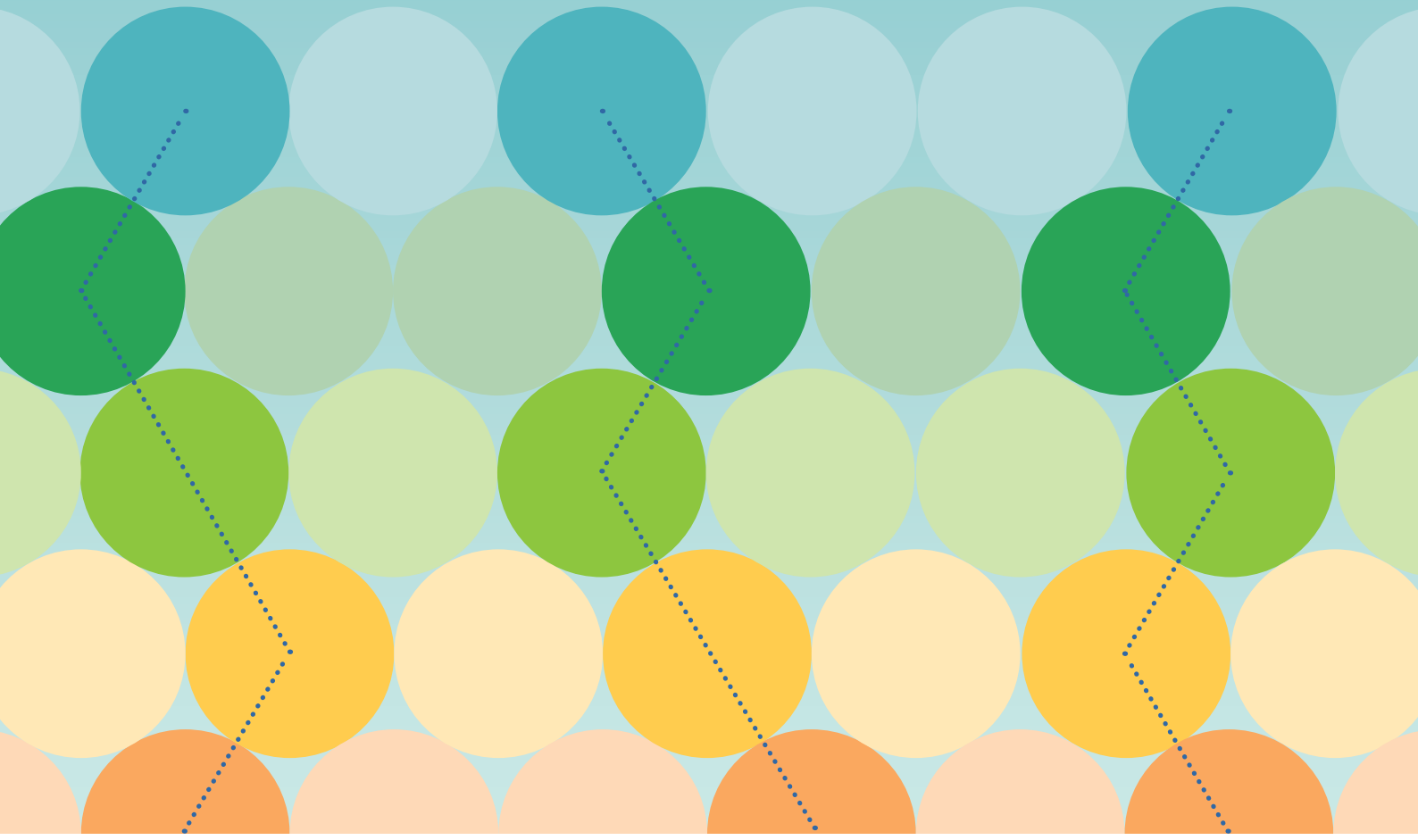
NAVIGATING CORPORATE TRANSITIONS

A tool for financial institutions to assess and categorise corporates by their transition credibility and maturity



Climate Bonds INITIATIVE

Prepared by the Climate Bonds Initiative

1. Background

Contents

This paper proposes a methodology to classify corporate transitions, based on the maturity, ambition, and credibility of the corporate's transition. It can be used by any financial institution to categorise its corporate exposures and track their transition progress over time. This is an important foundation for any financial institution seeking to decarbonise its corporate exposure in line with its own net-zero targets and plans. Adoption of a common methodology by financial institutions will ensure a consistent basis for the measurement and management of transition finance, and corporate and policy engagement. The proposal builds on and navigates between existing frameworks, filtering to the common, core principles and recommendations.

Current situation

Capital allocation to effectively transitioning corporates is critical to enable the real economy to transition to net zero. It is also critical to enable financial institutions to address their current transition risks.[1] Recognising this, many financial institutions have joined networks including the financial sector-specific net-zero alliances that make up the coalition of the Glasgow Financial Alliance for Net Zero (GFANZ),[2] and the Institutional Investors Group on Climate Change (IIGCC). Banks have made commitments to achieve net-zero emissions by financing and facilitating ambitious climate action to transition the real economy to net zero by 2050. Similarly, investors have made commitments to decarbonise and align their portfolios with net zero. Overall, financial institutions are increasingly reporting the volume of sustainable finance and forward-looking decarbonisation targets.[3]

To deliver on these targets, financial institutions may adopt a variety of strategies to decarbonise. Depending on the type of financial institution and the nature of its activities, this might include amending lending policies and covenants, portfolio construction, strategic asset allocation, engagement, selective divestment and/or policy engagement, given the interdependence of corporates and financial institutions and policy makers.[4]

Understanding the current emissions and forward-looking transition plans of the corporates they are financing, holding and/or facilitating is a precursor to any financial institution's effective corporate engagement and capital allocation to transition. To this end, asset managers and asset owners are analysing the transition plans of the corporates in their investment portfolios. Equally, banks are evaluating the transition plans of the corporates in their loan books and of their corporate advisory clients. These corporate investees, borrowers, and clients are collectively referred to as 'corporate exposures' in this paper.

This has resulted in the publication of numerous frameworks dedicated to determining the essential qualities of a credible corporate transition plan. Such frameworks provide guidance to financial institutions evaluating the ambition and feasibility of corporate transition plans, and some also present categories that reflect the maturity of a corporate's transition; from commitment and planning, to implementation then delivery. These categories can help financial institutions to reduce and translate the multi-criteria of credible transition plans into a uniform corporate classification system that can be used to support and track the financial institution's own transition delivery progress.

Climate Bonds published 'Transition Finance Mapping: Frameworks to assess corporate transition' in November 2023, which demonstrated a high degree of alignment between these frameworks in terms of the categorisation of corporate transition maturity and the principles underpinning credible corporate transition plans.[5] However, a notable variation in the more specific indicators and metrics put forward for the identification and categorisation of credible corporate transition was highlighted. Furthermore, the absence of granular data and information provided by corporates due to their nascent stage of transition plan development and disclosure (ahead of published regulations addressing transition plan disclosure) renders much of this guidance inoperable by financial institutions currently assessing corporates.

1. For example, according to the ECB Banking Supervision *2022 climate risk stress test* (July 2022), banks currently generate over 60% of their interest income from counterparties in carbon-intensive sectors. Recent analysis of 95 banks covering 75% of euro area loans for the ECB's January 2023 report "Risks from misalignment of banks' financing with the EU climate objectives" demonstrated that currently banks' credit portfolios are substantially misaligned with the goals of the Paris Agreement, leading to elevated transition risks for roughly 90% of these banks. These risks largely stem from exposures to companies in the energy sector that are lagging behind in phasing out high-carbon production processes and are late in rolling out renewable energy production.
2. Net Zero Banking Alliance (NZBA); Net Zero Asset Owners Alliance (NZAOA); Net-Zero Asset Managers initiative (NZAM); Paris Aligned Asset Owners (PAAO); Net-Zero Insurance Alliance (NZIA); Net Zero Financial Service Providers Alliance (NZFSPA); Net Zero Investment Consultants Initiative (NZICI); The Venture Climate Alliance (VCA); Net-Zero Export Credit Agencies (NZECA)
3. As of 30 September 2023, over 460 financial institutions from across the Net Zero Asset Managers initiative (NZAM), the Net Zero Asset Owner Alliance (NZAOA), the Net Zero Banking Alliance (NZBA), Net Zero Insurance Alliance (NZIA) and the Paris Aligned Asset Owners (PAAO) have set interim targets. More than 250 have committed to disclose their transition plans within the next year. GFANZ-2023-Progress-Report.pdf (bbhub.io)
4. As 'aggregators' of corporate transition plan analysis and capital allocation, financial institutions are in a prime position to engage with policy makers on the key elements needed from an enabling policy environment, including clear and consistent transition plan disclosure regulations, tools to support transition finance, and industrial policy to enable and incentivise real-economy transition.
5. Transition Finance Mapping: Frameworks to Assess Corporate Transition - Climate Bonds - Nov 2023

A classification system for corporate transitions

To address these issues, **this paper puts forward a classification system for corporate transitions** that identifies:

- Five categories of corporate decarbonisation transition maturity; and
- Key indicators for a corporate's inclusion in each of those categories.

