International Platform on Sustainable Finance

Implementing transition finance principles – Interim report December 2023

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Acknowledgements and disclaimer

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The recommendations proposed are voluntary and build on existing public and private initiatives.

Executive Summary

This interim report provides an overview of the ongoing International Platform on Sustainable Finance (IPSF) work on transition finance, building upon the foundational Principles outlined in the 2022 IPSF Transition Finance report for robust transition targets (target-setting principles) and for demonstrating the capacity to achieve those targets (delivery principles).

The interim report identifies four dimensions of transition finance: credibility, disclosure, financing, and assessment. These dimensions encompass various principles, strategies, and considerations for effectively transitioning to a sustainable and climate-resilient economy. The dimensions are intricately linked to the practical steps involved in the transition finance process, each representing the stages that institutions must navigate to achieve meaningful transition outcomes. This holistic approach enhances the credibility and effectiveness of climate transition initiatives, bridging the gap between ambition and action. Overall, the report underscores the vital role of sustainability reporting, and comprehensive transition plans. It emphasises the need for comparable data and open data platforms, for collaboration among initiatives to support and assess climate efforts effectively.

It is important to note that transition finance can cover a wide range of transitions, considering various climate and environmental goals and social objectives. For the purposes of this interim report, and as an important starting point, the IPSF has focused on climate, i.e. the transition to achieve Paris Agreement goals.

The significance of transition plans

Central to the discourse on transition finance, transition planning is emerging as a catalyst for concrete change. It is a powerful tool, embedded within corporate strategy, to guide organisations and financial institutions towards more sustainable pathways, as they look to navigate the complexities, risks and opportunities of the transition. The disclosure of transition plans will help to establish a robust, credible and comparable set of forward-looking information on companies' strategic ambition, strategies, actions and financing needs throughout the transition. As a result, transition plan disclosures will serve many purposes. They enable financial institutions to identify and channel investments into companies actively reducing carbon emissions, therefore helping align financial flows with climate goals. Furthermore, they foster transparency, enabling stakeholders to make informed decisions and investors to assess the credibility and ambition of companies' endeavours. Therefore, transition plan disclosures are foundational to the provision of credible transition finance.

Use cases and practical examples

The IPSF believes providing use cases helps illustrate the practical implementation of transition finance; some first use cases have been included in this interim report. These examples include the EIB Group's Paris Alignment for Counterparties (PATH) Framework, the European Bank for Reconstruction and Development's (EBRD) step-by-step approach to transition planning for emerging and developing markets, and Japan's Transition Finance Model Project.

In the subsequent stages, following this interim report, the IPSF would aim to delve into more use cases and practical examples. This expansion could involve a more in-depth analysis of the coordinated phase-out of coal and a more extensive exploration of examples involving instruments for financing transition.

Recommendations for further work

This interim report underscores the evolving landscape of transition finance and identifies a number of gaps and areas for further work, including some where the IPSF will continue discussions or where it could specifically play a role and add value:

1. **Monitoring developments on tools and pathway approaches to setting climate ambition and**

benchmark against: IPSF to monitor progress to develop guidance for corporates on the different tools and pathways available that inform climate ambition. In the absence of sufficient guidance, IPSF members may consider issuing best practice guidance on how different tools can be used in conjunction, in a way that enables a whole-of-economy transition to net zero.

2. **Development of further international guidance to support comparability and consistency of transition plan disclosures:** We recommend that the International Sustainability Standards Board (ISSB) consider developing further guidance for the disclosure of transition plans as part of broader sustainability reporting, building on existing work. This should help to promote comparability and consistency of disclosures.
3. **Empowering emerging and developing countries:** Recognising the particular challenges faced by emerging and developing countries, the IPSF could seek to develop more tailored approaches to transition finance. This further work would look to identify, bring together and build on ongoing initiatives around approaches to transition plans and finance in emerging and developing countries, avoiding duplication of work.
4. **Developing frameworks that enable transition finance to scale with integrity:** IPSF will continue to monitor ongoing developments for frameworks that embed credibility within the transition finance process and consider where further guidance on core metrics and Key performance indicators (KPIs), and their use to support transition finance, might be necessary to enable it to scale with integrity and effectively.
5. **Monitoring for tangible impact:** In view of the importance of a comprehensive monitoring framework for transition finance, the IPSF could promote guidelines and best practices for monitoring the progress of transition plans and the flow of capital to companies that are transitioning. IPSF members will continue discussing and sharing views on possible local or international measures that may be influencing the ability of firms to access finance.

I. Evolving climate transition finance ecosystem

The global community is faced with the urgent need to address climate change and to transition towards a sustainable and low-carbon future, in line with the Paris Agreement and the Sustainable Development Goals (SDGs). Achieving this whole-of-economy transition requires a significant amount of capital from public and private sources. Supporting activities that are already green and sustainable is not enough. A much larger part of the global economy, including sectors that are currently greenhouse gas (GHG) intensive, also require financing for their transition. Transition finance plays a vital role in facilitating this shift by providing the necessary capital and resources to support the transformation of industries, sectors, and economies.

Building on the IPSF Transition Finance 2022 report, this interim report aims at identifying possible approaches and providing some further guidance for transition finance. In particular, it articulates the prior Principles around several dimensions crucial to the success of transition finance, while noting that the challenges may differ across economies. It also points to areas where further work is needed.

Transition planning, and the disclosure of transition plans, is an important foundation for transition finance. Transition planning supports entities to take a strategic approach to how they will manage the risks and opportunities of the transition, including the financing that they will need to deliver the actions that they will need to take. The disclosure of these plans is a key factor in the issuance of credible transition finance instruments. The choice of financial instruments and approaches employed by financiers and investors to engage with and influence corporates to decarbonise will also be influenced by investor preferences and requirements.

Key dimensions and transition finance process steps

The interim report recognises the complexity of the challenges at hand and emphasises the need for a holistic approach to ensure the credibility, transparency, effectiveness, and assessment of transition finance initiatives. **In line with the IPSF Principles to set robust targets and for a credible delivery, four key dimensions** of the transition finance process **are identified: credibility, disclosure, financing, and assessment**.

These dimensions and associated initiatives could be captured within a series of 'process steps' for transition finance seekers (set out in Figure 1, and with further detail in Annex 1). The proposed approach, which embeds the principles developed by IPSF and G20, illustrates the connections between economy-wide needs, corporate plans, and investors'/lenders' capital allocation decisions.

Figure 1: Transition finance process steps

Credibility

The credibility dimension, as per the 2022 IPSF Principles, focuses on **assessing transition needs and opportunities and setting climate ambition**. It recognises the importance of identifying viable pathways for transitioning to a low-carbon economy and setting ambitious targets that are aligned with the goals of the Paris Agreement (Principle 1). By thoroughly assessing transition needs and opportunities and establishing science-based climate ambitions, stakeholders can build a solid foundation for their transition finance strategies. Climate ambitions should be tailored, embedding deep, rapid and sustained change (Principle 2), so that the transition is all-encompassing (Principle 3). At the same time, the transition should be compatible with other environmental and social goals, thereby adhering to the principle of Do No Significant Harm (DNSH) (Principle 4).

Disclosure

The disclosing dimension emphasises the importance of **developing and disclosing a robust transition plan and reporting on performance**. It involves creating a comprehensive and transparent roadmap that outlines the steps, strategies, and milestones for achieving the desired transition outcomes (Principle 5). By disclosing this plan and regularly reporting on performance against it (Principle 8), stakeholders can enhance accountability and foster trust in their transition finance practices. Furthermore, strong and supportive internal governance should be in place to enable the delivery of the plans (Principle 6). Lastly, external stakeholder engagement plays an important role in facilitating an organisation's transition journey, ensuring that the latter extends beyond internal actions to encompass the entire ecosystem (Principle 7).

Financing

The financing and assessing dimensions are interconnected and address critical aspects of the transition finance process.

In the financing dimension, stakeholders focus on **issuing credible transition finance instruments (or lending arrangements) that are underpinned by a robust transition plan** (Principle 5). These instruments help attract investments and channel capital towards projects and initiatives that will enable the whole-of-economy transition. Furthermore, as a result, the **design of financial instruments will also be determined by investors' needs and preferences**. In this context, it is important to highlight the proactive role that financial institutions can play in engaging with various entities and assets to support their transition, thereby contributing to the creation of an enabling environment (Principle 7).

Assessment

The assessing dimension involves the tools available to **evaluate performance against relevant benchmarks, sectoral pathways and other metrics** to assess the effectiveness and impact of transition finance efforts (Principles 8 and 9).

1. Credibility: Identification of risks, needs and opportunities, and science-based real-sector target setting

This section delves into the critical aspect of entities credibly identifying needs and opportunities and setting climate ambition to inform their transition finance needs. Embedding credibility throughout the transition finance process steps, starting with an entity's strategic and rounded approach to considering how it will prepare for and contribute to the transition, will help the market for transition finance to scale with integrity.

Therefore, this section draws out the meaning of credibility in this context with reference to the various principles, guidelines, and frameworks. Furthermore, this section explores the significance of incorporating science-based decarbonisation pathways at both the sectoral and national levels, providing valuable references for entities devising their transition strategies. It also addresses the challenge of carbon-intensive lock-in and the tools developed to safeguard against it, ensuring the credibility of transition investments.

1.1. Overview of the IPSF transition finance target-setting principles and other relevant principles

In November 2022, the IPSF published its **Transition Finance Report**, which proposed a set of voluntary Principles for robust transition targets (target-setting principles) and for demonstrating the ability to deliver on those targets (delivery principles). These principles are based on an analysis of the global landscape of frameworks and tools, and "intended to stimulate thinking on useful common approaches within transition finance frameworks and tools".

Box 1: IPSF Transition Finance Report Principles for robust transition targets

Principle	Sub-principle	Relevance for...		
		Company	Portfolio	Assessor
1. 1.5 degrees	1.1 Pathways aligned with 1.5 degrees	✓	✓	✓
	1.2 Recognition of regional variation	✓	✓	✓
	1.3 Metrics tailored to use	✓	✓	✓
2. Ambitious	2.1 Differentiate by sector	✓	✓	✓
	2.2 Extend targets to 2050	✓	✓	✓
	2.3 All material emissions addressed	✓	✓	✓
3. All-encompassing	3.1 All material activities	✓	✓	✓
	3.2 All sectors and sub-sectors	✓	✓	✓
	3.3 Challenge for everyone, recognising performance categories	✓	✓	✓
4. Compatible	4.1 Marry multiple objectives	✓	✓	✓
	4.2 Align with just transition	✓	✓	✓

The IPSF principles and other key frameworks and reports (such as the G20 Transition Finance Framework, or the Organisation for Economic Co-operation and Development (OECD) Guidance on Transition Finance[1], the recent Synthesis Report of the Intergovernmental Panel on Climate Change (IPCC) Sixth Assessment Report (AR6)) highlight a number of important points for corporates and financial institutions setting their climate ambitions:

- Set science-based net-zero and interim targets consistent with the Paris Agreement's temperature

[1] See Annex 4 for more details on the G20 Transition Finance Framework and OECD Guidance.

goals.

- Base targets and strategies on sectoral pathways, technology roadmaps, benchmarks or taxonomies.
- Use transparent metrics and Key performance indicators (KPIs) for measuring performance and progress in emissions reduction.
- Clearly communicate the use of high-quality carbon credits and offsets, where permitted/used.
- Develop a clear strategy with concrete actions to achieve targets, considering transition risks and opportunities.
- Address adverse impacts on workers, communities, and consumers and engage in stakeholder dialogue.
- Integrate the transition plan within the corporate business plan, ensuring coherence.
- Establish a robust governance framework, including involving senior management.
- Ensure regular disclosure of progress and third-party verification of the plan.

These key points help create credible and ambitious climate transition plans and strategies promoting transparency and accountability, aligned with international climate goals and other environmental objectives. With regard to these last objectives, while climate mitigation remains a paramount focus in the transition to a sustainable future, it is fundamental to recognise that a comprehensive approach involves not only reducing GHG emissions but also enhancing climate resilience, addressing broader environmental and social objectives, and adhering to the principle of DNSH (see IPSF Principle 4). Incorporating these diverse objectives within transition finance targets amplifies the impact of financial flows, ensuring that the transition journey encompasses not only emissions reduction but also the preservation of ecosystems, the promotion of circular economies, the reduction of pollution, and adherence to the DNSH principle.

1.2. Assessing risks and opportunities for responding and contributing to the transition towards a lower-carbon economy, climate resilient economy.

Companies embarking on the journey to a lower-carbon economy must assess the potential risks, needs and opportunities for their company throughout the transition. This evaluation encompasses both physical and transition risks, as well as opportunities that may emerge as part of the widespread shift toward a lower-carbon economy.

Scenario analysis is a powerful tool that can help companies in this endeavour. It allows companies to gain insights into the impact of various climate trajectories on their business strategy, offering a better understanding of potential future risks and opportunities associated with the transition. This analysis can be performed using a range of scenarios, including those that lead to more severe physical and/or transition risks. And, as a result, it can support companies in their efforts to assess the strategic options available to respond to different levels of risks and opportunities throughout the transition.

Scenario analysis can serve several important roles:

1. **Setting strategic ambition**: Companies can use it to define their strategic goals and chart actions corresponding to different transition scenarios, over various timeframes. This includes acknowledging the assumptions and dependencies required to achieve their aims, reinforcing their strategies.
2. **Financial planning**: It supports financial planning across these diverse scenarios. As a result, companies gain a clearer perspective on their transition finance requirements and can seek the necessary capital for these endeavours.
3. **Enhancing disclosures**: Through scenario analysis, companies can provide more comprehensive disclosures, boosting investor confidence in their transition finance needs. This transparency furnishes

investors with a deeper comprehension of the risks and opportunities they might encounter, enabling investors to assess the resilience of a company's transition plan.

