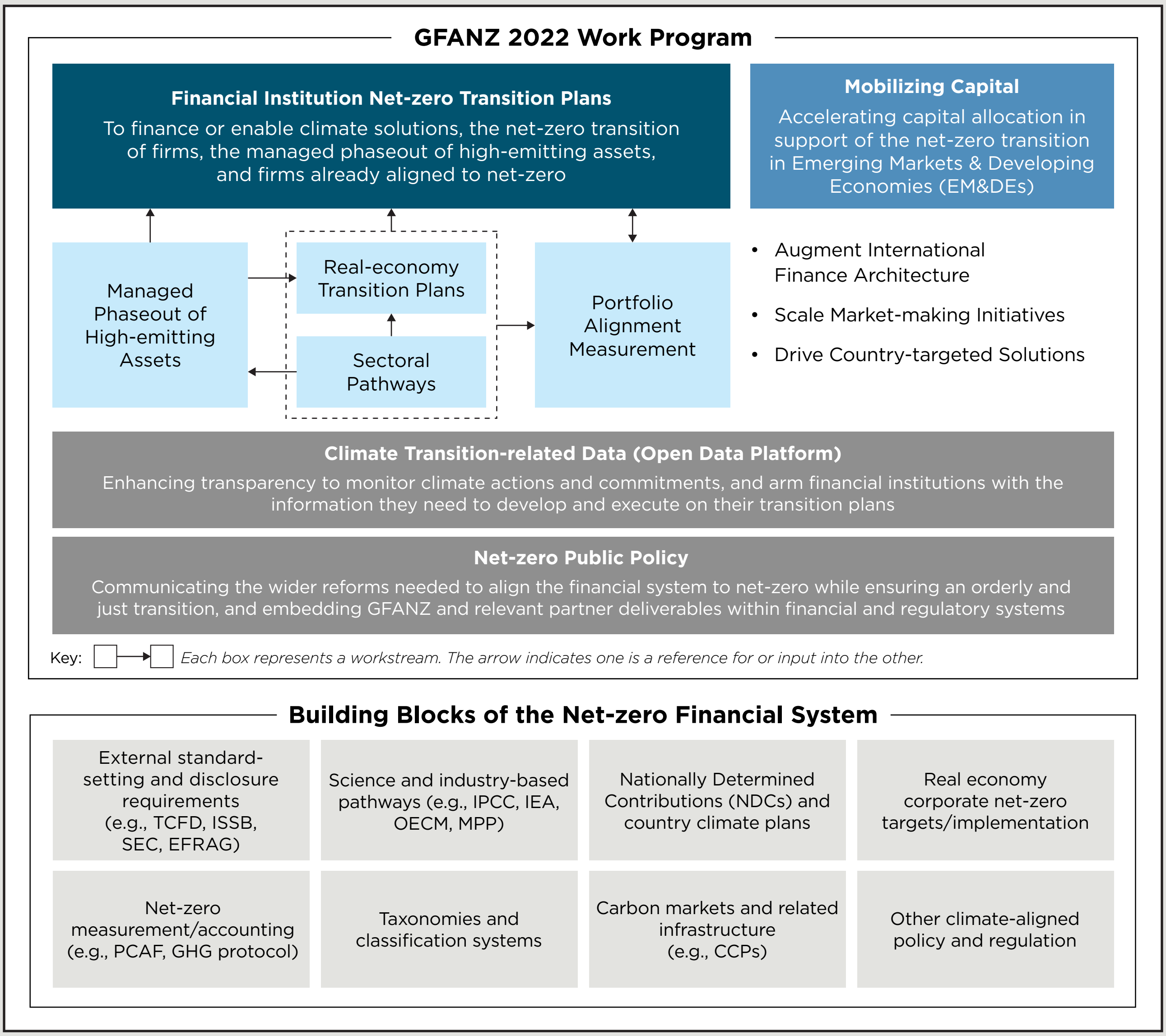
9 GFANZ: The Managed Phaseout of High-emitting Assets. 2022.

Appendix

Background on GFANZ work program

The Glasgow Financial Alliance for Net Zero (GFANZ) is a global coalition of leading financial institutions in the UN's Race to Zero that is committed to accelerating and mainstreaming the decarbonization of the world economy and reaching net-zero emissions by 2050. GFANZ brings together seven financial sector net-zero alliances, representing more than 500 members, into one global strategic alliance to address common challenges and elevate best practices across the sector. GFANZ core areas of work are practitioner-led and advised by leading technical civil society organizations.[10]

Figure 2: GFANZ 2022 work program[11]



10 The alliances are: The Net Zero Asset Managers initiative, the Net-Zero Asset Owner Alliance, the Net-Zero Banking Alliance, the Net Zero Financial Service Providers Alliance, the Net-Zero Insurance Alliance, the Net Zero Investment Consultants Initiative, and the Paris Aligned Investment Initiative.

11 In this note, orderly is defined as: early, ambitious action to a net zero CO_2 emissions economy, following the definition provided by NGFS. Noting that disorderly is defined as: action that is late, disruptive, sudden and/or unanticipated. NGFS Climate Scenarios for central banks and supervisors, 2020.

The elements of the GFANZ work program under Financial Institution Net-zero Transition Plans are all connected and intended to collectively support financial institutions' net-zero transition planning and implementation efforts. For the provision of finance to be aligned with net-zero goals, financial institutions need to understand and evaluate the transition strategies of their clients and portfolio companies.

GFANZ's work on real-economy transition plans will support this by delineating the financial sector's expectations for real-economy firms' transition plans to ensure that they include specific, consistent information that financial institutions can use in decision-making.

Sectoral pathways help inform transition strategy development for both real-economy firms and financial institutions, providing information on the alignment of real-economy activities with net-zero objectives.

Portfolio alignment metrics contribute to methodologies for evaluating the alignment of financial portfolios with net-zero objectives.

One approach to net zero-aligned finance is financing or enabling the early retirement of high-emitting assets, informed by sectoral pathways. The GFANZ work on Managed Phaseout sets out preliminary thinking and a work plan to support the use of early retirement as part of net-zero transition planning for both financial institutions and real-economy firms.

For more information, please visit gfanzero.com