Its primary audience is all and any financial institution analysing the transition of its corporate exposures. When using these indicators and categories as the basis of that analysis, financial institutions can consistently target and prioritise corporate engagement around the indicators that are not being met for any specific corporate and/or corporates at the lower end of the maturity scale, as part of a collective push to ensure all corporates are transitioning. This facilitates both the rapid and ambitious transition of the real economy and the achievement of the financial institution's own net-zero goals.

The proposed classification system combines and builds on the many frameworks that have been put forward to guide credible corporate transition and transition finance assessment, informed by the aforementioned 'Transition Finance Mapping: Frameworks to assess corporate transition'.[6] Its value-add over the existing guidance is three-fold:

1. It navigates on behalf of financial institutions the complexities and divergences in existing guidance. It draws on the identified alignment between the proliferation of existing guidance where such alignment exists, and where it does not, it puts forwards indicators that are understood to represent a majority or widely-held position in that guidance.

2. It filters that guidance to the core, prioritised indicators of credible corporate transitions. Many of the frameworks reviewed encompass a very high number of indicators of a credible transition, legitimately, as they are aimed at pushing corporates to develop, implement, and disclose robust and comprehensive transition plans. The caveat, as mentioned above, is that many of these indicators cannot currently be assessed across a large number of corporates given the nascent stage of corporate transition plan development and disclosure, particularly while operating in advance of published regulation on corporate transition plan disclosure. Instead, a relatively limited number of priority indicators are selected to be used in the short term to indicate sufficiently credible corporate transition until corporate transition reporting advances. It is therefore a tractable tool to help financial institutions with assessing and supporting the transition of hundreds if not thousands of corporate exposures.

3. It comes with support from those representing a large number of financial institutions. This paper is a collaborative effort from Climate Bonds Initiative, the Institutional Investor Group on Climate Change (IIGCC), the Sustainable Markets Initiative (SMI), and Climate Arc with methodological feedback from the GFANZ Secretariat and representatives from the finance world.

For the avoidance of doubt, at this time the focus is decarbonisation only. However, the indicators do touch on the impact of that transition on other environmental and social factors.

Next steps

The proposal will be subject to consultation with the authors of many of the existing transition frameworks used to inform this proposal, and selected financial institutions. Feedback will be gathered on:

a. Whether the categories and associated indicators adequately capture the varying transition maturity of corporates across sectors, geographies, and sizes, and hence can serve as a common approach; and

b. Whether financial institutions can access the necessary information to evaluate a corporate against these indicators (either directly or via third party assessors, assessment schemes or data providers); and

c. Whether this proposal does indeed represent a value-add to existing guidance.

The classification system will also be validated by screening the real portfolios of selected financial institutions against the proposed categories and associated indicators. Particular attention will be paid to perceived anomalies/miscategorisations of corporates, and any challenges in interpreting the indicators or accessing the information needed from corporates to assess compliance with the indicators.

A refined classification system will then be made public for the use of financial institutions on a voluntary basis. To further support this, discussions are also ongoing to embed the categories and indicators into an open-source online platform, pre-populated with existing corporate transition data and analysis from independent, third-party sources that have carried out enhanced due diligence of corporate transition plans and progress. This would both support the intention of a robust, common approach across financial institutions and enable acceleration by taking the analysis burden away from individual financial institutions. Financial institutions would of course continue to supplement their own additional elements of analysis to meet their own internal requirements.

Climate Bonds is also exploring how financial institutions might use this classification system to provide more insight into their overall emissions reduction targets and their strategy to deliver those targets, and by extension how they themselves can be monitored for their transition progress.

Lastly, the objective is to develop equivalent classification systems and associated indicators for non-corporate entities, including public bodies such as sovereigns and municipalities as well as financial institutions themselves. Financial institutions lend to, invest in, advise and/or provide other services beyond corporate entities and a full transition of their balance sheet and revenues requires a broader lens.

6. It has also been informed by the work of the 'Assessment of Transition Plans Collective (ATP-Col). This group's report 'Framework and guidance to assess the credibility of companies' Transition Plans' (forthcoming) provides principles and guidance to assess a company's transition plan credibility and robustness and lists assessment points for each component of a credible transition plan.

2. Overview of the classification system

Rationale for a shared classification system for corporate transitions

A number of initiatives have put forward a maturity ladder for corporate transitions where steps on the ladder represent progression from commitment to transition, to planning, to delivery of emissions reductions until net zero is reached. See **Figure 1** for a stylised schematic of this.

By mapping (selected) indicators of an ambitious and credible transition (plan) to the steps on this ladder, multi-criteria indicators for credible transitions can be categorised into summary evaluations of a corporate's current and planned transition. Using these categories and associated indicators to assess and classify corporates has multiple benefits for a financial institution:

- **It facilitates aggregation and differentiation between corporates.** For example, differentiation between corporates already aligned to net-zero versus companies which are in the process of aligning to net zero versus those which have set targets that are not yet ambitious enough, versus those that have made commitments but not yet gone beyond that.
- **Once aggregated and differentiated, this information empowers financial institutions to develop effective engagement strategies and roadmaps across their portfolios,** including providing active support to corporates whose transition planning and implementation is lagging.

Figure 1: A maturity scale, or ladder, for ambitious and credible corporate transitions

- **(Credible) corporate transition maturity may in itself be a useful target metric for financial institutions' own transition targets at the sectoral and/or product and/or portfolio level.** Arguably, transition maturity is a more directly influential impact indicator for financial institutions as corporate emissions impacts will take time to manifest at scale and can be heavily influenced by various factors, such as the size, emission intensity, domicile, and sector of its corporate exposures. See **Box 1** for three proposals in this respect.

Furthermore, the adoption by many financial institutions of a common classification system enables consistent interpretations of transition finance (and facilitation) across those financial institutions.

Box 1: Using transition maturity as a target metric for financial institutions' transition

The **IIGCC** first put forward five 'alignment maturity' categories as part of the Net Zero Investment Framework (NZIF) as a basis for investors to set portfolio coverage targets to increase the percentage of assets under management (AUM) categorised as either aligning towards a net-zero pathway, achieving net zero, or aligned to a net-zero pathway, and through the stewardship process, encourage companies to meet the associated criteria to move through these categories.[9]

The Net Zero Banking Alliance (**NZBA**) report 'Developing Metrics for Transition Finance'[10] notes that sustainable finance and emissions reduction metrics alone are not adequately nuanced to capture all of the sophistication in how financial institutions need to approach transition finance.[11]

It identifies three types of transition finance metrics that banks might use to provide additional transparency on their activities with transitioning companies:

1. 'Input metrics' that reflect the volume of financing provided to companies, categorised to reflect an appropriate segmentation of transition status;
2. Measurements of committed decarbonisation, including Expected Emissions Reduction (EER) metrics, (such as Avoided Emissions or Emissions Reduction Potential (ERP)) and/or Committed Emissions Reduction (CER);[12]
3. A range of supporting evidence which might include back-testing or validation of clients' committed decarbonisation plans, physical indicators of decarbonisation, and efforts to use transition numbers to forward project other measures such as sectoral net-zero targets.

Tracking corporates' progress against type 1 metrics, specifically, their transition plans and progress through the transition categories over time and reporting on this at the sectoral and/or product and/or portfolio level would provide transparency on the extent to which any financial institution can be said to be effectively supporting and delivering transition. It would add clarity to their transition targets and progress, supporting, not replacing any sectoral and/or portfolio emissions reduction metrics or decarbonisation targets to which the financial institution has already committed or will commit to.

Such tracking would require financial institutions to utilise a consistent method to categorise the transition progress of their clients. As the report notes, to begin with, this may involve banks defining their own transition categories and assessing clients against them. Over time, the aim should be to harmonise a market-wide definition of transition finance categories to promote consistency.