The use of scenario analysis is expanding, bolstered by multiple frameworks, initiatives, and guidance. It's an important feature of corporate sustainability reporting standards, as well as transition plan disclosures. Yet, challenges persist, presenting opportunities for further advancements as capabilities to understand the impact of different climate scenarios develop over time.

These activities align with Principles 2 and 3 of the IPSF 2022 Report, as they involve the comprehensive evaluation of transition needs and opportunities within the context of a rapid and widespread shift toward a net-zero economy.

1.3. Setting climate ambition with regard to the Paris Agreement and relevant national commitments

In the pursuit of credible transition finance, the approach a company takes in defining its climate ambitions is foundational to a company's plan and subsequent financing needs. A company's climate ambition is influenced by various drivers, including:

- **Scientific evidence**: When setting targets for climate ambition, companies should take into account the scientific evidence regarding the scale of decarbonisation required to align with the overarching goals of the Paris Agreement.
- **Public policy commitments**, which often encompass not only carbon reduction but also broader environmental and climate adaptation objectives.
- **National and sectoral benchmarks**, pathways or taxonomies.
- **Internal assessment**: A company's own evaluation of potential risks and opportunities across varying timeframes, coupled with the feasibility of actions they can undertake, informs their climate ambition. It's imperative that this assessment is strategic and take the broader economic transition into account, to avert pitfalls like "paper decarbonisation" or inadequate adaptation to climate change. A comprehensive approach here also equips companies to handle interdependencies with stakeholders, society, the economy, and the natural environment.

Furthermore, market discipline significantly influences corporate climate ambition. Investors critically assess the credibility of corporate ambitions concerning the broader transition and relevant public policy commitments. Consequently, companies may also consider investor expectations when formulating their climate ambitions.

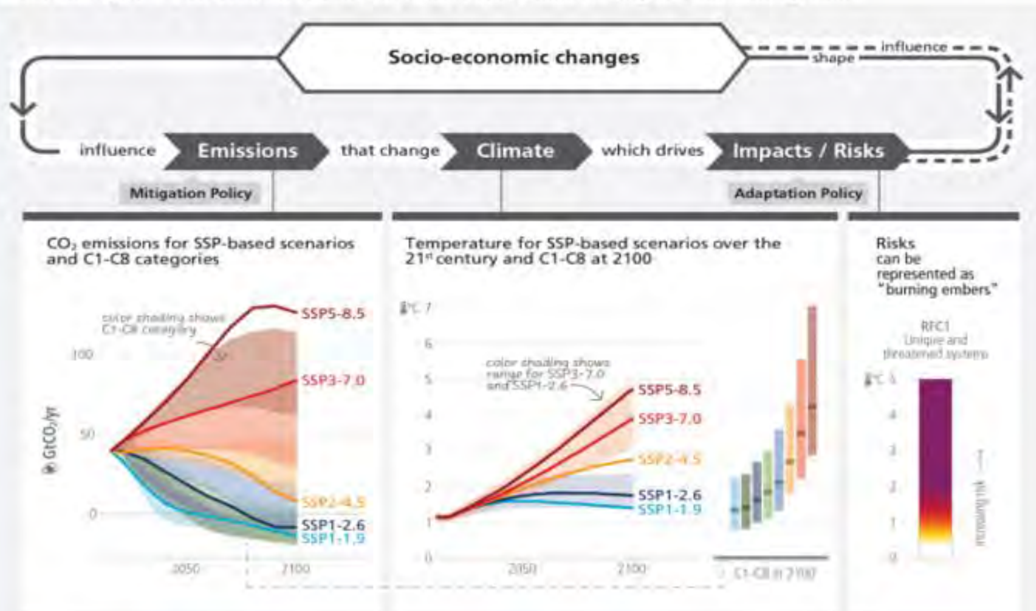
This process aligns with Principles 1 and 2 of the IPSF Transition Finance 2022 report. It emphasises the significance of assessing transition needs, identifying opportunities, and setting ambitious climate goals deeply rooted in the principles of rapid and far-reaching transformation. These principles provide the foundation for credible and comprehensive climate transition efforts.

Box 2: Credible transition pathways to keep global warming to 1.5°C

Scenarios presented in the latest IPCC report serve as a guide for target-setting, whether adopting a green taxonomies approach or a pathway/roadmap approach. The Synthesis Report of the IPCC AR6 provides a comprehensive summary of the current understanding of climate change, its extensive impacts and risks, and strategies for climate change mitigation and adaptation. According to the report, if GHG emissions continue unabated, global warming will intensify, and according to projected scenarios and modelled pathways, it is estimated that a 1.5°C increase in global temperature will be reached by 2040.

Integrated IPCC assessment on climate change, impacts and risks, and climate change mitigation and adaptation

a) AR6 integrated assessment framework on future climate, impacts and mitigation



b) Scenarios and pathways across AR6 Working Group reports

Category in WGIII	Category description	GHG emissions scenarios (SSPx-y*) in WGI & WGII	RCPy** in WGI & WGII
C1	limit warming to 1.5°C (>50%) with no or limited overshoot	Very low (SSP1-1.9)	
C2	return warming to 1.5°C (>50%) after a high overshoot		
C3	limit warming to 2°C (>67%)	Low (SSP1-2.6)	RCP2.6
C4	limit warming to 2°C (>50%)		
C5	limit warming to 2.5°C (>50%)		
C6	limit warming to 3°C (>50%)	Intermediate (SSP2-4.5)	RCP 4.5
C7	limit warming to 4°C (>50%)	High (SSP3-7.0)	
C8	exceed warming of 4°C (>50%)	Very high (SSP5-8.5)	RCP 8.5

c) Determinants of risk

* The terminology SSPx-y is used, where 'SSPx' refers to the Shared Socio-economic Pathway or 'SSP' describing the socio-economic trends underlying the scenario, and 'y' refers to the approximate level of radiative forcing (in watts per square metre, or $W\ m^{-2}$) resulting from the scenario in the year 2100.

To limit global warming to 1.5°C with little to no overshoot, as well as to achieve the goal of limiting warming to 2°C with a higher likelihood (>67%), all global-modelled pathways indicate the urgent need for substantial and immediate reductions in GHG emissions across all sectors in this decade.

Greenhouse gas and CO_2 reductions from 2019, median and 5-95 percentiles

		Reductions from 2019 emission levels (%)			
		2030	2035	2040	2050
Limit warming to1.5°C (>50%) with no or limited overshoot	GHS	43 [34-60]	60 [49-77]	69 [58-90]	84 [73-98]
	CO_2	48 [36-69]	65 [50-96]	80 [61-109]	99 [79-119]
Limit warming to 2°C (>67%)	GHG	21 [1-42]	35 [22-55]	46 [34-63]	64 [53-77]
	CO_2	22 [1-44]	37 [21-59]	51 [36-70]	73 [55-90]

The IPCC report includes over 200 scenarios falling into either the C1 (below 1.5°C with no or limited overshoot) or C2 (below 1.5°C with high overshoot) category, all aiming to limit global warming to 1.5°C. Among them, it is important to note that all pathways aiming to limit global warming to 1.5°C with no or limited overshoot require the implementation of carbon removal techniques, some of which are not deployed/existent. In other words, carbon removal has become an essential component to various extents, in order to effectively constrain the rise in global temperature to 1.5°C. In these scenarios, the deployment of carbon removal techniques varies

based on projected energy consumption levels and the pace and scale of renewable energy installations.

As a result, when referencing a scenario that is consistent with 1.5°C, it is crucial to specify which scenario is employed for target-setting in transition finance activities. Additionally, providing a **rationale for the selection of a particular scenario** is essential in the transition finance target-setting process.

1.4. Pathway approaches in target-setting

The 2022 IPSF Transition Finance Report highlights the importance of incorporating science-based decarbonisation pathways and associated targets when assessing the transition process of entities. Various public and private sector-led initiatives have emerged, focusing on the development of transition pathways, often at the sectoral level. These pathways serve as references for entities when formulating their transition strategies. As already mentioned in the 2022 IPSF Report, and also by others (e.g. the Glasgow Financial Alliance for Net Zero (GFANZ) (2021)), there may be top down and bottom up approaches to design transition pathways[2]. An OECD paper on climate change mitigation scenarios[3], highlights the challenges of assessing scenarios for their Paris consistency, emphasising the complex balance between bottom-up and top-down approaches.

The IPSF therefore believes there is a need for greater collaboration and action by multiple stakeholders to improve the use and interpretation of climate change mitigation scenarios in the financial sector, emphasising the significance of transparent, standardised data disclosure, improved granularity, and clearer communication of climate outcomes and uncertainties.

Use of taxonomies in target-setting

Taxonomies have emerged as valuable tools to guide companies, investors, and financial intermediaries in their efforts to identify and finance economic activities that contribute to climate mitigation and adaptation goals.

In June 2023, in the European Union (EU), the European Commission issued a Recommendation[4] providing guidance on how companies, investors, and financial intermediaries can voluntarily utilise the existing sustainable finance framework to finance their transition towards a climate-neutral and sustainable economy and offering practical examples and explanations. For instance, the taxonomy can assist in setting transition targets for specific economic activities covered by the taxonomy or, for economic activities with low environmental impact that fall outside the scope of the taxonomy, businesses can still consider using relevant taxonomy criteria to address residual impacts.

The synergy between taxonomies and transition plans plays an important role in effective climate transition strategies and in facilitating the communication of targets and investments within specific sectors. This symbiotic relationship offers a unique proposition that can significantly enhance the efficacy of climate action.

For instance, in the EU, the requirement for taxonomy-aligned capital expenditure to be accompanied by an

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[2] Top-down trajectories often use integrated assessment models to understand the pathway for the entire economy to transition to net zero. They can be used to create sector pathways and to better understand some of the interactions between different sectors set against the overall ambition to reach net zero. However, solely focusing on a top-down approach might have the unintended consequence of excluding companies from transition finance, where there might be a less clear or longer pathway to net-zero emissions.

Bottom-up trajectories are typically developed by industry-led organisations and provide a practical view of what sectors can achieve based on their unique perspectives. However, they often fail to consider the broader economy-wide perspective. Given the varying potentials of different sectors to contribute to decarbonisation due to technological limitations or decarbonisation needs, it is essential to select pathways that assist in devising decarbonisation trajectories specific to each sector while accounting for constraints imposed by the economy-wide carbon budget.

[3] OECD (2023), *Climate change mitigation scenarios for financial sector target setting and alignment assessment: A stocktake and analysis of their Paris consistency, practicality, and assumptions*, Environment Working Papers No. 223, (link).

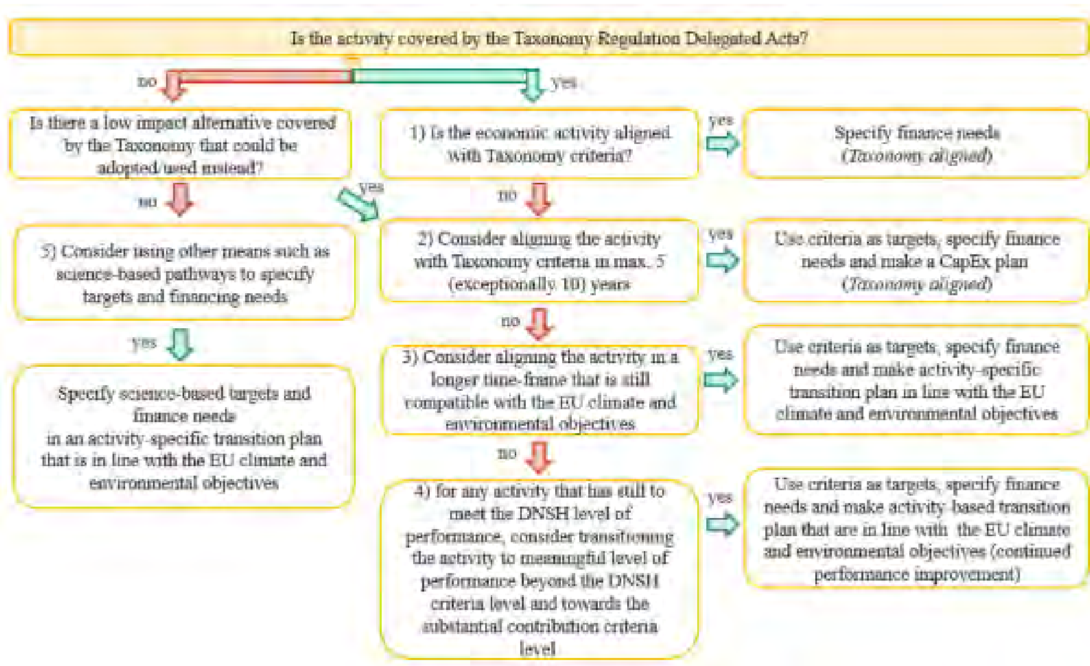
[4] See https://ec.europa.eu/finance/docs/law/230613-transition-finance-recommendation_en.pdf.

activity-based transition plan underscores the intertwining of these two elements. This approach ensures that investments earmarked for taxonomy-aligned endeavours are effectively contextualised within comprehensive transition strategies. This dynamic alignment facilitates a streamlined and cohesive approach toward achieving climate goals.

Moreover, entities are increasingly recognising the value of articulating a portion of their transition finance needs in terms of taxonomy-aligned capital expenditure as a subset of their broader capital investment landscape, with the taxonomy serving as a unifying framework for communicating both intent and action.

Box 3: Using the EU Taxonomy to specify transition finance needs

The figure below underscores the versatility of taxonomies in diverse applications within the sphere of transition plans.



Source: Commission Recommendation (EU) 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy, Annex.

The integration of taxonomies into activity-based transition plans offers a strategic advantage that goes beyond mere compliance.

National-Sector Pathways and Sectoral Policies

Decarbonisation pathways are typically established at the sectoral level, and the IPSF (2022) recommends the development of activity-specific transition pathways as complements to activity-level taxonomy criteria. Some jurisdictions have taken steps to enhance national-sector pathways and develop accompanying sectoral policies.