Similarly, **SBTi**'s draft Net Zero Standard for Financial Institutions notes the importance of portfolio alignment targets, alongside portfolio emissions targets.[13] SBTi defines financial institution ambition as the rate at which different asset classes are aligned to 1.5°C pathways in a manner that is also consistent with key milestones needed for the transition. Both portfolio alignment and portfolio emissions targets can be established to track overall progress towards long-term net-zero goals. Over the near-term, portfolio alignment goals are considered mandatory given that they directly focus on the alignment of portfolio holdings against 1.5°C pathways, while portfolio emission targets may be used to support alignment targets but are not considered sufficient on their own to evaluate the contribution of a financial institution's actions to a 1.5°C transition given portfolio emission metrics represent 'lagging' indicators of the overall emissions exposure.

Overview of the proposed categories

The proposed categories classify corporates according to their transition maturity, taking into account the ambition and credibility of their transition as they move through the key steps to net zero.

For the majority of corporates, these steps will see them move from commitments to plans (including emissions reduction targets and roadmaps to deliver those targets) to implementation action to emissions reduction, all within an enabling governance structure.

Figure 2 provides:

- An overview of those categories and what they aim to capture;
- A determination of whether exposures in each category could legitimately be counted as transition and/or green finance.

Five key components are utilised to organise the selected indicators underpinning the corporate transition categories. These are: A. Commitment, B. Emissions Targets, C. Delivery Strategy, D. Governance, and E. Performance.

Broadly speaking, this proposal reflects a commonality of views across a number of transition categorisations and transition plan guidance from a variety of sources as summarised in the recent 'Transition Finance Mapping: Frameworks to assess corporate transition'.[7] **Figure 3** provides a high level comparison to the category labelling used elsewhere.

Given the purpose of this categorisation is to provide a practical tool for financial institutions to assess their corporate exposures, two further 'non-classified' categories have been added that are not found in existing guidance. These capture a) corporates for which insufficient data is currently available to determine their transition status,[8] and b) corporates that have disclosed data but this has not yet been assessed by the financial institution due to its own transition assessment phasing/prioritisation decisions. Understanding the number and emissions profile (even at a generic level) of corporate exposures allocated to these categories will assist financial institutions with their own transition screening planning and/or their corporate engagement strategies.

The remainder of Section 2 addresses key issues in the determination of these categories and associated indicators, and implications for their application and interpretation. Section 3 details the specific indicators used to assess eligibility for each category.

7. One change has been made to that mapping. In the mapping there was provisionally an additional category 'near net-zero emissions'. This has now been incorporated into the 'Aligning' category.
8. Note this is not the same as the 'No action' category. 'No action' captures those that have made no commitment, have no transition plan (however rudimentary), nor have aligned their emissions with sectoral pathways. This category captures those that have disclosed some information on their transition, but not at sufficient depth to evaluate against the indicators in any transition category.
9. IIGCC_Investor-expectations-of-corporate-transition-plans_Final.pdf (hubspotusercontent-eu1.net)
10. Developing-Metrics-for-Transition-Finance.pdf (unepfi.org)
11. For example, financing the managed phaseout of high-emitting assets leads to increased financed emissions and emissions intensity, and does not qualify as sustainable finance in existing taxonomies. Financing companies which are currently carbon intensive but have credible transition plans could lead to an increase in a bank's or equity investor's portfolio emissions in the short-term and create the view that the bank is not progressing in line with its stated emissions reduction targets.
12. For further discussion on these metrics see: Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf (bbhub.io)
13. The-SBTi-Financial-Institutions-Net-Zero-Standard-Consultation-Draft.pdf (sciencebasedtargets.org)

Figure 2: Understanding what the categories represent

Key components for assessment	*No analysis undertaken*	*Insufficient data for analysis*	1. No action	2. Committed	3. Aligning	4. Aligned	5. Net zero*
A. Commitment	-	-	-	Net zero commitment	← As left	← As left	← As left
B. Emissions targets	-	-	-	May have short term emissions targets	Ambitious and comprehensive emissions targets	← As left	-
C. Delivery strategy	-	-	-	-	Internally coherent, comprehensive, feasible, and trackable decarbonisation action plan, aligned with identified decarbonisation levers and with supporting financial indicators	← As left	-
D. Governance	-	-	-	Internal governance in place	← As left	← As left	-
E. Performance	-	-	-	-	Milestone actions (and financial indicators) identified in the action plan delivered	← As left	-
	-	-	-	-	Actual emissions align with corporate's emissions targets	Actual emissions align with credible benchmarks	Net-zero emissions
***** Net zero means net zero notwithstanding any residual emissions[14]							
Implications for classification of general purpose loans to/ investment in/ advisory services to corporates in these categories	Not classified		Inadequate performance to count as transition		Adequate performance to count as 'transition finance'		n/a
	Not classified		Inadequate performance to count as green		Adequate performance to count as 'green finance'		

14. Where residual emissions are defined as 'greenhouse gas emission that remains after taking all possible actions to implement emissions reductions, and when net zero has been reached. All possible actions refer to what is technically and scientifically feasible'. Per ISO's IWA Net Zero Guidelines (IWA 42 3.2.9).

Figure 3: How other categorisations map to this proposal[15,16]

	1. No action	2. Committed	3. Aligning	4. Aligned	5. Net zero
Climate Bonds[17]	-	-	Transition	Aligned	Aligned
GFANZ[18]	Not aligned	Committed to Aligning	Aligning	Aligned	Aligned
IIGCC[19]	Not aligned	Committed to Aligning	Aligning Towards a Net-Zero Pathway	Aligned to a Net Zero Pathway	Achieving net zero
SBTi[20]	Not aligned	Not aligned	1.5°C Transition: 1.5°C aligned ambition	1.5°C Transition: 1.5°C aligned performance	Net-Zero aligned
SMI[21]	-	Aiming to Transition	Committed to Transition	Transitioning	-
WBA (ACT)[22]	Not transitioning in a credible and robust way	Not transitioning in a credible and robust way OR Committed (depending on whether have short-term targets)	Transitioning in a credible and robust way	Transitioning in a credible and robust way	-

Focussing on the short-term plan but with a view to the longer term

Category '2. Committed' captures corporates which have targets but not yet a plan for how to deliver on those targets. This includes those with a net-zero commitment (i.e., a long-term target) only, and those that also have short-term targets. These are captured in two sub-categories: '2a. Pledged' and '2b. Short-term targets only' respectively. This sub-categorisation affords additional recognition to the not-insignificant step of developing more detailed short-term targets. However, short-term (or any) targets without a supporting plan describing how it is anticipated those targets will be achieved are an insufficient basis for transition implementation. Only once an associated delivery strategy has been developed will a corporate move up the maturity scale to category '3. Aligning'.

Specifically, category '3. Aligning' is intended to capture corporates that have developed a robust transition plan, but whose actual emissions are not yet aligned with 1.5-degree benchmarks. Ideally, those transition plans will be 'complete' in that they will address short-, medium- and long-term targets, and corresponding short-, medium- and long-term action plans to deliver those targets. However, in the current nascent stage of transition, many corporate transition plans do not establish interim targets and associated delivery strategies for the full timeline to net zero.

A short-term focus is a priority to both kick-start the transition and to give a fighting chance to halve global emissions by 2030. From a practical point of view it also makes sense for a corporate to focus here to utilise and align with their shorter-term planning and budgeting timeframes.

However, a short-term focus only, provides no reassurance that the necessary transition will be maintained beyond the short-term through to net zero, particularly where action is needed in the short term for emissions reduction later, as is commonly the case.[23] This is particularly important for those sectors where emissions reduction will probably be back-loaded due to the lack of available decarbonisation solutions in the short-term.

To reflect this, a subdivision has been introduced in category '3. Aligning' to create '3a. Aligning – short-term+ plan' and '3b. Aligning – full-term plan'. The intention is to enable corporates to be categorised as 'Aligning' in the absence of specified medium- and long-term targets, as long as they are demonstrating forward-thinking in terms of how emissions reduction into the medium-term and beyond will be achieved and that actions needed in the short-term to deliver the future emissions reduction are planned and disclosed so progress can be monitored.

Specifically, categorisation into '3a. Aligning – short term+ plan' requires:

- Short-term targets to be set and associated decarbonisation levers and actions to deliver those short-term targets to be identified; and
- The identification of the decarbonisation strategy and associated decarbonisation levers that will be used to deliver any additional emissions reduction needed over and above those covered by the short-term targets which together with the short-term targets emissions reduction account for 50% of the corporate's baseline emissions; and any actions needed in the short term to deliver those additional emissions reductions.

Categorisation into '3b. Aligning – full term plan' requires:

- Short-, medium- and long-term targets to be set, and associated decarbonisation levers and actions to deliver those short-, medium- and long-term targets to be identified.

See **Box 2** for note on key terminology here, including the difference and linkages between decarbonisation strategies, levers, and actions.

15. The categories presented in this table should not be misconstrued as implying equivalence or substitutability between the listed frameworks and their categories, nor should it be interpreted that the guidance within the listed frameworks can replace one another, or directly correlate to the guidance provided in this note. It is noted that the transition maturity categories here draw from but do not match the four transition financing categories identified by GFANZ — 'climate solutions', 'aligned', 'aligning' and 'managed phase-out'. This is because, when assessing at a corporate level, the 'climate solutions' and 'managed phase-out' financing strategies describe decarbonisation strategies that an individual corporate may or may not employ (depending on the nature of their economic activities) en-route to aligning with net zero. Where the corporate needs to invest in climate solutions or phase out high emissions assets, this should be seen in their delivery strategy describing the actions that they will take to reduce their emissions. However, they are not inherently stages of transition maturity hence are not explicitly recognised through a distinct transition maturity category.
16. The Transition Pathway Initiative's methodology for assessing publicly listed equity does reflect an interpretation of transition status but cannot be captured in this table as the management quality levels are separated from the emissions target and performance indicators. Furthermore, the management quality levels (of which there are six) have a more granular interpretation of management readiness, with the development and implementation of a transition plan representing level 6.
17. Climate Bonds Standard V4.0 | Climate Bonds Initiative
18. These draw on GFANZ's four transition financing strategies. 'Climate solutions' and 'managed phase-out' financing strategies describe decarbonisation strategies that an individual corporate may or may not employ (depending on the nature of their economic activities) en-route to aligning with net zero. Where they do so, this should be evident in their delivery strategy describing the actions that they will take to reduce their emissions. However, they are not inherently stages of transition maturity hence are not explicitly recognised through a distinct transition maturity category here. See https://assets.bbhub.io/company/sites/63/2023/11/Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf
19. IIGCC's 'alignment maturity' categories. These are the most comprehensive and well-developed of the categorisations listed in this table. See Investor Expectations of Corporate Transition Plans: From A to Zero (iigcc.org)
20. Noting that SBTi categories address emissions targets and performance only, not other aspects of the transition plan (delivery strategy, governance etc.,). See The-SBTi-Financial-Institutions-Net-Zero-Standard-Consultation-Draft.pdf (sciencebasedtargets.org)
21. A framework to define a transition category for investors, July 2022 PowerPoint Presentation (unepfi.org)
22. The World Benchmarking Alliance's (WBA) Assessing Corporate Transition (ACT) methodology has a scoring system for corporate transition – see https://actinitiative.org/wp-content/uploads/pdf/act_generic_methodology_v2.0.pdf. A forthcoming paper considers how these scores might be mapped to transition maturity categories: 'ACT Assessment Categorization Framework' (forthcoming)
23. For example, multi-year research and development programmes might be required to deliver the technologies and capabilities needed for longer-term emissions reductions or planning for and construction of new facilities might mean multiple years of action before a new facility becomes operational.

Box 2: A note on key terminology[28]

The strategies that may be deployed by a corporate to decarbonise are well understood, including building up 'climate solutions', phasing out 'stranded assets', and/or otherwise decarbonising its ongoing activities.

These decarbonisation strategies will be realised by activating 'decarbonisation levers'. These levers are aggregated types of mitigation actions such as energy efficiency, electrification, fuel switching, use of renewable energy, products change, supply-chain decarbonisation, phase out of high-emitting assets, and potentially divestment.

Decarbonisation actions are the corporate's specific actions undertaken to implement its selected decarbonisation levers and deliver its emissions reduction targets, through which it seeks to address material impacts, risks, and opportunities.

Capturing 'Climate Solutions' and 'Enabling Activities'

The categories and associated indicators are sufficiently generic to capture the transition status of corporates across all sectors, sizes, and geographies, but assume the transition process involves the development of a transition plan to guide their 1.5 degree alignment.

However, some corporates may deliver low-emission goods and services without, or prior to, developing a formal transition plan. These include:

- Corporates with inherently low-emission activities that have not undergone any previous decarbonisation, such as electrical utility companies using only solar or wind power, rather than transitioning away from fossil fuels, or car manufacturers producing only electric vehicles rather than those transitioning from the production of fossil fuel fleets;
- Corporates whose goods or services enable others to deliver substantial emissions reduction, such as manufacturers of low-carbon technologies, or those mining transition critical minerals;
- Corporates which have substantially decarbonised their own activities in advance of a formal, disclosed transition plan.

These low-emission corporates are generally not yet zero emissions, due to some relatively immaterial emissions in the materials used in their construction for example, which in time will require a transition plan to address. Even so, they deserve recognition for their relatively low emissions today, even in the absence of a transition plan.

These activities (and corporates) are generally described as 'Climate Solutions' or 'Enabling Activities'.[24]

It is proposed that these corporates can be categorised as '4. Aligned' based on their current emissions performance even in the absence of a commitment and public transition plan to reach net zero.[25] However, it is further proposed that this categorisation is valid for a limited period of five years only. If these corporates do not deliver a net-zero commitment and associated transition plan within that timeframe (a commitment and transition plan that meets the indicators for '3. Aligning') they should then be recategorised as either '1. No action' or '2. Committed' depending on whether they do or do not have a suitable net-zero commitment, regardless of any ongoing emissions performance. This proposal, and the potential for downward recategorisation, reflect the view that all corporates will ultimately need a transition plan to govern their full transition to net zero.

Using the categories to identify transition finance

Corporates in category '3. Aligning' and category '4. Aligned' are determined to be credibly transitioning to net zero. Therefore, as illustrated in Figure 2, primary and secondary general purpose financing (and facilitating the general purpose financing) of these corporates can be considered 'transition finance'.

This determination is made on the basis of the status, ambition, and credibility of the corporate's transition, as evidenced by their transition commitments, plans, and performance, regardless of the sector or industry in which they operate. That is, the label 'transition finance' is not limited to hard-to-abate sectors because, as argued above, all corporates not already at net zero need to transition. Even those viewed as 'Climate Solutions'.

This position does not conflict with a recognition that corporates in the hard-to-abate sectors will likely account for a significant portion of (many) financial institution's emissions, are highly significant to a successful transition to a net-zero economy, and may need significant finance to enable their transition. Hence, financial institutions may at least initially prioritise their transition activities on corporates in these hard-to-abate sectors but transition, and the concept of transition finance, should not be limited to these sectors.

However, these categories can also be considered as 'green finance' on the premise that transition is a subset of green as long as the speed and ambition of that transition is consistent with the collective goal to halve emissions by 2030 and achieve net zero by 2050.[26] The green label has never been restricted to net zero. Green bond proceeds are predominantly linked to projects, assets, and activities which are not yet net zero, whether that be 'Climate Solutions' or financing the decarbonisation of assets or asset values for assets not yet at zero, such as buildings. Various green taxonomies, including the EU Taxonomy for Sustainable Activities (often known as a green taxonomy in the current absence of social criteria) include sectors and eligibility criteria for activities and assets in the process of transitioning.