For example, in **Japan**, the “Basic Guidelines on Climate Transition Finance” released by the Ministry of Economy, Trade, and Industry (METI), the Ministry of Environment (MOE), and the Financial Services Agency (FSA) in May 2021 require issuers and fundraisers to articulate a transition pathway and establish targets aligned with the Paris Agreement. To assist companies, METI and other relevant agencies are developing sector-specific decarbonisation roadmaps that outline the effectiveness and availability of transitional and innovative technologies contributing to net zero by 2050. In March 2023, a roadmap for the automobile sector was newly formulated, in addition to existing roadmaps for sectors such as iron & steel, chemistry, electricity, oil, gas, paper & pulp, cement, shipping, and aviation. These roadmaps are subject to regular updates to account for changing socioeconomic conditions and economy-wide perspectives. Furthermore, in June 2023, the ministries

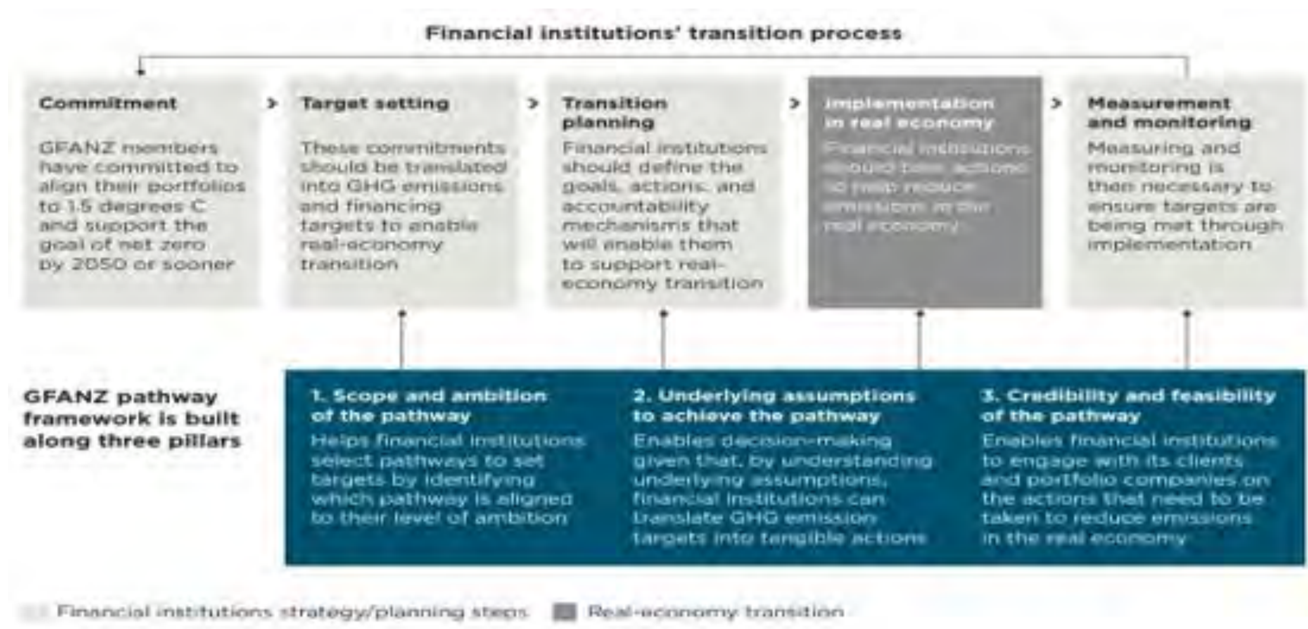
issued the Follow-up Guidance on Transition Finance for Financiers to support effective dialogue between financiers and issuers on the implementation of transition strategies and tracking progress towards decarbonisation targets in the execution of transition finance.

In June 2023, the **European Commission** recommendations on transition finance mentioned that, to support the adjustment of science-based pathways for individual companies in line with EU climate and environmental objectives and based on the starting point of companies, it is also recommended to consult the European Commission's qualitative EU Transition Pathways per industrial ecosystem. Such transition pathways have been developed or are in course of being developed for tourism, energy-intensive industries, chemicals, steel and metals, mobility, construction, proximity and social economy, textiles, retail, agri-food, aerospace and defence, renewables, creative and cultural industries, digital, electronics. Each of these transition pathways describe the most important elements that need to be addressed in an actionable plan to make the transition possible: infrastructure, investment and funding, regulation and public governance, research & innovation techniques and technological solutions, skills, social dimension and sustainable competitiveness.

Use of Pathways by Financial Institutions

GFANZ "Guidance on Use of Sectoral Pathways for Financial Institutions" (June 2022) provides financial institutions with guidance and a framework to evaluate the suitability of sectoral pathways in their transition planning and implementation efforts.

Figure 2: Financial institutions' transition process and GFANZ pathway framework pillars



Asia Transition Finance Study Group: Launched in October 2021, the Asia Transition Finance Study Group, led by Asian and global banks, with observers from development banks, export credit authorities, public agencies, and finance associations, released its final report on the Asia Transition Finance Guidelines in October 2022. The guidelines offer practical assistance to financial institutions that are beginning to provide transition finance and require support in conducting necessary assessments. The International Capital Market Association (ICMA) Handbook is the starting point for financial institutions (FIs) seeking to understand whether the financing is suitable for transition finance, with four elements to assess (Climate Transition Strategy and Governance, Business model environmental materiality, Science-based targets and pathways, Implementation transparency). The FI should determine whether the fundraiser's decarbonisation plan is aligned with the country and sectoral pathways identified by the fundraiser's government or other globally recognised bodies. Those pathways will be aligned with the Paris Agreement, meaning the ones to climate (carbon) neutral/net zero if respective

national governments have committed to it. The FI is also expected to assess the fundraiser's suitability for transition finance by comparing the fundraiser's technology roadmap, threshold-defined taxonomies, and activity lists to those in the Paris Agreement. Considering the limited availability of region-specific pathways and technology roadmaps in Asia, the guidelines recommend utilising a broader range of sources for financial institutions to assess the suitability of transition finance. Where no country or sector-specific pathway has been compiled by the relevant government, financial institutions may refer to pathways issued by external parties such as the International Energy Agency (IEA), Network for Greening the Financial System (NGFS), and Economic Research Institute for the Association of Southeast Asian Nations (ASEAN) and East Asia (ERIA).

Pathway approaches offer a holistic and granular assessment of entities transitioning toward net-zero emissions in a forward-looking manner, and with a direct reference to emissions data. It will become a powerful tool to connect emissions data reporting under climate-related disclosure regimes with credible target-setting for transition finance.

There is a wide range of initiatives for developing credible pathways, and within this, there is a mixture of both top-down and bottom-up approaches, which bring their own unique challenges, particularly for sectors that might not currently be able to align with top-down targets. For example, certain sectors might rely on the development and scaling of new technologies to achieve alignment with Paris Agreement targets but still require access to finance to deliver on their near-term decarbonisation actions.

Therefore, promoting further standardisation may help transition finance and support investors in assessing what is credible. Further work could be valuable in helping companies establish credible climate ambition at the outset of the transition finance process. To solidify pathway approaches in the transition finance framework, it would be worthwhile to outline critical characteristics that credible pathways should possess. This will aid investors in confidently selecting from the available pathway options. This guidance should look to manage the balance between maintaining ambition towards achieving a lower carbon economy, while not excluding companies from the ability to access the finance that they need. And there could be further work to provide guidance to support credible climate ambition for where region-specific pathways might not be available. This will be an important area for the IPSF to continue to monitor and work on over time.

Relevant issues to consider for setting credible climate ambition

In addition to the above considerations, companies also encounter several critical issues when determining their climate ambitions. These include the use of credible data in target setting, strategies to prevent emission-intensive lock-in during their transition journey, and (where permitted) the utilisation of verified/high-quality carbon credits (see Annex 5 for some reference to initiatives looking into the credibility of claims and quality of carbon credits). Adhering to best practices in these areas, as summarised below, not only reinforces credibility in target setting but also reduces the risks associated with greenwashing.

Approaches to safeguarding against emission-intensive lock-in

Since transition finance includes financing to transitional activities, there is potentially greater uncertainty associated with the investment, and a greater need to exercise judgement and seek assurances about both the profile of underlying assets and the investee's future plans. In addressing this concern, it is particularly important to tackle the issue of carbon lock-in.

Carbon lock-in occurs when fossil fuel infrastructure or assets, whether existing or new, hinder the transition to low or zero-emission alternatives by persisting in their use instead of adopting potentially substitutable low-emission options. Various types of investments carry the risk of carbon lock-in, with ongoing debates surrounding their environmental integrity. These investments primarily include natural gas, industrial fossil fuel applications, and efficiency improvements in fossil fuel assets, particularly coal. The European Bank for Reconstruction and Development's (EBRD) Paris alignment methodology includes guidance on assessing carbon

lock-in for directly financed investments.[5]

The risk of lock-in undermines the credibility of transition investments and can lead to accusations of greenwashing, as they may impede progress towards achieving net-zero goals. To mitigate this risk, several tools have been developed and are currently in use:

- Sectoral pathways, such as those provided by the Transition Pathway Initiative and the Science Based Targets initiative (SBTi), assess whether an asset or company aligns with chosen decarbonisation or net-zero trajectories.
- Transition taxonomies, including those established by ASEAN, Singapore, Indonesia, and others, define eligibility criteria and sunset clauses for transition activities. The EU Taxonomy includes a specific category "transitional activities" and the related criteria could be considered as safeguards against carbon lock-in.[6]
- Technology roadmaps outline future-oriented approaches to aligning with net-zero technologies, extending up to 2050. Notably, the government of Japan has developed industry roadmaps to guide this process.
- Portfolio-level approaches employ metrics, targets, and strategies to transition portfolios toward net-zero alignment. These approaches are utilised by various jurisdictions and private sector alliances such as those within GFANZ.
- Entity-level approaches centre around company transition plans and associated sustainability disclosures, as exemplified by the UK Transition Plan Taskforce and the OECD.

Building on the 2022 OECD Guidance on Transition Finance[7], another 2023 OECD report[8] provides an analysis and good practices to strengthen relevant mechanisms to prevent carbon lock-in in transition finance. The report finds that existing approaches and policy frameworks for transition finance emphasise the need to avoid carbon lock-in, but largely do not set clear guidance or criteria on how to do so. Key findings of the report include:

- Existing approaches and policy frameworks for transition finance emphasise the need to avoid carbon lock-in, but largely do not set clear guidance or criteria on how to do so.
- Transition finance definitions can be strengthened by providing clarity on how to assess feasibility as part of eligibility criteria, and by taking a long-term approach in the assessment.
- National sectoral emissions pathways can guide technology roadmaps, robust transition taxonomy criteria, and similar tools, as well as allowing companies to develop credible net-zero plans and targets.
- Sunset clauses for use of fossil fuels can reduce carbon lock-in risk for assets where a fuel switch is planned to ensure alignment of the asset with the Paris temperature goal.
- For assets where a fuel switch is needed to achieve alignment with the Paris temperature goal, flanking measures that ensure the switch happens in a timely manner can contribute to preventing carbon lock-in.
- The development of standards and policy frameworks for sustainability-linked instruments is

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[5] EBRD, 'Methodology to determine the Paris Agreement alignment of EBRD investments' (link).

[6] In addition, the ESRS Disclosure Requirement E1-1 – Transition plan for climate change mitigation – also mentions information to be disclosed in relation to locked-in emissions.

[7] OECD (2022), *OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans*, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/7c68a1ee-en.

[8] OECD (2023), *Mechanisms to Prevent Carbon Lock-in in Transition Finance*, Green Finance and Investment, OECD Publishing, Paris, https://doi.org/10.1787/d5c49358-en.

necessary to address emerging loopholes which increase the risk of lock-in of related investments.

The report's findings and good practices are relevant to policymakers and regulators who have developed or are considering developing transition finance policies (for example, taxonomies, roadmaps, or guidance), standards for green, transition and sustainability-linked debt, frameworks for corporate transition plans, or broader climate-related disclosure frameworks.

1.5. Conclusions and recommendations for further work

In this section, we have explored a range of transition finance-related initiatives with a specific focus on the credibility dimension. It is encouraging to note the substantial progress made in developing frameworks to enhance the credibility of transition finance in alignment with the principles outlined in the 2022 IPSF report. Nevertheless, as also mentioned, several gaps and challenges persist, necessitating further attention and action, from IPSF but also from other relevant international fora/bodies, including:

- **Consistency of pathways**: Credible pathways are an essential component of transition finance, not only within pathway approaches but also in green taxonomies approaches. Presently, numerous pathway-related initiatives are progressing independently. Further work to compare and contrast these initiatives may support companies and investors and promote further comparability and/or suggesting further standardisation/critical characteristics of credible pathways. The IPSF will continue to monitor progress in this space and consider best practice for how these tools can be used to support ambition-setting, in a way that enables a whole-of-economy transition to net zero.
- **Climate data availability**: Promising developments, such as the development of International Financial Reporting Standards (IFRS) S2 and European Sustainability Reporting Standards (ESRS), along with ongoing efforts by data-related initiatives like the Future of Sustainable Data Alliance (FoSDA) and Net-Zero Data Public Utility (NZDPU), suggest a continuous improvement and availability of credible climate data. However, a comprehensive analysis may still be required to determine the extent to which these developments can and have filled existing data gaps.
- **Carbon lock-in, carbon credits**: The establishment of principles and guidelines pertaining to carbon lock-in, carbon credits, and offsets marks a positive step forward. It is essential to continue shaping these guidelines to ensure they effectively contribute to the credibility of transition finance.

2. Disclosure: Governance and transparency around credible transition planning

Good corporate disclosure is a key ingredient for the issuance of robust transition finance instruments. Transition plans are emerging as a global norm in global corporate reporting. Companies that have performed an effective and holistic cross-organisation exercise on transition planning, and have produced a credible transition plan, are able to lay effective foundations for financing their transition. In this section, we expand on the IPSF Transition Finance Principles to look at existing available frameworks and the key requirements of disclosures for transition finance.