Note: this section relates to general purpose finance including equity investment, corporate bonds and loans, and other general purpose debt. It does not include finance with a specific use-of-proceeds such as project finance or targeted loans, which would require evaluation to determine their eligibility to be included as transition and/or green finance.[27]

24. The December 2023 GFANZ report https://assets.bbhub.io/company/sites/63/2023/11/Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf identifies three sub-types of Climate Solutions: i) Solutions that directly reduce or remove emissions; ii) Enablers that contribute indirectly; and iii) Nature-based solutions that mitigate climate impacts and sets out two attributes for them: a) Real-economy emissions reduction: Direct or indirect net contribution to emissions reductions should be significant and should not lead to the extension of the lifetime emissions of assets identified for phaseout. b) Expectations of net-zero alignment: The Climate Solution's own emissions should be reasonably expected to progress toward net zero over time.
25. That is, subject to meeting the emissions performance indicator E3 as described in Figure 4.
26. As is tested by the Indicator E3 per Figure 4.
27. Indeed, it is possible that general purpose finance and known use-of-proceeds finance for the same corporate may be differently categorised. For example, an energy utility corporate transitioning away from fossil fuel to renewable generation may be categorised as '3. Aligning' on the basis of their current transition plan and stage of implementation, in which case equity investments in that company and general purpose debt raised by that company may be considered 'transition finance'. However, a use-of-proceeds bond issued by that same corporate to finance the installation or acquisition of solar or wind farms may be categorised as '4. Aligned' given current emissions performance (in line with the discussion of 'Climate Solutions' above) and marketed (labelled) as a 'green bond'.
28. These definitions of decarbonisation levers and actions are based on those in the European Union Environmental and Social Reporting Standards (ESRS): Commission Delegated Regulation (EU) 2023/2772 of 31 July 2023 supplementing Directive 2013/34/EU of the European Parliament and of the Council as regards sustainability reporting standards (europa.eu)

3. The proposed classification system

Figure 4 captures the indicators for a corporate with a transition plan.
The accompanying notes are found in **Table 1** below. **Box 3** provides some context for the selection of the indicators.

Box 3: Selection of the indicators

As noted above, the categories are intended to demarcate the stages of maturity of corporate transition planning and implementation, as evidenced by the delivery (or not) of ambitious and credible commitments and transition plans, governance structures, and completed action with resulting emissions reduction, which is what the indicators focus on.

Currently, the indicators are relatively limited in number, which is intentional to both address the nascent stage of corporate transition disclosure and to accelerate assessment across a large number of corporates. Investor portfolios, for example, typically include stakes in hundreds, if not thousands, of publicly listed companies. This presents a challenge when selecting these indicators from the large number introduced across the variety of existing guidance, despite that guidance having a high degree of alignment. Also challenging is ensuring indicators address the ambition and the credibility of the corporate transition, both of which may be highly contingent on an individual corporate's circumstance. Adopting aspirational indicators would help push corporates to improve the quality of their transition plans; however, setting an unrealistically high bar would limit the goal of rapid and widespread assessment, and corporate engagement by financial institutions. With these considerations in mind, during the selection process, priority was given to indicators that best satisfied the following requirements:

- Met overarching requirements for ambition – namely alignment not just with a net-zero goal, but 1.5 degree pathways to that goal with limited overshoot;
- Consistently identified in the corporate transition guidance previously reviewed; and
- Left less room for subjectivity either in the interpretation of the indicator or in determining whether a particular corporate satisfied that indicator; and
- Could be applied to all corporates, regardless of sector, geography or size;[29] and
- Should be applied to all corporates, regardless of sector, geography or size, (i.e., essential not just desirable and/or applicable to only some corporate strategies); and
- Assessable from information that is or is likely to be publicly disclosed (i.e., is not likely to be subject to confidentiality concerns); and
- Could be used by all types of financial institutions.

Figure 4: Corporate transition categories and associated indicators

	1. No action	2. Committed		3. Aligning		4. Aligned	5. Net zero
		2a. Pledged	2b. Short term targets only	3a. Short-term+ plan	3b. Full plan		
A. Commitment	-	A1. Public commitment to achieving net-zero emissions in line with a 1.5 degree sectoral pathway with no or limited overshoot [note 1]	← As left	← As left	← As left	← As left	A3. Public commitment to maintaining net zero emissions
	-	A2. The corporate has no plans to expand fossil fuel capacity [note 2]	← As left	← As left	← As left	← As left	← As left

29. For this reason, indicators do not for example identify specific sectoral and/or regional emissions pathways which must be followed or specific decarbonisation levers that must be addressed in the delivery strategy. Rather, they seek to set principles to capture the essence of credibility across all these variants. However, to assist users, some pre-screening and selection has been carried out following these principles. See the accompanying notes in Table 1 for more information.

Figure 4 *(continued)*: Corporate transition categories and associated indicators

	1. No action	2. Committed		3. Aligning		4. Aligned	5. Net zero
		2a. Pledged	2b. Short term targets only	3a. Short-term+ plan	3b. Full plan		
B. Emissions targets	-	-	B1a. Emissions inventory of baseline emissions [note 3] addressing all material scope 1, 2 and 3 emissions [note 4]	← As left	← As left	← As left	← As left
	-	-	B2a. Short-term [note 5] emissions targets [note 6] addressing all material scope 1, 2 and 3 emissions [note 4]	← As left	B2b. Short-, medium- and long-term [notes 5, 7] emissions targets [note 6] addressing all material scope 1, 2 and 3 emissions [note 4]	← As left	-
	-	-	B3a. The short-term emissions targets align [note 9] with credible science based benchmarks [note 8]	← As left	B3b. The short-, medium- and long-term emissions targets align [note 9] with credible science based benchmarks [note 8]	← As left	-
	-	-	B4a. The short-term emissions targets were set or reviewed no more than two years ago [note 10]	← As left	B4b. The short-, medium- and long-term emissions targets were set or reviewed no more than five years ago [note 10]	← As left	
C. Delivery strategy	-	-	-	C1a. The delivery strategy sets out the decarbonisation levers envisaged to enable the corporate to achieve the minimum of a) a 50% reduction in its baseline emissions (per Indicator B1) and b) its short-term emissions targets (per Indicator B2) [note 11]	C1b. The delivery strategy sets out the decarbonisation levers it is envisaged will enable the corporate to achieve its short-, medium- and long-term emissions targets (per Indicator B2b) [note 11]	← As left	-
	-	-	-	C2. The decarbonisation levers to achieve the short-term emissions targets specifically are technologically and economically feasible [note 12]	← As left	← As left	

Figure 4 *(continued)*: Corporate transition categories and associated indicators

	1. No action	2. Committed		3. Aligning		4. Aligned	5. Net zero
		2a. Pledged	2b. Short term targets only	3a. Short-term+ plan	3b. Full plan		
C. Delivery strategy	-	-	-	C3a. The decarbonisation levers do not include the use of offsets, except for any residual emissions that cannot otherwise be mitigated [note 13]	C3b. The short-, medium- and long-term decarbonisation levers do not include the use of offsets, except for any residual emissions that cannot otherwise be mitigated [note 13]	← As left	
				C4a. The key risks and uncertainties relating to delivery of the decarbonisation levers are (re) assessed and disclosed annually [note 14]	C4b. The key risks and uncertainties relating to delivery of all decarbonisation levers envisaged for the delivery of short-, medium-, and long-term targets are (re) assessed and disclosed annually [note 14]	← As left	
	-	-	-	C5a. Annual trackable actions to deliver the decarbonisation levers over the short-term are identified [note 15]	C5b. Annual trackable actions over the short-term and interim trackable actions thereafter to deliver all decarbonisation levers are identified [note 15]	← As left	
	-	-	-	C6a. Trackable financial milestones are identified [note 16]	C6b. Annual trackable financial milestones over the short-term and interim trackable financial milestones over the medium- and long-term are identified [note 16]	← As left	
	-	-	-	C7a. The impact on key environmental and social factors in the short term arising from the identified decarbonisation l evers and associated actions, and the steps the corporate plans to take to mitigate those impacts are identified [note 17]	C7b. The impact on key environmental and social factors arising from the delivery of the short-, medium- and long-term emissions targets and the steps the corporate plans to take to mitigate those impacts are identified [note 17]	← As left	

Figure 4 *(continued)*: Corporate transition categories and associated indicators

	1. No action	2. Committed		3. Aligning		4. Aligned	5. Net zero
		2a. Pledged	2b. Short term targets only	3a. Short-term+ plan	3b. Full plan		
	-	-	-	C8a. The short-term delivery strategy was established or reviewed no more than two years ago [note 10]	C8b. The delivery strategy for the short-, medium- and long-term targets was established or reviewed no more than five years ago [note 10]	← As left	
D. Governance	-	D1. The Board is formally responsible for the development and implementation of the transition plan [note 18]	← As left	← As left	← As left	← As left	← As left
E. Performance	-	-	-	E1a. Overall, trackable interim actions and financial milestones identified in the delivery strategy as being due in the last 12 months (per indicators C5 and C6) have been implemented or delivered. Any delays are well explained and have triggered, where needed, adjustments to the delivery strategy to stay on track with delivery of the emissions targets [note 19]	E1b. Overall, trackable interim actions and financial milestones identified in the delivery strategy as being due in the last 12 months (per Indicators C5b and C6b) have been implemented or delivered. Any delays are well explained and have triggered, where needed, adjustments to the delivery strategy to stay on track with delivery of the emissions targets [note 19]	← As left	-
	-	-	-	E2a. Actual emissions align with the corporate's short-term emissions targets (if any arising during the last 12 months) [note 20]	E2b. Actual emissions align with the corporate's emissions targets (if any arising during the last 12 months) [note 20]	E3. Actual emissions align with the corporate's selected science-based benchmark (per Indicator B3) [note 20]	E4. Actual emissions at net zero [note 20]

Table 1

Accompanying notes for Figure 4

1. While the global collective goal for net-zero emissions is 2050 or sooner, a specific net-zero date is not set because the target net-zero date for each corporate will vary according to the nature of the activities they undertake. Appropriate net-zero dates by sector are indicated by credible sectoral net-zero pathways (see note 7).

At a minimum, the net-zero commitment shall cover all scope 1 emissions and upstream scope 3 emissions. Some scope 2 and 3 emissions may not be covered in the commitment where the corporate has no direct control and little influence over emissions reductions. For example, scope 2 emissions reliant on the decarbonisation of the grid to decarbonise electricity used, or downstream scope 3 emissions arising from other actors' use of the company's products. Note however that downstream scope 3 emissions for fossil fuel related companies are not covered by this exclusion, as 'stranded fuels' companies involved in the extraction, transportation or energy generation of/from those fuels or associated trading activities should be committed to phasing out those activities.

Where any emissions are excluded from the scope of the commitment, this is clearly identified and the rationale given.

Net zero means net zero notwithstanding any residual emissions, which are defined as 'greenhouse gas emission that remains after taking all possible actions to implement emissions reductions, and when net zero has been reached. All possible actions refer to what is technically and scientifically feasible.' Per ISO's IWA Net Zero Guidelines (IWA 42 3.2.9)

2. If the corporate is in the business of the exploration or extraction of fossil fuels, or is a utility company generating or supplying power or heat generated from fossil fuels, the corporate has, within the last year, publicly (re)committed to no expansion* of any of the following activities since 1 Jan 2023:
i. The exploration and extraction of conventional and unconventional fossil fuel reserves; or
ii. The exploration of new conventional and unconventional fossil fuel resources; or
iii. Natural gas production; or
iv. Refining crude oil to produce derivative products; or
v. The supply and/or use of fossil fuels for power generation and heat.

These activities include unconventional sources such as hydraulic fracking, arctic drilling, oil sands and shale deposits.

**No expansion means no additional commitment of capex for the acquisition or leasing of new fossil fuel assets. These assets might be fixed (e.g., property, plant, equipment) or intangible (e.g., goodwill, capitalised licences). Already committed capex with pre-dated board sign-off is not included in the exclusion. Capex for maintenance of existing fossil fuel assets is permitted, as long as it does not extend the life of those assets.*

3. This emissions inventory to have been carried out no more than two years prior to the setting of the emissions targets and any associated delivery strategy. The scope of and methodology for assessment of the emissions included in the emissions baseline matches that of the credible-science based benchmark selected by the corporate for the purposes of aligning their emissions targets (per Indicators B2 and B3).

4. Materiality is defined as at least 95% of scope 1 and 2 emissions. Additionally, for companies with scope 3 emissions that are at least 40% of total emissions (scope 1, 2, and 3 emissions), at least 90% of scope 3 emissions.

5. Short-term is defined as no less than four years and no more than six. This (limited) flexibility balances the likelihood that some corporates may be focussing on a relatively short budgeting and planning cycle, while others are aligning with the acknowledged significance of the period to 2030, by which time global emissions need to be halved compared to 1990 levels.

6. The specific intensity or absolute metric used may be determined by the science-based benchmark the corporate chooses to benchmark their activity against (see Indicator B3). However, the following restrictions apply: i) Emissions intensity may only be product or physical emissions intensity (e.g., tCO_2e/tonne of cement) not economic intensity (e.g. cCO_2e/$ revenue), and ii) An absolute emissions metric may only be used where the targets only go down, never up.

If emissions intensity metrics are used, the corporate should also disclose equivalent absolute emissions targets, but these need not be benchmarked to a science-based pathway.

One caveat to this approach is where the sectoral benchmarks are not captured via an emissions metric. For example in agriculture where benchmarks may describe best practices. Similarly, there may be exceptions where activities are deemed to be so low carbon that sector criteria deem them to be 'automatically eligible' at this time.

Temperature metrics e.g., 1.5 degree aligned, are not in themselves eligible metrics for this indicator.

7. The long-term target date is the net-zero target date of the company. If residual emissions are anticipated at that date, these should be clearly identified and justified. The medium-term target date should be approximately half-way between the short-term and long-term target dates. That is, where a company has set short-term emissions targets for 2030 and has committed to net zero in 2050, its medium-term target date should be around 2040. Roughly ten-yearly interim emissions targets balance the need for trackable and monitorable targets, with the reality that long-term targets will not be as forecastable or precise as short-term targets.

Residual emissions are defined as 'greenhouse gas emission that remains after taking all possible actions to implement emissions reductions, and when net zero has been reached. All possible actions refer to what is technically and scientifically feasible.' Per ISO's IWA Net Zero Guidelines (IWA 42 3.2.9)

8. A credible science-based benchmark is one that meets the following principles:

1. It is consistent with a carbon budget that limits the global mean temperature rise to 1.5°C with a 50% probability with low or no overshoot;

2. It may be global or regional but in either case it has been derived from and is consistent with climate modelling where the global carbon budget is allocated across time and to different regions and sectors – typically via an Integrated Assessment Model. For example, derived from IEA climate scenarios;

3. Ideally it is sector specific. If it is not sector specific only the SBTi's Cross Sectoral Pathway is recognised under these principles and use of that benchmark is subject to the guidance set by SBTi;

4. It includes all material scopes and types of emissions for that sector/activity (and what is material is defined in note 4);

5. It covers the full timeline to net zero/to only residual emissions, as long as any residual emissions are clearly identified (residual emissions are defined in note 6);

6. It does not incorporate the use of offsets i.e., it does not assume the corporate will need to use offsets to meet the benchmark, except in the case of residual emissions (see note 11);

7. If the benchmark uses emissions intensity metrics, these may be product or physical emissions intensity only (e.g. tCO_2e/tonne of cement) not economic intensity (e.g. cCO_2e/$ revenue). If it uses absolute emissions, the benchmark should only go down over time, never up;

8. It has been produced by an independent third party, not by the corporate themselves, with climate science expert input to the process and has been subject to public review;

9. Its technical documentation confirms that it meets principles 1-7.

For convenience, a number of (sources of) benchmarks have been pre-assessed as meeting these principles. These are the 1.5 degree aligned sectoral pathways of SBTi, TPI, Climate Bonds Initiative, and the cross sectoral pathway of SBTi.

9. Alignment for short-term emissions targets

If the corporate has selected a sector-specific benchmark, alignment means that:

- The corporate's short-term targets are projected to align with their selected sectoral pathway by the short-term target date.

If the corporate has selected SBTi's Cross Sectoral Pathway as its benchmark, alignment means that:

- The corporate's short-term emissions targets align with the Cross-Sectoral Pathway for all years up to and including the net-zero target date.

Alignment for medium- and long-term emissions targets

If the corporate has selected a sector-specific benchmark, alignment means that:

- The corporate's medium- and long-term emissions targets (and any associated interim emissions targets) are projected to align with their selected sectoral pathway; OR
- The corporate's cumulative projected emissions targets are less than the cumulative emissions of their selected benchmark, assessed using the Cumulative Benchmark Divergence (CBD) approach developed by IIGCC.[30]

If the corporate has selected SBTi's Cross-Sectoral Pathway as its benchmark, alignment means that:

- The corporate's medium- and long-term targets align with the Cross-Sectoral Pathway for all years to net zero; OR
- The corporate's cumulative projected emissions targets are less than the cumulative emissions of their selected benchmark, assessed using the Cumulative Benchmark Divergence (CBD) approach developed by IIGCC.[31]

10. Categories '2b. Committed – Short-term targets only' and '3a. Aligning – short-term' allow for corporates to be categorised as aligning with a 1.5 degree economy without having set medium- or long-term emissions targets. To minimise the risk of a corporate being classified here but then not maintaining short-term momentum to really drive through to net zero, the 'short-term' targets/ transition plan respectively must be reviewed at least every two years to extend the timeframe for short-term targets and any associated actions.