2.1. Applying IPSF transition finance principles to transition planning

This interim report focuses on the disclosing dimension of the transition finance landscape, particularly high-quality and credible entity-level transition plans. Transition plans play a vital role in conveying decision-useful and comparable information. They support transition finance through various use cases:

- Capital allocation and stewardship: investors are able to assess investee entities' transition paths to inform investment decisions, and to align with their own climate objectives and transition plans. Investors can also use transition plans to inform their stewardship, including prioritising engagement activities and identifying escalation points.
- Market for credible transition-oriented financial instruments: enabling alignment of debt instruments (such as Sustainability-Linked Bonds) to credible decarbonisation pathways. Transition plans help lenders assess the credibility of transition-oriented debt instruments against the issuer's decarbonisation plans. They also show whether the issuer's transition plan is aligned with a 1.5°C pathway or other, industry-specific pathways. Providing transparency over these elements supports the requirements of guidance from ICMA and Climate Bonds Initiative (CBI) (see Section 3 on the financing dimension).

The application of IPSF transition finance Principles 5 (comprehensive transition plan), 6 (internal governance), 7 (external engagement), and 8 (external reporting) to the transition planning process is central to the disclosure dimension. These Principles serve as the foundational framework for creating and communicating on high-quality and credible entity-level transition plans.

The IPSF's analysis on the implications of the IPSF Principles for the successful implementation of transition planning, including wider ecosystem development is set out in Annex 2. Table 1 below consolidates and summarises this information into a set of proposed 'success factors' for high-quality transition plans. By aligning with these success factors, reporting entities can enhance the quality, credibility, and comparability of their transition plans, contributing to the overall effectiveness of the transition finance ecosystem.

Table 1: Factors for successful transition plans

Success factors for 'setting climate ambition' process step	**Success factors for process steps of 'developing and disclosing a robust transition plan' and 'reporting on performance against the plan'**
Internal targets should be set with reference to/benchmarked from external targets	Transition plans need to include both concrete transition targets and a credible strategy to meet those targets
Targets should extend to 2050 (or be aligned with national commitments) and include interim targets	Transition plans should describe board and senior management level oversight

Target setting should include all material scope 1, 2 and 3 emissions and activities	Transition plans should describe how internal polices support transition
Transition plans should enable users to identify which stages of transition the reporter is at, including the impact of its current technology profile	Transition plans must be a living strategy, subject to regular re-evaluation and updating
Transition targets should focus on reducing emissions rather than relying on offsets	Transition plans should describe external engagement with key stakeholders, including supply chain partners
Transition plan objectives should, at a minimum, avoid harming the achievement of other objectives (including social and environmental)	Financial sector reporters should describe client engagement in their Transition plans
	Organisations should publicly disclose their transition plans in a way that makes them comparable
	External reporting on those plans and their implementation should be done on annual basis (minimally)

2.2. Climate-related and sustainability reporting standards and transition planning

Transition planning refers to the strategic process through which organisations assess their current state, set climate-related targets, and outline actions to align with a net-zero future. Transition plans, on the other hand, are formal documents that encapsulate the outcomes of this planning process, detailing specific steps, timelines, and strategies for achieving these targets. Material information from an entity's transition plan should be included in its general-purpose financial reports, as part of its wider climate-related reporting, with more detailed information perhaps published periodically in a standalone report.

Existing and developing climate-related and sustainability reporting standards play a crucial role in transition planning. While these standards may not explicitly require transition plans, they often contain implicit requirements and guidance related to the disclosure of such plans/strategies for transition. The IPSF Transition Finance Report (2022) provides a summary[9] of current practices for corporate and financial institution transition plans. It also includes relevant features of disclosure frameworks, target setting methodologies, assessment methodologies and investor groupings[10].

Specific requirements of climate-related and sustainability reporting standards adopted or being developed by jurisdictions will increasingly support the further development of entity-level transition plans. Table 2 outlines some specific transition plan requirements of internationally recognised climate-related reporting standards.

It is worth noting that the content and manner of disclosure should be determined through the lens of investor and impact materiality, meaning the information that is decision-useful and can influence the capital allocation

[9] See 2022 IPSF Transition Finance Report, page 59.

[10] See 2022 IPSF Transition Finance Report, Annex, Table 2.

decisions of users of general-purpose financial reports. This principle applies to both climate-related and sustainability reporting standards, as well as emerging frameworks for transition plan disclosure. Additionally, the ESRS mandates that if a company determines that climate change is not a material topic and, therefore, chooses not to report in accordance with the standard, it must provide a comprehensive explanation outlining the conclusions drawn from its materiality assessment.

Table 2: Transition plan requirements of selected climate-related / sustainability reporting standards

	Specific requirement to have a transition plan?	**Specification about the content (or level of ambition) of a transition plan?**	**Requirement to disclose any transition plan?**
International Sustainability Standards Board (ISSB) (inaugural standards, IFRS S1 and IFRS S2, June 2023)	No explicit requirement to have a transition plan but implicit in requirements, including "how the entity has responded to, and plans to respond to, climate-related risks and opportunities in its strategy and decision-making, including how the entity plans to achieve any climate-related targets it has set and any targets it is required to meet by law or regulation" (14(a))	No specification about the level of ambition or content of a transition plan, but does require disclosures of targets and metrics (including cross-industry and (SASB-based) industry-based GHG metrics)	Requirement to disclose "the climate-related risks and opportunities that could reasonably be expected to affect the entity's prospects" (9(a)) and "the effects of those climate-related risks and opportunities on the entity's strategy and decision-making, including information about its climate-related transition plan" (9(c))
European Sustainability Reporting Standards (ESRS)[11]	Disclosure requirements in relation to transition plans are proportionate and contingent on the undertaking having these, which may depend on the size, capacity, resources, and skills of the undertaking.	(a) Transition plan to reach climate neutrality by 2050 requires disclosure about the undertaking's mitigation efforts with the limiting of global warming to 1.5°C in line with the Paris Agreement	(a) No requirement to disclose if the undertaking does not have a climate transition plan. No requirement to disclose either if climate is not relevant to the companies' specific circumstances.

[11] The ESRS distinguish between the disclosure of sustainability targets and transition plans. This flexibility allows the market and real economy to tailor their transition finance requirements according to their needs. While comprehensive transition plans are essential tools for major corporations in high-impact sectors, they may not always be suitable for SMEs or companies with lower impacts. In such cases, science-based targets could prove to be a more fitting approach.

		(b) If disclosing a transition plan on biodiversity, the undertaking may explain how it will adjust its strategy and business model to improve and achieve alignment with relevant policy goals and targets.	In case the undertaking does not have a transition plan in place, it shall indicate whether and, if so, when it will adopt a transition plan. (b) Disclosure of transition plan on biodiversity is voluntary.
Task force on Climate-related Financial Disclosures (TCFD)	No explicit requirement to have a transition plan but implicit in requirements with additional guidance in Guidance on Metrics, Targets, and Transition Plans (October 2021).	No specification but guidance includes characteristics of effective transition plans (Guidance on Metrics, Targets, and Transition Plans, October 2021, page 40)	Guidance for Strategy Recommended Disclosure (b) states that "Organisations that have made GHG emissions reduction commitments, operate in jurisdictions that have made such commitments, or have agreed to meet investor expectations regarding GHG emissions reductions should describe their plans for transitioning to a low-carbon economy"

From this analysis, several conclusions can be drawn:

- Requirement: while climate-related reporting standards may not explicitly mandate the production of a transition plan, they can be considered implicit requirements. Reporting entities can be expected to consider these requirements and take necessary actions to fulfil them.
- Content: climate-related reporting standards provide broad guidance on the content of transition plans, but do not provide detailed specifications. This lack of specificity may result in variability in the content of transition plans, making it challenging for users to interpret and compare plans across entities. However, some standards do specify appropriate metrics that can be used for transition planning, particularly when they are industry-specific, thereby supporting comparisons between entities.
- Disclosure: standards may require the disclosure of transition plans where they exist.

The development of the NZDPU could help to provide open access to comparable high-quality data. The Recommendations for the Development of the NZDPU (November 2022) "aim to contain a central repository for emissions reduction targets that will allow for users to filter and compare organisations' targets based on sector, scope, and ambition". More details on the NZDPU can be found in sub-section 4.2.

2.3. Alignment of transition plan guidance and frameworks with IPSF success factors

Approaches to the disclosure of transition planning are crucial for the success of transition plans, in line with Principles 6 (internal governance) and 8 (external reporting) of the 2022 IPSF Transition Finance Report. The

previous section identified how reporting standards support and provide the basis for transition planning. This section focuses on detailed transition plan guidance and assesses how well it aligns with the success factors identified in Table 1.

There are a number of initiatives underway to try to establish guidance and frameworks for best practice in disclosure of transition plans. These frameworks should, where possible, look to provide guidance that builds from existing disclosure recommendations for sustainability-related disclosures in general purpose financial reports. In doing so, they will ensure alignment and integration with those standards and enable more effective reporting on transition plan elements. For instance, the UK Transition Plan Taskforce (TPT) has developed a disclosure framework for good practice transition plans that builds on and supplements the corporate reporting standards published by the International Sustainability Standards Board (ISSB) as well as drawing from GFANZ's framework and guidance for credible, comprehensible and comparable transition planning. By taking an international perspective, the TPT aims to support the development and convergence of approaches to transition planning and transition plan disclosures internationally and to that end, the TPT is engaging with a number of the different international organisations and standard setters.

In the EU ESRS, when disclosing its transition plan, an undertaking is expected to provide a high-level explanation of how it will adjust its strategy and business model to ensure compatibility with the transition to a sustainable economy and with the limiting of global warming to 1.5°C, in line with the Paris Agreement and the objective of achieving carbon neutrality by 2050 with no or limited overshoot, as established in the European Climate Law. The ESRS ensure a very high degree of interoperability between EU and global standards and to prevent unnecessary double reporting by companies by taking into account discussions with the ISSB and the Global Reporting Initiative (GRI). With the adoption of the ESRS, the EU goes further than any other major jurisdiction to date in terms of integrating the ISSB standards into its own legal framework. In doing so, the EU makes a major contribution towards the development of a coherent global framework and towards the global comparability of reported sustainability information[12].

It is encouraging to see ongoing work to develop guidance and best-practice frameworks around transition plan disclosures that elaborate on disclosure recommendations within broader reporting standards. However, as noted in the section above, given the increase in different standards, benchmarks and frameworks around transition plan disclosures there is a risk of confusion what constitutes as best practice, in particular for entities that operate over multiple jurisdictions. Therefore, it may be important to promote international consistency and interoperability in this space. This could be an area that for instance the ISSB, over time, looks to further elaborate their disclosure expectations on.

Annex 3 builds upon the mapping in the IPSF Transition Finance Report (November 2022) to determine whether the IPSF success factors (see Table 1) are addressed in the detailed transition plan guidance. The findings are summarised in Table 3 below.

[12] The approach of integrating ISSB disclosure requirements into ESRS is also fully in line with the ambition of the recent IOSCO decision to endorse ISSB sustainability-related disclosure standards.

Table 3: How detailed transition plan guidance addresses IPSF transition finance Principles success factors[13]

Name	Type	Relevance for Transition Plans	Coverage of TP content 'success factors': ambition	Coverage of TP content 'success factors': plan and performance
UK Transition Plan Taskforce	Transition plan disclosure framework	Disclosure framework specifying content of credible transition plans	Requires disclosure of the degree of alignment with relevant external benchmarks (e.g., Paris).	Requires comprehensive disclosures against plan and performance factors.
EU ESRS	Climate and biodiversity transition plans disclosure framework	Disclosure framework specifying content of climate and biodiversity transition plans	When disclosing a transition plan, requirement to publish strategy and business model to achieve alignment with the transition to a sustainable economy and with the limiting of global warming to 1.5°C in line with the Paris Agreement	It covers undertaking's progress in implementing the transition plan. In case undertaking does not have a climate mitigation transition plan in place, it shall indicate whether and, if so, when it will adopt a transition plan
OECD Guidance on Transition Finance	Guidance – including description of what credible transition plans should contain	Include 10 elements of credible corporate climate transition plans	Requires all the elements of the "ambition" success factors (recognising that target dates may vary by sector and jurisdiction)	Requires all the elements for "plan" and "performance" success factors[14]
EIB	Counterparty Paris alignment framework	Requests high emitting and high vulnerability counterparties to develop decarbonisation and resilience plans and TCFD reports	Requires most elements, but does not specify a level of ambition needed	Requires public disclosure

[13] The scope/application of the EIB and EBRD examples is intended for counterparties rather than having a broader applicability (unlike the other examples in the table).

[14] The only element that is not included in the Guidance is the one concerning financial sector reporters describing client engagement, as the Guidance is focused on non-financial corporates.

European Bank for Reconstruction and Development (EBRD)	Counterparty Paris alignment framework for partner financial institutions in emerging and developing countries	Requests transition plans from some financial institutions	Requires different elements of the plan, depending on the baseline level of climate practices of the counterparty, in recognition of the need for step-by-step approaches in less developed countries.	Requires public disclosure of core elements of the plan

The EU ESRS establishes disclosure requirements related to action plans, targets, policies, scenario analysis, and transition plans, which are contingent on the undertaking having these provisions. The ESRS also outlines Minimum Disclosure Requirements, which undertakings must incorporate when disclosing information concerning their metrics and targets. These requirements are proportionate, considering the size, capacity, resources, and skills of the undertaking. Furthermore, the framework mandates the inclusion of transition plans that underscore alignment with international targets and policy objectives.

The proposal for a Corporate Sustainability Due Diligence Directive (CSDDD) would introduce the mandatory requirement for in-scope companies to have a transition plan to ensure that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement.