As Category '3b. Aligning – long-term' requires corporates to have short-, medium-, and long-term targets and associated delivery strategies, this risk is reduced. Therefore, transition plans for those in this category need to be reviewed and updated only at least every five years, to maintain relevance in changing market conditions.

11. Which decarbonisation levers and actions are included in a transition plan is not prescribed. The most likely decarbonisation levers by sector are increasingly well documented (see for example the sectoral guidance from the Transition Plan Taskforce Sector Deep Dive - Transition Taskforce). However, each corporate will determine which strategy and associated decarbonisation levers, and actions to deliver those levers it will deploy and when to meet its emissions targets in a manner that best meets its needs.

What is required is that the corporate clearly identifies the decarbonisation levers being/to be deployed over what timeframe, and the contribution each lever is making/is expected to make to any short-, medium- and/or long-term targets set.

The levers address all sources of emissions included in the emissions reduction targets. This includes levers/ actions related to the supply chain and any associated engagement strategy. Similarly, levers and actions related to any phase-out or climate solution build-up should be covered here if achievement of the emissions targets relies on either/both of these strategies.

Supporting information for the expected emissions impact of each decarbonisation lever planned to deliver the short-term emissions targets is given.[32] Depending on the nature of the decarbonisation lever, plausible evidence may include academic studies, third party expert verification, evidence from comparable action taken in similar circumstances, and contractual undertakings.

As part of phase two of this project, proxies for this indicator will be explored, most notably the existing transition plan assessment schemes carried out by independent third parties such as the Transition Pathway Initiative, the World Benchmarking Alliance, and Climate Bonds Initiative.

12. An evaluation that the decarbonisation levers identified by the corporate are feasible is required. Any lever should be considered commercially feasible if it has been demonstrated in an industrially relevant environment to be fine-tuned to a variety of operating conditions; it is reliable and performance matches expectations; it is interoperable with other connected technologies; and that all environmental, regulatory, and socio-economic issues are addressed.[33]

Long-term targets may be dependent on currently non-commercially viable levers, but if so, there must be ongoing R&D aimed at making them viable, and trackable milestones to monitor progress to this goal.

Supporting information is given for the technical and economic viability of the decarbonisation lever at the time is it is planned to be deployed. Depending on the nature of the decarbonisation lever, plausible evidence may include academic studies, third party expert verification, evidence from comparable action taken in similar circumstances, and contractual undertakings.

Assessing the viability of the decarbonisation levers is a critical part of the assessment of the transition plan, and arguably the most complex. The guidance above provides some direction to assessors. As part of phase two of this project, proxy indicators for this element will be explored, most notably the existing transition plan assessment schemes carried out by independent third parties such as the Transition Pathway Initiative, the World Benchmarking Alliance, and Climate Bonds Initiative.

13. Offsets cannot be counted towards the planned or achieved emissions reduction needed to align with the selected science-based benchmark.

If offsets are used or planned to be used by the corporate, they can only be allocated to emissions reduction over and above those needed to align with the selected benchmark. This includes bridging the gap between any residual emissions in the end goal per the selected sectoral benchmark and a corporate's final net-zero emissions.

Where offsets are used to address residual emissions, the standard or methodology used/to be used to certify the carbon credits is identified.

14. The corporate has indicated which decarbonisation levers and/or actions are subject to particular uncertainty and therefore pose more significant risks to the delivery of the transition plan and attainment of the emissions reduction targets.

These risks may relate to:

- Policy and regulatory change;
- The decarbonisation trajectory of the global economy, relevant geographies, and/or sectors;
- Macroeconomic trends (e.g., labour availability, cost of borrowing etc.,);
- Microeconomic and financial factors (e.g., availability of finance, relative prices);
- Technological developments;
- Access to corporate data and its reliability;
- Shifts in client and consumer demand;
- The levels of warming over the short-, medium-, and long-term;
- The physical impacts of the changing climate, and the regional and spatial implications of these;
- The effectiveness of adaptation efforts and possible limits to adaptation, and the regional and spatial implications of these.

30. Assessing Climate Target Alignment with cumulative benchmark divergence: CBD methodology_February2024.pdf (iigcc.org)
31. Ibid
32. For further discussion on potential emissions impact metrics see: Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf (bbhub.io)
33. This requirement broadly corresponds to Technology Readiness Level 6 (TR6) as described here: technology readiness level-KINB27988ENN.pdf

15. The corporate lays out a time-bound action plan specifying the actions being/to be taken and over what timeframe to ensure those decarbonisation levers can be/are being deployed. These actions are trackable and can be used to monitor implementation progress on, and risks to, delivery of the identified decarbonisation levers. For example, if the decarbonisation lever is the deployment of a new technology, the action plan should detail the time-bound steps planned to be taken to develop and deploy that technology, from investments in R&D, patent registering, pilot projects, scaling projects etc. Likewise, if the decarbonisation lever is a switch to renewable energy, the action plan should detail the time-bound steps taken to source that energy, such as intentions for and source of renewable energy certificates (RECs), and/or purchasing power agreements (PPAs), as well as any action to install and operate on-site generation.

This action plan identifies the actions to be taken internally by the corporate (for example, the installation of new equipment, installation of renewable energy, changing the transportation fleet, engagement with suppliers to support decarbonisation in their activities) and which externally (for example, the external development of a technology upon which the corporate is dependent to achieve its emissions reduction, or the external greening of the grid, or policy changes by the government to enable a certain outcome).

The actions identified are concrete. Vague descriptions such as 'accelerate our transition to cleaner energy solutions', 'modernise our operations' or 'leverage green solutions' without a description of the specific actions that will be taken, and the impact of those actions, are not eligible.

To enable stakeholders to track progress in the delivery of the action plan, the corporate may report on progress in rolling out the action plan, and/or on business and operational metrics that have been disclosed alongside the action plan. For example, percentage of product sold that is low carbon, percentage of energy from renewable sources/emissions intensity of energy used/total energy emissions used, and percentage of recycled source materials. As part of phase two of this project, proxies for this indicator will be explored, most notably the existing transition plan assessment schemes carried out by independent third parties such as the Transition Pathway Initiative, the World Benchmarking Alliance, and Climate Bonds Initiative.

16. Trackable financial milestones are identified that can be used to monitor implementation progress on, and risks to, delivery over the short term of the identified decarbonisation levers and associated actions.

These financial milestones are identified for the short-term target date and one interim date between then and the publication date of the transition plan.

These financial milestones may not be limited to but must include:

- Any capex necessary to deliver the decarbonisation levers, disaggregated by decarbonisation lever; and
- Revenue impact and asset write-down arising from:
  - Any phasing out of certain activities and assets e.g., fossil fuel energy generation assets and activities; and
  - Any ramping up of 'green activities'*

These financial milestones are feasible. Specifically, any estimated capex costs are reasonably sized compared to sector peers and/or the overall plausibility is supported by external evidence from credited third-party sources. Material deviations are explained and supported. If expected costs or revenue impacts are substantially different when compared to equivalent estimations elsewhere, the corporate provides reasonable explanation to justify this. Assumptions on growth, market demand for products, prices, and costs related to future business mix are broadly aligned with industry trends. As part of phase two of this project, proxy indicators for this element will be explored, most notably the existing transition plan assessment schemes carried out by independent third parties such as the Transition Pathway Initiative, the World Benchmarking Alliance and Climate Bonds Initiative.

*These 'green activities' are clearly defined and identified by the corporate. Definitions might include 'aligned with the EU Taxonomy' or the corporate's interpretation of Climate Solutions as described in the GFANZ paper: Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf (bbhub.io) or the IIGCC's 'Investing in Climate Solutions Listed Equity Fixed Income_Nov2023.pdf (hubspotusercontent-eu1.net)

17. At this stage, this indicator is not prescriptive about the scope of potential impacts nor the level of mitigation required to minimise or prevent those impacts but is aiming to promote transparency. However, the corporate should disclose the potential negative environmental and social impacts of its planned decarbonisation transition and the steps it is taking to mitigate these impacts.

18. This may be demonstrated by:

- A clear public statement of the Board's commitment to the transition plan and the Board's mandate to deliver the plan; or
- The Board and senior executive remuneration being linked to the delivery of the net-zero goal/emissions reduction targets.