2.4. Opportunities and challenges of transition plans for SMEs and EMDEs

Emerging approaches in transition finance and planning increasingly rely on data to demonstrate alignment with 1.5°C pathways. However, while there is a need to accelerate the transition of small and medium-sized enterprises (SMEs), that are key to supply chains, of developing countries and certain entities in emerging and developing economies (EMDEs). In many regions, the establishment of frameworks supporting the provision of robust data, sectoral pathways, and relevant expertise may not scale quickly enough to support transition finance effectively, potentially diverting capital away from these SMEs/markets. Interoperability approaches should account for the status of developing markets and their different transition trajectories, given the need to reach global goals and their role in global supply chain considerations[15].

To address these concerns, credible transition planning and disclosures can play a crucial role in facilitating clear communication of transition strategies.

There is a need for further efforts to embed transition planning in these areas while learning from evolving best practices. This includes understanding the primary challenges and opportunities in corporate transition planning and developing practical solutions to address identified issues, providing guidance on essential elements of sustainability policy frameworks or enabling environment. Organisations like the IPSF, in collaboration with international agencies and development banks, could facilitate the exchange of best practices and information to support these endeavours, building from existing work that is underway.

2.5. Conclusions and recommendations for further work

This section reviews the IPSF Transition Finance Principles and draws out ‘success factors’ needed to embed transition plans. These success factors are matched to the process steps for transition finance and implications considered for those responsible for the preparation of transition plans. The following conclusions are

[15] See 091323-synthesis.pdf (imf.org).

highlighted:

- **Development of further international guidance to support comparability and consistency of transition plan disclosures**: Climate and sustainability reporting standards are expected to promote the development and disclosure of transition plans. As a result, various standards and guidance documents incorporate provisions for transition plans, but the level of detail provided varies and there is a risk of inconsistencies developing. Therefore, the IPSF recommends that ISSB consider developing further guidance for the disclosure of transition plans as part of broader sustainability reporting, building from existing work. This should help to promote comparability and consistency of disclosures.
- **Empowering emerging and developing countries:** Further work is needed on transition finance and the application and disclosure of transition planning for SMEs and EMDEs. This work should be undertaken in collaboration with organisations that are already progressing on this issue, to avoid duplication. This work could consider whether there might be some prioritisation of different transition plan elements that are material to enable the provision of transition finance to SMEs or companies in EMDEs, as well as whether there may be simplified methods to support the assessment of credibility of transition plans and finance, for example, where there might be data gaps.

3. Financing: Effective finance and engagement by the financial sector and monitoring metrics

Once companies have identified their transition finance needs, they will need to consider the most appropriate form of financing to deliver actions, projects and initiatives that will enable the whole-of-economy transition. This section explores the financing dimension of climate transition and engagement strategies in the financial sector to embed credibility and integrity within the transition finance market. Furthermore, the section explores some of the challenges with the reporting of financed emissions and ongoing work to develop solutions to address those issues.

3.1. Embedding credibility within transition finance

Building on Principle 5 (comprehensive transition plan) of the 2022 IPSF Transition Finance Report, it is essential for companies to demonstrate their commitment and that their transition plans are not just abstract aspirations but are backed by concrete, well-structured actions. When organisations consider their financing options in this context, it is key to ensure that they align with the disclosed financial needs outlined in the transition plan. This alignment assures investors and lenders that their resources are being directed toward tangible and actionable sustainability initiatives. It also mitigates risks and aligns with investors' and lenders' goals, making the financing more appealing to these stakeholders.

In this step of the process, companies should hence carefully consider the most suitable options for transition financing to meet their financial needs. This may involve issuing credible transition instruments or exploring alternative financing solutions. Regardless of the financing method chosen, it should directly address the financial needs identified and disclosed in the financial planning section of the transition plans.

This connection is vital because it enables investors to evaluate whether the company's strategic ambition and pathway are credible and ambitious enough. For instance, the ESRS and TPT include disclosure of financial planning, resources, impacts on financial position, financial performance, and cash flows in the short, medium, and long term. The TPT framework (sub-section 2.3) advises entities to disclose details about how it is resourcing or plans to resource activities necessary to achieve the plan's strategic ambition. This disclosure should include both qualitative and quantitative estimates of resourcing requirements. The TPT framework also recognises that entities might be able to provide more precise information on short-term financing needs.

Providing this information in transition plan disclosures is instrumental in establishing credibility within the transition finance market right from the beginning. It allows investors to assess the intended purpose and credibility of transition finance instruments. This transparency can facilitate market discipline, leading to the enhanced design of transition finance instruments and covenants.

3.2. Transition finance strategies: GFANZ guidance for financial institutions

In November 2022, GFANZ published the "Financial Institutions Net-zero Transition Plans" report, which outlines four key financing strategies that define transition finance:

- **Climate solutions**: Financing or enabling entities and activities involved in developing and scaling climate solutions. This strategy promotes the adoption of low-emission technologies and services, including nature-based solutions, to replace high-emission alternatives, remove GHGs from the atmosphere, or accelerate the net-zero transition in a just manner. For example, this could include financing a company that produces green hydrogen or supporting a regenerative agriculture project.
- **Aligned**: Financing or enabling entities that are already aligned with a 1.5°C pathway. This strategy supports climate leaders and signals the financial sector's expectation of transition alignment from the real-economy companies they engage with. An example of an aligned entity could be a company with a SBTi-validated target, demonstrating progress towards the target through performance reports. It could also include companies whose climate transition plans and performance are assessed by the World Benchmarking Alliance.

- **Aligning**: Financing or enabling entities committed to transitioning in line with 1.5°C-aligned pathways. This strategy supports both high-emitting and low-emitting firms that have robust net-zero transition plans, set targets aligned with sectoral pathways, and implement changes in their business operations to achieve their net-zero targets. An example could be a manufacturer implementing energy efficiency and clean energy projects to reduce Scope 1 and 2 emissions or a retailer engaging with its supply chain to invest in projects that reduce Scope 3 emissions.
- **Managed phase-out**: This strategy involves the identification and planned early retirement of assets to achieve significant emissions reduction while managing issues of service continuity and community interests. GFANZ considers this activity crucial for reducing global emissions and facilitating a smooth and equitable economic transition. An example could be a fossil fuel power plant identified for early decommissioning, consistent with the broader net-zero trajectory. In June 2022, GFANZ published the "Managed Phaseout of High-emitting Assets" report, which outlines an initial approach to identify assets suitable for managed phase-out, along with potential financial mechanisms and guidance for developing credible asset-level phase-out plans. In June 2023, the GFANZ Asia-Pacific (APAC) Network initiated a public consultation on voluntary guidance for financing the early retirement of coal-fired power plants in the APAC region. Additionally, the ASEAN Taxonomy for Sustainable Finance Version 2 (March 2023) and Singapore-Asia taxonomy public consultation (28 June 2023) also consider the criteria for early phase-out of coal fired power plants in Asia.

These strategies provide financial institutions with a framework for assessing whether specific assets, activities, or clients align with the transition and how they can support them. In particular, the framing of transition finance strategies in this way is instrumental in clarifying the objectives of transition finance and outlining the ways in which financial institutions can actively contribute to guiding entities toward net-zero emissions.

This section is strongly tied with Principle 5 of the 2022 IPSF Transition Finance Report. It underscores the significance of financial institutions considering the four key financing strategies for transition finance, encompassing climate solutions, aligned entities, aligning entities, and managed phase-out. These strategies are instrumental in defining the comprehensive nature of transition finance plans, addressing a broad spectrum of entities, activities, and assets aligning with net-zero transitions. The framework created by these strategies offers clarity on the objectives of transition finance and delineates how financial institutions can play an active role in guiding entities toward net-zero emissions. This approach to transition finance closely aligns with the principles of transition planning, which emphasise the necessity for transition plans to be both comprehensive and credible, ultimately highlighting the significance of actions over promises (per Principle 5). Moreover, this section resonates with Principle 7, particularly in outlining how financial institutions can engage with various entities and assets to support their transition, thereby fostering active external engagement to cultivate an enabling environment.

In the following sub-sections, we will delve deeper into the array of choices available to financial institutions in the realm of transition finance. These choices encompass a spectrum of strategies and approaches, providing flexibility for institutions to tailor their transition finance efforts according to their specific circumstances and priorities.

3.3. Types of financing available to meet companies' transition finance needs

A range of transition-related financing instruments is available to facilitate the journey to a sustainable economy. This includes labelled options such as:

- **green loans or bonds**, which typically refers to the financing of activities that can already be deemed as "green" (often with reference to a taxonomy);
- **sustainability-linked loans or bonds**, which are loans or bonds that aim to facilitate and support environmentally and socially sustainability economic activity by incentivising the borrower's achievement of ambitious, predetermined performance targets;

- **transition bonds,** are labelled bonds that a used to fund a firm's transition to achieve their climate objectives; and
- **equity-related instruments/investment products**.

However, a significant portion of the whole-of-economy transition might be delivered through non-transition labelled products. For example, small or medium-sized enterprises may use existing corporate lending relationships to address financing needs identified within their transition plan.

As a result, it may be important to consider how to embed the foundations provided by good transition planning and disclosure within the broader capital markets and lending ecosystem. This might include the extent that the disclosure of forward-looking information is incorporated by underwriters in pricing the issuance of new debt or by credit rating agencies in the credit assessment of securities. This is an area where regulation may need to adapt over time to further enhance the credibility of the transition finance market.

In this dynamic landscape of transition financing, it is crucial to consider the Principles of the 2022 IPSF Transition Finance Report. Principle 5 underscores the significance of comprehensive transition plans. Financial instruments, such as green loans and sustainability-linked bonds, should not only align with taxonomies but also contribute to the broader objective of facilitating the transition to a sustainable economy. This necessitates robust transition plans that encompass a variety of assets, activities, and entities.

Blended finance: Fostering collaboration

Blended finance, combining public and donor capital with private investments, emerges as another promising solution. This approach can de-risk climate projects and mobilise private funds, facilitating a more comprehensive climate financial ecosystem. The NGFS plays a pivotal role in promoting blended finance. With its global membership of central banks and regulators, the NGFS can establish best practices, offer guidance, and address regulatory barriers to enhance blended finance adoption. The NGFS is developing a comprehensive handbook, which will draw from past case studies, outline essential elements for a mature climate blended finance ecosystem, and present best practices to scale up blended finance for climate adaptation and mitigation, fostering a sustainable transition in emerging market and developing economies and beyond.

The role of taxonomies

Taxonomies have various uses to offer. They can find applications in entity or activity-level transition plans, investment plans, milestones, and intermediate targets as part of a credible transition strategy. For instance, in the EU, the recommendation on facilitating finance for the transition to a sustainable economy advocates a range of transition-related financing instruments to facilitate the journey to a sustainable economy. It encourages undertakings to utilise options such as green loans, sustainability-linked loans, and sustainability bonds to fund their transition efforts. These instruments align with taxonomy criteria and sustainability targets, ensuring both financial viability (of transition efforts) and environmental integrity. Additionally, the recommendation emphasises the role of financial intermediaries and investors in operationalising transition finance strategies. They are urged to consider corporate disclosures, EU climate benchmarks, and the Taxonomy framework to identify suitable projects. The recommendation also promotes engagement and dialogue between these stakeholders, promoting a collaborative approach towards sustainable financial transformation. Acknowledging the unique challenges of the transition, aside from general lending and financial solutions, the recommendation invites financial intermediaries to consider offering transition-specific financing solutions, and provides a few examples of relevant loans and financial products, such as those based on investment that help increase the share of taxonomy-aligned activities carried out by an undertaking in a meaningful way.

Driving capital flow and monitoring progress

While there is no shortage of guiding principles in place to shape financial institutions' actions in transition finance, the true measure of success lies in their ability to substantially redirect capital flows. The goal is to

channel financing not only towards already green endeavours but also to those in the process of transitioning to greener practices. This includes scaling up financial support for these evolving initiatives. Accountability is key, not just at the individual institution level but also at a macro-level. In this respect, it becomes imperative to establish a macro-level framework for monitoring progress in transition finance. Such a framework will enable us to track and evaluate the impact of these guiding principles on the broader financial landscape. There have been discussions about the global international financial architecture, with some stakeholders calling for broader reform.[16] And such a monitoring framework could feature as part of that.

3.4. High-level overview of approaches to mobilise finance and enable it to scale with integrity

In terms of mobilising finance for transition, diverse guidance resources have emerged to steer financial institutions, seeking to align their actions with the principles of comprehensive and credible transition, as highlighted in Principle 5 of the IPSF's 2022 Transition Finance Report. This guidance spans various aspects, from the design of financial instruments, including fund labelling, to the structuring of financial schemes. This section provides an overview of different market-led and regulatory initiatives that are intended to strengthen the robustness of transition finance products and enable the market to scale with integrity. Such initiatives, with a strong emphasis on credibility and transparency, directly resonate with IPSF Principle 5, reinforcing the importance of transition plans that are both comprehensive in scope and firmly grounded in reality. Moreover, these initiatives echo the spirit of Principle 7, emphasising the need for financial institutions to actively engage with a spectrum of entities and assets, creating an enabling environment for a sustainable transition.

Guidance for issuers

ICMA's Handbook: In December 2020, ICMA released the "Climate Transition Financing Handbook", providing high-level, principles-based guidance for climate transition bonds. The handbook outlines recommended forms of financing and disclosure requirements to ensure the credibility of the transition. It specifies four key elements for disclosure: 1) Issuers' climate transition strategy and corporate governance, 2) Consideration of environmental elements in the business model, 3) Alignment of the climate transition strategy with scientifically based goals and pathways, and 4) Transparency of information regarding implementation. In June 2023, ICMA issued its first update of the Handbook. It includes dedicated recommendations for climate-themed green, sustainability and sustainability-linked bonds and acknowledges the development of "climate transition" bonds in certain jurisdictions. It includes new annexes with illustrative disclosures, infographics and a list of wider market and official sector guidance for climate-themed bonds.

Climate Bonds Initiative (CBI): In April 2023, the CBI launched a new Certification Scheme for entities, assets and sustainability-linked debt. The purpose of the certification is to signal to investors that the relevant corporate is on a Paris-aligned pathway of 1.5°C. It focuses on key aspects needed to demonstrate a credible transition for debt instruments – for both labelled debt but also regarding wider general-purpose debt and equity investment.

Loan Market Association (LMA): In August 2023, the LMA published guidance on sustainability-linked loan terms.

The following examples of regulatory initiatives are intended to improve transparency and the credibility of transition-related investments.

Portfolio Scoring

Switzerland: The Swiss Climate Scores were launched in June 2022 to enhance portfolio-level transparency and comparability with respect to the alignment of financial investments with the goals of the Paris Agreement. These scores encompass several indicators that assess the current situation (e.g., emissions or exposure to high-emitting sectors) as well as forward-looking aspects (e.g. the share of the portfolio subject to a net-zero target,

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[16] For example, this report by Aviva Investors: How to reform the financial system for a net-zero world - Aviva Investors.

engagement strategy, and potential global warming level). The scores allow for different investment strategies (e.g. aligned portfolio or aligning portfolio with robust engagement strategy). The scores will undergo regular reviews to reflect evolving practices. Notwithstanding their voluntary nature, several financial institutions have or are in the process of rolling out the scores to help investors better factor in climate aspects in their decisions.

Fund labelling

United Kingdom: The Financial Conduct Authority (FCA) published a consultation paper (CP22/20) on Sustainability Disclosure Requirements and Investment Labels, which sought feedback on new disclosure requirements for asset managers, as well as the introduction of a sustainable investment labelling regime. The FCA proposed three investment labels as part of the consultation:

- Sustainable Focus: Products with an objective to maintain a high standard of sustainability in the asset profile by investing to meet a credible environmental and/or social sustainability standard or aligning with specified sustainability themes. At least 70% of assets in a sustainable focus product must meet the specified environmental and/or social sustainability criteria.
- Sustainable Improvers: Products with an objective to deliver measurable improvements in the sustainability profile of assets over time. These products invest in assets that are not currently environmentally or socially sustainable but show potential for improvement, including through the influence of stewardship activities.
- Sustainable Impact: Products with an explicit objective to achieve a positive and measurable real-world impact. These products invest in assets that provide solutions to environmental or social problems, particularly in underserved markets or to address observed market failures.

The purpose of these labels is to help consumers navigate the market for sustainable investment products and to build transparency and trust. Of these labels, Sustainable Improvers is typically most aligned with the transition finance goals of supporting higher emitting sectors to improve their carbon emissions over time. But all the labelled funds will likely have a role in the whole-of-economy transition to a lower carbon economy.

3.5. Approaches to engage for real economy impacts

While the initiation of transition finance may begin with a small step of providing specific financial instruments, it should evolve into a broader strategic orientation for entire portfolios. Transition finance must go beyond the realm of instrument design, becoming a fundamental strategy embedded throughout financial institutions.[17] To truly integrate the concept of transition finance into the core of each institution's operations, it is of paramount importance to institutionalise a strategy. This strategy should actively engage with high-emission activities or entities within their portfolios, aiming to significantly reduce emissions originating from these sources. Furthermore, while financial market participants can make progress towards net-zero aligned portfolios by divesting from carbon-intensive industries, this strategy alone does not provide capital to companies that are actively transitioning to net zero.

The **2022 IPSF Transition Finance Report** emphasises the importance of engagement strategies for incentivising companies to reduce their emissions. It highlights that transition finance and transition risks are interconnected, meaning investments in transitioning to lower-emitting and more sustainable economic activities and companies contribute to the financial sector's resilience by reducing transition risks on their balance sheets. IPSF transition finance Principle 7 emphasises the significance of client engagement by financial market participants. This section sets out some of the published guidance intended to support investors in their client engagements, both in relation to any commitments made and on delivering real-world decarbonisation.

[17] This, for example, was a key message within the FCA's discussion paper DP23/1: Finance for positive sustainable change: governance, incentives and competence in regulated firms (fca.org.uk) The discussion paper explores how sustainability objectives can be embedded across a firm's governance, incentives, skills and capabilities.

The **G20 Sustainable Finance Report**, published in October 2022, includes recommendations to enhance the credibility of private sector financial institution commitments. Recommendation 2 explicitly acknowledges the crucial role of engagement by financial institutions:

> *"Recommendation 2 - Engage with clients to align practices with appropriate sectoral pathways and engage with client and portfolio companies to encourage and, if feasible, enable them to make voluntary net-zero commitments and implement them."*

In the "**Financial Institutions Net-zero Transition Plans**" released in November 2022, **GFANZ** presents a set of recommendations covering foundations, governance, implementation strategy, engagement strategy, metrics, and targets. Engagement with clients and portfolio companies is a key element of the proposed engagement strategy.

Global regulatory bodies echo this sentiment. In July 2022, the FSA in **Japan** published the "**Supervisory Guidance on Climate-related Risk Management and Client Engagement**", which places proactive support for clients in dealing with climate change at the core of financial institutions' actions. The guidance provides supervisory dialogues between the FSA and financial institutions, offering approaches and case studies on engaging with clients, particularly focusing on regional banks for reference.

In **Singapore**, the Monetary Authority of Singapore (MAS) published in May 2022 "Information Papers on Environmental Risk Management" for banks, insurers and asset managers, which highlighted that financial institutions can play an active role in facilitating their clients' transition. This includes encouraging client transition towards sustainable business practices and enhancing their environmental risk disclosures over time, which in turn mitigates financial institutions' own environmental risks. In October 2023, MAS issued a set of consultation papers proposing guidelines on transition planning by banks, insurers and asset managers. The proposed guidelines set out MAS' supervisory expectations for financial institutions to have a sound transition planning process to enable effective climate change mitigation and adaptation measures by their customers and investee companies in the global transition to a net-zero economy and the expected physical effects of climate change.[18]

In December 2021, the **Hong Kong** Monetary Authority (HKMA) shared with the industry a number of sound practices[19], adopted by banks to support the transition to carbon neutrality. It is noted that some banks catalyse decarbonisation efforts through working closely with their clients and assisting them to transition by, for example, offering transition financing, facilitating clients to obtain green certification and assessment, as well as promoting clients' awareness of climate change-related issues and opportunities. In August 2023, the HKMA also set out some high-level principles on transition planning to assist banks in maintaining safety and soundness in the transition.[20] Specifically, the principles highlight the importance of engaging with clients.

The **EU's** direction, as highlighted in the Banking Package of 2021[21] and the European Central Bank's (ECB) report on good practices for climate-related and environmental risk management[22], underscores the significance of transition planning in empowering financial institutions to champion the decarbonisation of the real economy while adeptly navigating transition risks. These strategic pathways collectively foster a resilient and sustainable financial environment. Central to this drive, the EU Banking Package introduces fresh regulatory benchmarks tailored for effectively managing environmental, social, and governance (ESG) risks within banks. These standards harmonise with established ECB supervisory expectations for ECB-supervised banks, with a noteworthy expansion of focus to encompass ESG dimensions beyond climate and environmental concerns. The obligatory integration of transition plans emerges as a pivotal component, obliging banks to formulate

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[18] See https://www.mas.gov.sg/news/media-releases/2023/mas-proposes-guidelines-for-financial-institutions-on-transition-planning.

[19] See https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2021/20211208e1a1.pdf.

[20] See https://www.hkma.gov.hk/media/eng/doc/key-information/guidelines-and-circular/2023/20230829e1.pdf.

[21] See https://finance.ec.europa.eu/publications/banking-package_en.

[22] European Central Bank, 'Good practices for climate-related and environmental risk management', November 2022.

these plans while furnishing supervisory bodies with the authority to ensure and assess their implementation. The extent of these changes, especially for banks outside direct ECB supervision, may hinge on the priorities set by respective national supervisors. The foundation of sustainability rests at the core of these novel regulations. Banks are now mandated to methodically recognise, unveil, and effectively manage sustainability risks, encapsulating the entirety of ESG factors, as indispensable facets of their risk management strategies.

The **Institutional Investors Group on Climate Change (IIGCC) Net Zero Bondholder Stewardship Guidance** provides corporate bondholders with a foundational framework to enhance their climate stewardship practices, building on IIGCC's Net Zero Stewardship Toolkit for listed equities and practical steps aligned with the Net Zero Investment Framework (NZIF). The Guidance identifies and addresses key challenges and opportunities across different bond types, highlights best practices in bondholder stewardship and investors' ability to achieve long-term outcomes.

The centre piece of the Guidance outlines bondholder specific considerations for engagement and the importance of alignment between the issuance, the issuer's climate transition strategy and net-zero alignment over time. The Guidance emphasises the importance of a long-term approach across the financing lifecycle and engaging across the ecosystem.

Considering the emerging and developing country context, the **EBRD's "Methodology to determine the Paris Agreement alignment of EBRD investments"** laid out an engagement approach with the EBRD's financial institutions clients. The approach, focused on supporting transition planning, differs depending on the entity's starting point when it comes to their business practices in relation to climate change. Specifically, the EBRD developed a matrix, demonstrating the progression of climate practices of financial institutions, including the incremental steps along the TCFD dimensions of governance, strategy (covering policies, financial products, and engagement with clients and peers), risk management, metrics and targets, and disclosure.

The essence of transition finance lies in its commitment to addressing emissions at their source. Instead of avoiding sectors with high emissions, finance is expected to become a proactive solution for emissions reduction in the real economy. This principle underpins the core of transition finance, but it also introduces certain risk considerations. Financial institutions that actively engage with clients on their strategies to manage the transition can reduce the transition risks associated with their exposure to high-emission activities or entities. Moreover, their actions can help reduce physical risks that might either impact them directly or indirectly through the broader economy. This further underscores why it is important for a company to take a strategic and rounded approach to transition planning – recognising that their contributions to the economy-wide transition might impact their own future climate-related risks.

This risk-reduction aspect of transition finance has prompted global regulatory bodies to emphasise the importance of engaging with clients involved in emissions-intensive activities. It also re-emphasises why disclosure of a company's engagement plans as part of a transition plan disclosure can provide investors with relevant information to understand a financial institution's strategy to reduce risk. The interaction between transition finance and climate-related risks presents a compelling case for further exploration within international fora. Designing an effective regulatory and supervisory system to facilitate this interaction is an evolving challenge that requires continued attention and collaboration on a global scale.

3.6. Monitoring metrics

It is important to note that a substantial proportion of financial institutions' GHG emissions lie in Scope 3 emissions as part of their financed emissions. In light of this, there is an expectation for financial institutions to disclose not only their own GHG emissions, but also the emissions associated with their financed activities.

Financing the transition of companies in hard-to-abate sectors is crucial for facilitating the society-wide shift towards net-zero emissions. However, financial institutions that provide such financial support may temporarily experience an increase in financed emissions and risk exposures in the short term. This is due to their heightened exposure to companies that are in the process of transitioning.

These potential short-term side effects can create disincentives for financial institutions to engage in transition finance and may lead to divestment in unnecessary cases. It's crucial to comprehend that financed emissions, while initially contributing to overall climate-positive outcomes, might not reflect immediate results due to the lag inherent in transition processes. However, providing transition finance to the real economy enables the financial sector to fulfil its financing function during the transition, reduces transition risk over time, and supports the sector in making an orderly transition. Transition finance and related investments can effectively reduce financial transition risk in the future, even if they may not be automatically subject to less financial risk than other investments.

To address this incentive problem, financed emissions could be complemented with other, forward looking indicators. This information enables a forward-looking and comprehensive assessment that takes into account these temporary effects and supports a holistic approach to encourage transition finance.

The development of a menu of forward-looking metrics represents a critical next step in reinforcing the credibility and accountability of financial institutions involved in transition finance-related activities. Additionally, it contributes to strengthening the assessment dimension (as discussed in detail in section 4), for investors engaging in transition finance activities. As various organisations work on this front, it will soon become imperative to assess the outcomes of these endeavours and extract valuable insights. These insights can then serve as a foundation for shaping future reporting guidelines tailored to the unique demands of financial institutions involved in transition finance. This iterative process is vital in ensuring that transition finance not only aligns with ambitious climate goals but also remains transparent and accountable throughout its implementation.

Then, with the aim of addressing the shortcomings of a backward-looking financed emissions metric, several proposals have been already made on a set of complementary metrics. Those proposals could be categorised into two groupings.

One group is for enhancing the financed emissions calculation so that it would be consistent with the purpose of transition finance. The Japan's Public and Private Working Group on Financed Emissions for Promoting Transition Finance (JPPWG) has proposed the idea of classifying separately transition assets that are defined as the use of proceeds for transition finance instruments and calculating financed emissions for the transition assets and those for the rest respectively, thereby providing transparency for contributions of transition finance activities to the pathway of financed emissions. In a similar vein but a different focus, GFANZ has proposed the use of an Expected Emissions Reduction (EER) metric that seeks to quantify the expected real-world emissions impact and has further proposed the attribution of EER to the financing entity in a similar manner for financed emissions calculations.

Another grouping is for attempting to identify alternative metrics that would complement a financed emissions metric. Examples of such efforts are summarised in Table 4 below. GFANZ's proposal on EER itself is a proposition of alternative metrics and it advocates an Emissions Reduction Potential method (ERP) for financing to the aligned and the aligning and an Avoided Emissions method (AE) for financing to climate solutions and managed phase-out. ERP is the method that attempts to capture the difference between a business-as-usual (BAU) emissions pathway and a company's forward-looking emissions profile enabled by its transition efforts. AE compares the difference between life-cycle emissions in a BAU case and those in a climate solution-employed case but, in the case of managed phase-out, it will be allowed to look into how much emissions will be potentially avoided by retiring a high-emitting activity earlier than initially planned.