19. The intention here is to determine that implementation of the transition plan is on track. The corporate's annual reporting shall confirm that the trackable actions and financial targets identified in the transition plan as due in the last annual reporting period (per Indicators C5 and C6) have been carried out/attained. Plausible evidence will vary but might include management reports, board papers, audited sustainability reports, audited financial reports, public announcements, evidence of capital expenditure or contracted services or equipment, and sales contracts.

The only exception to this requirement for evidence of the carrying out of the actions identified in the transition plan, is if alternative, mitigating actions have been taken that have or will achieve the same emissions impact. However this needs to be clearly explained and justified by the corporate, addressing the impact not just on any current milestones and emissions performance but also the impact on any future milestones or emissions performance also dependent on the missed milestone.

20. To clarify, no history of alignment with the corporate's own targets (Indicator E2) or selected benchmark (Indicator E3) is required to satisfy this indicator. That is, the corporate will meet these indicators in the first year that actual emissions align with the targets/benchmark respectively.

Therefore, a corporate will be categorised as 'Aligned' once its actual emissions align with its selected science-based benchmark (per Indicator B3), and there is no requirement for [X] years of past emissions performance aligning with the selected benchmark before the corporate can be categorised as 'Aligned'. A requirement for a specified number of years of past alignment may be too harsh when companies may not have the necessary data trail and/or actual emissions may veer above or below target year by year purely because emissions cannot be perfectly projected and plans cannot be perfectly implemented. The implications of this for the required frequency of assessment are discussed in Section 4 – Guidance notes.

On this point, it is noted that the GFANZ Secretariat proposed a two-year window to be considered but determined that ultimately it is up to financial institutions to assess on a case by case basis, leveraging information ideally from the corporate's transition plan to support the assessment.[34]

34. See https://assets.bbhub.io/company/sites/63/2023/11/Transition-Finance-and-Real-Economy-Decarbonization-December-2023.pdf

4. Guidance notes for use of the proposed classification system to assess a corporate

Assessment of corporates practising more than one activity

The boundary of a corporate would ideally be a listed entity. Where a listed entity carries out more than one business activity, each activity should be assessed separately, applying the indicators in **Figure 4** to determine the transition categorisation of that activity. Given that different activities may be at different stages of transition maturity, i.e., each falling into different transition categories, a methodology is needed to determine the overall categorisation at the corporate level.

The following three-step methodology is proposed and will be tested in the next phase of this work.

1. Assign a point score to each category. For example: '0. Unclassified' or '1. No action' = 0 points; '2a. Committed - pledged' = 1 point; '2b. Committed - short-term targets only' = 2 points; '3a. Aligning – short-term+ plan' = 4 points; '3b. Aligning – full plan' = 6 points; '4. Aligned' = 8 points; and 5. Net zero' = 10 points.[35]

2. Assess each business activity separately to determine which transition category it falls into based on its compliance with the indicators for each category.

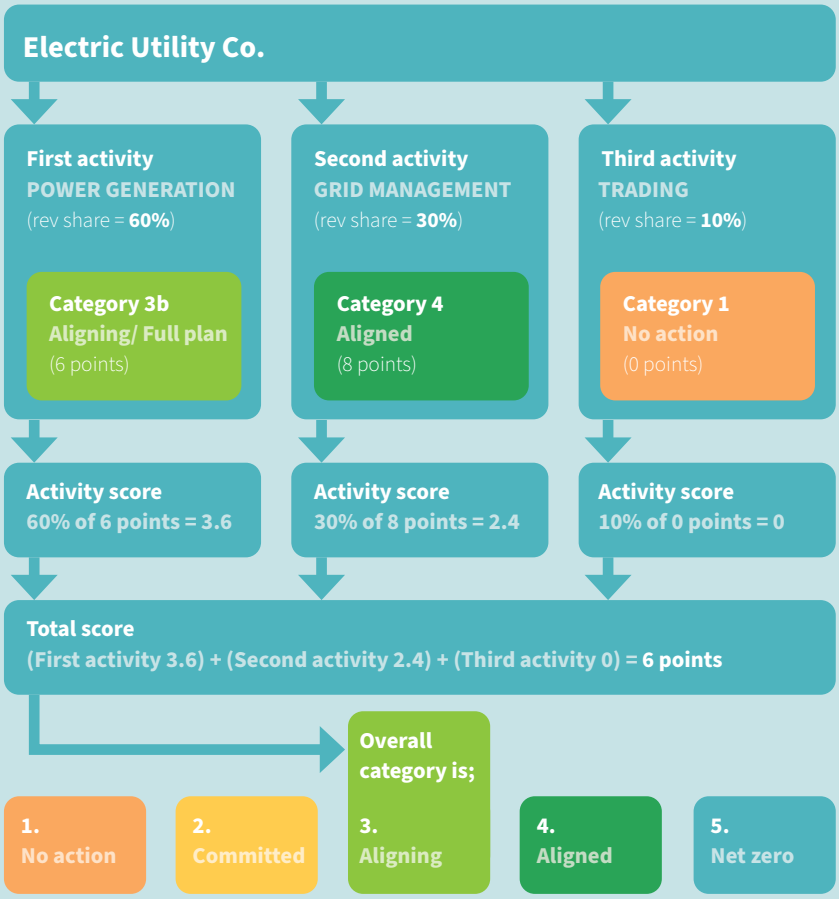
3. Calculate a weighted-average score for the corporate, weighting individual business activity category scores by either their share of the total revenue or emissions of the corporate.[36] This weighted-average score determines the overall score and hence category for the corporate.

A theoretical example of this is given in **Figure 5**.

All indicators must be met

Given the relatively limited number of indicators, it is proposed that a corporate/a corporate's business activity must meet all indicators for a category to be classified in that category. Similarly there is no weighting of different indicators, all are deemed equally important.

Figure 5: A worked example of the corporate aggregation methodology



Annual (re)assessment is required

To ensure the classifications are as current as possible, it is recommended that financial institutions reassess each corporate annually. This is already standard practice in independent corporate transition assessment schemes such as that of the Transition Pathway Initiative and the Climate Bonds Standard. It is a precedent that financial institutions should follow where they are doing their own assessments.

Given transition plans will not be reset each year, in interim years reassessment will need to focus on where interim actions, targets, and metrics laid out in the transition plan have been met and therefore the reassessment should not be too onerous; even less so once data access platforms such as those discussed in Next Steps section above are readily available.

No timeframe is imposed for a corporate's speed of progress through the categories

Timeframes for a corporate's progress through the categories is not prescribed here. For the move from '3. Aligning' to '4. Aligned' in particular, each corporate's timeframe will be determined by their specific operating environment and transition strategy, although checks are built into the indicators to ensure that the corporate's timetable is appropriate.[37]

Instead, it would seem more viable for a financial institution's own transition targets to reflect a movement of its corporate exposures up the transition categories over time at sector, product, and portfolio level. This issue will be subject to further consideration as described under 'Next steps' above.

35. These point allocations are given for the purposes of example only. The most appropriate weightings should be determined in conjunction with analysis of a real portfolio, to best test the implications of different weightings, per the next step of this project.
36. Weighting by emissions share is to be used where the corporate has an emissions inventory across all of its material emissions (scope 1, 2 and 3). However, weighting by revenue is permissible where the corporate does not have a baseline estimate of all its material emissions.
37. For example, its emissions reduction targets are required to align with a credible benchmark within an appropriate timeframe (Indicator B3) and the corporate is monitored to ensure it is delivering on those targets (Indicator E2).

Corporates may be reclassified downwards through the categories

As a consequence of the requirement that all indicators for a category need to be met in order for the corporate to be allocated to that category, it is possible for a corporate's transition status to reverse if indicators that were formerly met are found not to be met after subsequent assessment.

As discussed above, a corporate without a transition plan that was previously categorised as '4. Aligned' on the basis of its actual emissions performance may be recategorised down to '2. Committed' if it does not develop and implement a transition plan for its 'last mile' emissions within the specified timeframe.

Other cases where a corporate may be reclassified down the categories are:

- Where delivery actions (including interim milestones) or financial metrics or emissions targets arising are not met. In this case, the corporate would be recategorised from '3. Aligning' to '2. Committed';
- Where actual emissions previously aligned with the selected science-based benchmark, but on latest assessment have been found to no longer meet the benchmark. In this case, the corporate would be recategorised from '4. Aligned' to '3. Aligning' (presuming all indicators for '3. Aligning' continue to be met.

The only exception to this would be where compensatory action has been taken to ensure any underperformance is quickly redresseded. However, this would need to be judged on a case-by-case basis.

Climate Bonds INITIATIVE

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