The development of complementary metrics such as these would augment the scope 3 emissions disclosure framework for financial institution and provide more clarity to how their transition finance efforts will have a real-world impact in terms of emissions reduction. Essentially, they will likely become an integral part of the transition finance ecosystem and it will be important to consider how they might be reflected into the overall regulatory system governing transition finance, including disclosure requirements for financial institutions.

Table 4: Examples of metrics

	Examples of metrics	Explanation
Efforts on real-economy transition Metrics related to efforts for real-economy transition. Includes avoided emissions to transition based indicators.	Avoided emissions (by specific products and/or services)[23]	Financial institutions may disclose fundraisers avoided emissions (impact created by the use of specific products or services) as financial institutions' avoided emissions.
	Amount, absolute or proportion of portfolio aligned with net-zero targets or Paris Agreement	Indicates the financial institution portfolio's degree of at the point of calculation/disclosure. Financial institutions may select criteria to assess alignment according to their policy.
	Temperature ratings	Allows assessment for the degree of alignment with temperature objectives of investments, commitments, and reduction targets of portfolio companies.
	Amount or proportion of finance companies with transition strategies or related projects	Focuses on supporting companies promoting the transition and decarbonisation of society by replacing high-emission products and services with low-emission alternatives.
	Future reduction effects through transition finance (limited to use of proceeds instruments)	Indicates the contribution of transition finance to decarbonisation by calculating and disclosing the emission reductions attributable to transition finance out of the total GHG reductions expected from a company in the future.
	Physical indicators	Indicates the contribution towards specific projects. Examples of indicators include the number of financed managed phaseout projects, or the generation capacity of renewable energy investment projects.
	Decarbonisation contribution (currently under development by GFANZ)	Indicator to quantify the associated decarbonisation contribution impact of financial institutions' assets. The indicator is currently (October 2023) under development, thus it is needed to closely follow the discussions toward the finalisation of these metrics.
Execution capability for decarbonisation-related measures Metrics related to the degree of progress of financial institution's decarbonisation plan.	amount, number, or proportion of portfolio covered by key policies	Key policies are expected to include the following: - Fossil Fuel Policy - Deforestation Policy
	Amount, number, or proportion of products and services that are aligned to the net-zero transition plan	One of the indicators represent the extent of financial institution's net-zero transition plan execution.

[23] The "avoided emissions" metric refers to emissions savings that occur outside of a company's value chain. Emphasising avoided emissions can help identify opportunities with a positive impact and facilitate financing for climate solutions. At the same time, due to its nature of relying on counterfactual scenarios, the metric needs to be used carefully, so as to not be conflated with real world emissions reductions. In March 2023, the World Business Council for Sustainable Development (WBCSD) published the "Guidance on Avoided Emissions: Helping business drive innovations and scale solutions toward Net Zero". This guidance outlines five key areas for making credible claims on avoided emissions: (1) Defining avoided emissions, (2) Leveraging avoided emissions, (3) Ensuring the legitimacy of the contribution, (4) Assessing avoided emissions, and (5) Reporting avoided emissions. As highlighted in the WBCSD report, 'avoided emissions' should be reported separately from GHG inventory footprints. When properly employed, this tool becomes a potent instrument for financial institutions to identify climate solutions with substantial emissions reduction potential. Given that this metric is still in its early stages of deployment, it becomes crucial to establish a set of best practices. Leveraging successful cases can then facilitate the application of this metric to various potential use cases across the financial sector. This approach ensures that the metric is employed effectively and consistently, contributing significantly to emissions reduction efforts.

Includes plan execution, governance and engagement.	Amount, number, or proportion, of clients or portfolio companies with climate-related engagement activities	Possible indicators include the number or proportion companies and/or the amount of finance/investment to such engaged companies (includes academia & government authorities)
	Number or proportion of employees and board members involved in decision-making and efforts on climate related affairs	Possible indicators include: - Employees and management who have completed climate-related training - Specialists on climate change and other related issues - Management and board members with remuneration linked to the progress against and achievements of climate-related targets - Amount of human capital investment to enhance capacities

The demand for transparent and accountable transition plans has surged as one component of forward-looking information. Effective disclosure of transition plans hinges on the use of clear, quantifiable metrics and benchmarks, often tailored to specific industries to address their unique challenges. Work to enable investors and financial institutions to assess the credibility of any commitments within those plans is an important step to embedding credibility within transition finance. A key component of this will be companies' ongoing sustainability and corporate reporting disclosures, which will provide regular updates on corporates' strategy and carbon emissions that will inform investors of progress against any short-term targets in particular. This is further reinforced by requirements to update transition plan disclosures both regularly and where there might be material changes in a company's strategy. In addition to ongoing sustainability reporting, and in line with the evolving sustainability landscape, stakeholders now seek forward-looking insights that go beyond historical performance metrics to complement this information.

A number of initiatives are underway that attempt to help users better assess an individual company's commitments against sector peers and broader transition pathways. One notable example is the Transition Pathway Initiative (TPI), which operates as a research and data hub in the financial and corporate sectors' transition to a low-carbon economy, aligning with Principle 9 of the 2022 IPSF Transition Finance Report. It analyses companies based on their "management quality" and "carbon performance", evaluating the quality of their governance and management in dealing with carbon emissions, aligning with TCFD recommendations. The assessment of management quality uses a series of indicators to place companies on a range from "unaware of climate change as a business issue" to those that are demonstrating performance across all management indicators. The carbon performance assessment allows for the translation of emissions targets made at the international level into sectoral benchmarks, against which the performance of individual companies can be compared.

The Transition Pathway Initiative represents just one facet of enhanced climate disclosure. Another noteworthy player in this landscape is the investor-led initiative Climate Action 100+. It seeks to elevate corporate transparency and accountability in climate action. Stakeholders work together to encourage companies to enhance their corporate disclosure practices and implement well-defined transition plans, all while adhering to the recommendations of the TCFD and other sector-specific and regional guidance. This fosters resilience in companies' business strategies and facilitates well-informed investment decisions.

The Climate Action 100+ Net-Zero Company Benchmark, designed to assess companies' alignment with ten key indicators, mirrors the commitment priorities of Climate Action 100+. This benchmark, akin to TPI, demonstrates the value of data-driven assessments and multi-stakeholder collaboration in reshaping corporate climate disclosure. Anchored in data analysis and enriched by insights from leading climate research organisations, it offers a robust model for assessing companies' alignment with the ambitious goal of achieving net-zero emissions.

Initiatives such as TPI and the Climate Action 100+ Net-Zero Company Benchmark play an important role in steering the ongoing transformation of the corporate landscape, thereby adhering to Principle 7 of the 2022 IPSF Transition Finance Report. They drive transparency, facilitate data-driven decision-making, and inspire a collective shift towards a more sustainable future. As they set new standards and garner support from a growing cadre of initiatives, they hold the potential to guide the corporate world toward greater accountability and a sustainable future.

The development of such tools play an important role in the broader transition finance ecosystem, particularly when supported by clear and transparent methodologies that allow investors to understand how any judgements on underlying data and assumptions have been made. Over time, the disclosure of further information through sustainability reporting or transition plan disclosures may support to further increase the richness and sophistication of such tools.

Box 4: Benchmarking companies using public disclosures: The Climate Action 100+ example[24]

Climate Action 100+ has set forth an agenda for company engagement with the aim of securing commitments to reduce emissions, enhance governance, and improve climate-related financial disclosures and transition plans. This effort is geared towards creating sustainable value for shareholders. In alignment with their fiduciary responsibility and as institutional investors, Climate Action 100+ members are aiming to address the financial implications of climate change. They work closely with invested companies to encourage actions that contribute to the global goal of halving GHG emissions by 2030 and achieving net-zero emissions by 2050, aligning with the Paris Agreement's ambition to limit warming to 1.5°C.

Key features of the Climate Action 100+ Net-Zero Company Benchmark:

- **Comprehensive assessment:** The offers a comprehensive assessment of companies' commitment to achieving net-zero emissions. It delves into various aspects of a company's operations, including its governance, emissions reduction targets, and climate-related lobbying efforts.
- **Data-based evaluation:** The framework relies on publicly disclosed information from companies, including their annual reports, financial filings, and CDP disclosures. This reliance on publicly available data ensures transparency and objectivity in the assessment process.
- **Collaboration and expertise:** The development of this benchmark involved the collaborative efforts of nearly 50 signatories, investor network experts, and leading climate research and data NGOs. This multi-stakeholder approach reflects the urgency and complexity of the climate challenge, demonstrating that a collective effort is essential to drive meaningful change.
- **Research and analysis:** To carry out the company disclosure research and analysis, the initiative partnered with TPI. In collaboration with their research and data partners, including the Grantham Research Institute on Climate Change and the Environment at the London School of Economics (LSE) and FTSE Russell, TPI plays an important role in conducting in-depth analysis and ensuring the integrity of the assessment process.

Summary of the 10 disclosure indicators and sub-indicators:

1. **Net Zero GHG emissions ambition (2050 or sooner)**

   Sub-Indicator 1.1: Ambition for net-zero GHG emissions by 2050 or sooner.

2. **Long-Term GHG reduction targets (2036-2050)**

[24] See https://www.climateaction100.org/wp-content/uploads/2021/10/V1.1-Disclosure-Framework-assessment-methodology-Oct21.pdf.

Sub-Indicator 2.1: Target for GHG reduction between 2036 and 2050.

Sub-Indicator 2.2: Covers at least 95% of scope 1 & 2 emissions and relevant scope 3 emissions.

Sub-Indicator 2.3: Alignment with the 1.5°C global warming goal.

3. **Medium-Term GHG reduction targets (2026-2035)**

   Sub-Indicator 3.1: Target for GHG reduction between 2026 and 2035.

   Sub-Indicator 3.2: Covers at least 95% of scope 1 & 2 emissions and relevant scope 3 emissions.

   Sub-Indicator 3.3: Alignment with the 1.5°C global warming goal.

4. **Short-Term GHG reduction targets (up to 2025)**

   Sub-Indicator 4.1: Target for GHG reduction up to 2025.

   Sub-Indicator 4.2: Covers at least 95% of scope 1 & 2 emissions and relevant scope 3 emissions.

   Sub-Indicator 4.3: Alignment with the 1.5°C global warming goal.

5. **Decarbonisation strategy (target delivery)**

   Sub-Indicator 5.1: Decarbonisation strategy to meet long and medium-term GHG reduction targets.

   Sub-Indicator 5.2: Commitment to 'green revenues' from low-carbon products and services.

6. **Capital allocation alignment**

   Sub-Indicator 6.1: Efforts to decarbonise future capital expenditures.

   Sub-Indicator 6.2: Disclosure of methodology for Paris alignment of future capital expenditures.

7. **Climate policy engagement**

   Sub-Indicator 7.1: Paris Agreement-aligned climate lobbying position.

   Sub-Indicator 7.2: Paris Agreement-aligned lobbying expectations for trade associations.

   Sub-Indicator 7.3: Process to ensure trade associations lobby per the Paris Agreement.

8. **Climate governance**

   Sub-Indicator 8.1: Board oversight of climate change.

   Sub-Indicator 8.2: Executive remuneration scheme includes climate performance elements.

   Sub-Indicator 8.3: Board's capabilities to assess and manage climate-related risks and opportunities.

9. **Just transition (under development)**

   This indicator is being further developed for future assessments.

10. **TCFD disclosure**

    Sub-Indicator 10.1: Commitment to implement TCFD recommendations.

3.7. Conclusions and recommendations for further work

In scaling up transition finance, the establishment of a coherent framework is paramount. This framework should not only activate transition finance-related actions within financial institutions but also empower them to effectively monitor and report their progress. As demonstrated in this section, such a framework seems to be emerging, yet it remains in its early stages of development and requires nurturing in the right direction. In light of this, several key actions are recommended in the following areas:

- **Continue to build on initiatives to enable the transition finance market to scale with integrity**: A number of initiatives are underway to embed the right foundations for the provision of finance to companies that are seeking to reduce their carbon emissions. As the different labelled and unlabelled transition finance instruments and products continue to evolve, these frameworks and regulatory initiatives might need to adapt, building on best practices and strengthening the integrity of the transition finance ecosystem. The IPSF will continue to monitor ongoing developments for frameworks that embed credibility within the transition finance process and consider where further guidance might be necessary.

- **Monitoring framework**: The development of a comprehensive monitoring framework for transition finance is crucial, both at the individual institution level and at macro-level. Initiatives like GFANZ are progressing toward establishing such frameworks within individual institutions. However, there is currently no equivalent effort focused on macro-level monitoring. To address this gap, convening stakeholders and fostering collaboration will be essential to drive progress toward a macro-level monitoring framework. The IPSF could promote guidelines and best practices for monitoring and assessing the progress in developing credible transition plans and finance frameworks. IPSF members will continue sharing views on possible local or international measures that may be influencing the ability of firms to access finance.

- **Climate-related risks nexus**: To ensure that actions undertaken by financial institutions translate into tangible real-sector emissions reductions, exploring the intricate relationship between transition finance and climate-related risks is imperative. In collaboration with ongoing work from organisations such as international standard setters that are considering the materiality of climate-related risks, this could help to better understand and enable the mitigation of both transition and physical climate-related risks faced by financial institutions.

- **Forward-looking metrics**: The development of a set of forward-looking metrics tailored specifically for transition finance is a priority, in line with Principle 9 of the 2022 IPSF Transition Finance Report (underscoring the need for credible assessment mechanisms). These metrics should complement the existing financed emission metric and provide a more nuanced assessment of the decarbonisation impact of transition finance. This is essential to prevent the mechanical use of the financed emission metric from inadvertently discouraging financial institutions from engaging in transition finance. Progress is being made in this area, through market-led initiatives such as GFANZ. It would be worthwhile for the IPSF to continue monitoring and sharing best practices in order to inform ongoing efforts in developing a set of complementary forward-looking metrics that might become embedded within the transition finance ecosystem.

4. Assessment

This section provides an overview of the main existing approaches for evaluating the credibility, ambition, and progress of private sector commitments, as well as assessing their vulnerability to physical and transition risks. The assessing dimension will be a key step to legitimising transition finance, and enabling the transition finance market ecosystem to develop in a way that supports investing for the whole-of-economy transition. Transition plan disclosures are just one component in the suite of tools available to investors to benchmark performance of entities and assess the effectiveness and impact of transition finance efforts.

Over time, as discussed above, some of these tools will embed within the broader market ecosystem and develop into new market norms for investment in patient capital, for example in relation to investment horizons, performance monitoring and reporting horizons and pricing of climate risks over the course of the asset maturity.

It is important to note that this overview represents a current snapshot, as some of these approaches are still being developed and may expand in scope and coverage over time. For the purpose of this discussion, only approaches that fully disclose their methodologies for utilising publicly available firm-specific data will be considered. Aggregate sustainability ratings and indices, despite their value for market participants with limited sustainability expertise, are not included in this analysis.

4.1. Guidance, recommendations and best practices on transition plans

The guidance, recommendations, and best practices on transition plans, such as the TCFD Guidance, GFANZ Guidance on Transition Plans, NGFS Stocktake on Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities[25], ECB best practices for climate-related and environmental risk management, UK Transition Plan Taskforce Disclosure Framework (and accompanying guidance), and Planet Tracker Transition Plan Assessment Template, mentioned in previous sections (see section 3), serve as valuable starting points for assessing the credibility and ambition of private sector commitments, aligning with the principles laid out in the 2022 IPSF Transition Finance Report. These frameworks, templates, and principles-based approaches can guide the identification of core elements in effective transition plans and provide specific guidance for formulating credible strategies and concrete targets. They play a crucial role in capturing aspects related to the quality of measures (e.g. engagement coverage, joint engagements and engagement strength) and a wider range of indicators. Analysing multiple indicators and concrete targets is particularly important in assessing the credibility of a transition plan and identifying potential vulnerabilities during the transition.

However, principles-based guidance alone cannot ensure strong comparability, and best practice metrics are still emerging for many indicators. While they emphasise the connection between the current state and forward-looking plans, they may be less suitable for factoring in past efforts (e.g. if a company has already pursued ambitious goals and only more challenging emissions remain) and assessing a firm's track record in achieving its targets.

As frameworks for disclosing transition plans continue to evolve and gain broader adoption, it is expected that variations in the quality and comparability of disclosures will arise across the real economy, highlighting the need for standardised assessment mechanisms, in alignment with Principle 9 of the 2022 IPSF Transition Finance Report. An important consideration is how to help companies enhance their capabilities in this realm without hindering their ability to secure financing for their transition efforts, in keeping with the overarching objective of empowering the financial sector to play a pivotal role in achieving net-zero emissions while managing the risks associated with the transition.

[25] See https://www.ngfs.net/sites/default/files/stocktake_on_financial_institutions_transition_plans.pdf.

4.2. Net Zero Data Public Utility

The concept of the NZDPU aligns with the spirit of the 2022 IPSF Transition Finance Report, particularly highlighting the need for transparency and robust data in assessing climate transition efforts, thereby advocating for standardised and credible assessment mechanisms (Principle 9). It is designed to be an open data platform that presents climate-related information from private sector firms and financial institutions in a comprehensive and comparable manner. Initially, the NZDPU will focus on emissions and emissions target data across all Scopes (1, 2, and 3), including carbon credit data. It will also provide information on the methodology used and whether the data has been verified. Additional data categories, such as exposures to high-emitting sectors, facilitated emissions, and climate solutions targets, may be included at a later stage. A pilot version of the platform is scheduled to launch at COP28. The Climate Data Steering Committee (CDSC), comprised of international organisations, countries, and data providers, provides strategic guidance to the NZDPU. At this stage, it is important to note that the NZDPU is in a test phase, with still limited coverage and comparability.

The NZDPU aims to enhance stakeholders' ability to assess forward-looking commitments by enabling more comprehensive comparisons:

a) over time, by providing historical, current, and forward-looking emissions data;

b) across institutions and sectors, through a set of standardised core indicators for all companies; and

c) across jurisdictions, by mapping methodological differences between regional standards.

The datasets will enable assessment of:

1) firms' ambition based on forward-looking targets compared to sectoral averages or industry benchmarks;

2) progress over time; and

3) firms' ability to fulfil commitments by comparing original targets with actual values.

Additionally, the platform will employ a system of flags to assess the comprehensiveness, quality, and coverage of the data provided by firms, identifying any unreported or unverified data categories, assets under management, or other relevant information.

The NZDPU aims to provide free access and ensure ease of use, allowing a wider range of stakeholders to assess private sector commitments and reducing disclosure costs for firms that rely on the platform for reporting their Scope 3 emissions. This is particularly important for developing countries and small and medium-sized enterprises (SMEs) with limited resources and capacity.

While data upload to the NZDPU is currently voluntary, firms have an incentive to disclose comprehensive and granular data. Market participants will interpret non-disclosures, omissions, or poor quality as red flags. Improved comparability may drive firms to strengthen their climate efforts over time. However, governments play a crucial role in establishing appropriate disclosure frameworks to support the climate data ecosystem and ensure the availability of decision-useful climate data.

In its initial stage, the Public Utility will primarily focus on emissions, as definitions, methodologies, and data collection for emissions are more standardised. The trade-off for increased data comparability within the NZDPU is a narrower range of indicators that could otherwise be valuable for assessing private sector transition efforts. Nonetheless, the NZDPU plans to add additional indicators over time, potentially also covering qualitative aspects such as governance and strategy.

4.3. Verification, validation and assurance

In the context of the 2022 IPSF Transition Finance Report, the processes of third-party verification, validation, and assurance play a critical role in ensuring the integrity and credibility of transition plans. These processes

align with Principle 8, which emphasises the significance of external reporting and the need for transparency. These verification and validation procedures aim to provide stakeholders with confidence in the accuracy and reliability of historical and forward-looking disclosures, supporting transparency and accountability in the transition finance domain.

- **Verification** refers to evaluating historical emissions data, the elements of transition plans including forward-looking ambition and emission reduction targets, and business and financing plans, etc. Verification assesses whether disclosures are materially correct and conform to specific carbon accounting criteria, standards or guidance, such as the GHG Protocol or ISO 14000 Standards, and alignment with the corporate strategies alignment of the targets and action plan with the latest climate science. Here, a great variety of verification standards exists, with one example of prevalent guidance being ICMA's Transition Finance Handbook.

- **Validation** refers to the process that evaluates forward-looking targets, assumptions, methodologies and processes to assess whether they are credible, science-based and help achieve stated climate goals. One example involves verification of company targets based on the Science Based Targets initiative (SBTi).

- **Assurance**, i.e. the outcome of verification or validation, can be done with various levels of comprehensiveness and reliability. In the case of **limited assurance**, third-party auditors may interview management, review analytical procedures, and evaluate internal controls for data collection. **Reasonable assurance** involves more extensive tests, evidence gathering, and side visits and allows the auditor to form conclusions with a high level of certainty although the cost of these audits is significantly higher.

For transition bond issuers and any other high-emitting sectors in need of financing, verification is particularly critical in ensuring the credibility and robustness of data in relation to transition. Since third-party verifiers can play a role of independent verification for the fund-raiser, they are expected to uphold independence and fairness while demonstrating professional skills. Japan, the UK, and the EU have proposed or introduced a code of conduct or regulatory provisions for verification providers to ensure transparency and quality.

Verification is provided by entities such as second-party opinion providers, accounting firms, and business consultants, with a diverse range of assessment methodologies. Recently observed market enhancements include the launch of evaluation services regarding the credibility of elements in transition plans. The common elements include ambition and GHG emission reduction targets, accompanying action and financing plans, robustness of emission calculation methodology and data, governance of planning and monitoring, review and disclosure of transition plans.

It is also closely related to data quality and can significantly enhance comparability when a common verification standard is adopted. The existence of multiple verification standards, albeit with slight methodological distinctions, can impede comparability across these standards. Creating a mapping of variances in methodologies and assumptions could facilitate stakeholders in understanding potential differences more effectively. Moreover, ongoing initiatives like the work conducted by the International Auditing and Assurance Standards Board (IAASB) in developing a sustainability reporting assurance standard might contribute to achieving greater consistency. The IAASB standard aims to elevate trust and confidence in sustainability information, which is essential for investors, regulators, and other stakeholders. It closely aligns with the objective of credible assessment mechanisms mentioned in Principle 9 of the 2022 IPSF Transition Finance Report. The International Organisation of Securities Commissions (IOSCO) has also been actively involved in this area, publishing a report in March 2023 regarding international efforts to establish a global assurance framework for sustainability-related corporate reporting.[26] A potential future consideration is the role of assurance for forward-looking statements within transition plans, which warrants close monitoring as part of

[26] FR04/23 Report on International Work to Develop a Global Assurance Framework for Sustainability-related Corporate Reporting (iosco.org).

the broader transition finance ecosystem.

Similarly, certification schemes hold substantial potential in helping investors gauge the degree to which the methodologies behind claims and commitments outlined in transition plan disclosures meet specific standards. However, ensuring transparency around these schemes is essential to enable investors to differentiate between certified and uncertified aspects of a disclosure and assess the overall credibility of the transition plan.

Validation, in particular by showing that forward-looking targets are science-based, i.e. compatible with limiting global warming to 1.5° or 2°C above pre-industrial levels, can ensure that targets meet certain minimum criteria with respect to methodology and benchmarks. SBTi has also developed sector-specific guidance to better tailor methodologies, frameworks and requirements to the specificities of individual sectors. The SBTi Net Zero Standard and sectoral guidance still allow for significant leeway in determining what should be included or excluded when calculating emissions targets of various Scopes. For instance, although Scope 3 targets are a requirement under the SBTi Net Zero Standard, a near-term Scope 3 target is not required if a company's Scope 3 emissions are less than 40 percent of total Scope 1, 2 and 3 emissions. SBTi near- or medium-term target certification (e.g. 2030 targets) can thus confer credibility to levels of ambition that may fall short of achieving net zero by mid-century. In addition, although 100 percent of GHG emissions need to be validated by SBTi, companies are allowed to exclude 5 percent of emissions of Scopes 1 and 2 combined and 5 percent of Scope 3. Companies also use offsets and insetting to various extents to meet their goals.

Nevertheless, targets represent just the initial step and must be translated into concrete and credible decarbonisation plans with regular progress disclosure. While target validation is an effective means of ensuring a baseline level of credibility, it alone cannot provide the high degree of comparability and consistency needed to fully assess a company's actions, ambition and integrity.

Verification, validation and assurance will be important to ensure a minimum level of disclosure quality and integrity in target setting. In fact, various jurisdictions will start requiring assurance of emissions disclosures. For instance, the EU CSRD will require limited assurance, with the aim to move to reasonable assurance over time. New Zealand will also require limited assurance on GHG emissions starting in October 2024. Furthermore, the SEC draft disclosure rules would require larger companies to obtain limited assurance for their Scope 1 and 2 emissions, with the intent to move to reasonable assurance and to widen the coverage of companies over time. Nonetheless, it will be important to clarify to stakeholders that verification, validation and assurance should be seen as ways to avoid incorrect, misleading and insufficiently credible disclosures and targets, rather than ways to vouch for the credibility, ambition and high integrity of disclosures or to promote greater comparability.

4.4. Climate alignment assessments

In the context of the 2022 IPSF Transition Finance Report, climate alignment assessments play an important role in enhancing transparency and comparability, adhering to Principle 8, which underscores the importance of external reporting, comparable transparency, and consistency. These assessments serve as mechanisms for gauging the specific contribution of financial institutions to achieving net-zero goals, supporting external transparency and accountability while facilitating cross-jurisdictional comparisons.

The tests can incentivise ambitious action by providing a basis for governments and financial institutions to refine their climate policies and strategies. The Paris Agreement Capital Transition Assessment (PACTA) tests, which utilise an open-source methodology, offer a useful means for jurisdictions to assess the climate alignment of financial institution portfolios in a comparable manner. If the results are disclosed, these tests can even enable cross-jurisdictional comparisons. They allow for an evaluation of whether the commitments made by financial institutions are effectively implemented and result in tangible outcomes, such as reduced direct exposures to high-emitting sectors. Several alignment assessment methodologies other than PACTA exist. Such methodologies each make different methodological choices based on different perspectives that make results

currently hard to compare.[27]

However, it is important to note that climate alignment assessments currently only cover listed equity, bonds, and, in some cases, real estate and sovereign bonds, which represent only a portion of the total investment value of financial institutions. Non-listed financial products (e.g. private equity) and other off-balance sheet activities (e.g. facilitated emissions) are not adequately considered. At present, jurisdictions tend to offer these assessments on a voluntary basis, without requiring financial institutions to disclose their results, or only allow access to aggregate results for progress assessment. As a result, the ability of the general public to assess the progress of individual institutions is often limited. Furthermore, there are limitations regarding the completeness and quality of the voluntarily uploaded data from financial institutions, as they may choose to upload only selected portfolios, and the data lacks verification. Climate alignment tests are inherently forward-looking and quantitative, providing snapshots of specific points in time, and may be less suited to capturing qualitative information. However, they can be complemented by qualitative questionnaires that help capture the efforts made by financial institutions in terms of strategy (e.g. engagement with portfolio firms), processes, governance and risk management.

To address these complexities and broaden the scope of climate alignment assessments, various considerations warrant attention. The diversity of methodologies employed by different assessments introduces disparities in results, emphasising the need for harmonisation and standardisation. Furthermore, the global applicability and legitimacy of these initiatives require careful cultivation, considering their predominantly developed-country origins. Leveraging existing international frameworks and business standards, like the OECD’s Responsible Business Conduct Due Diligence Guidance, can enrich assessments while promoting consistency.

Ultimately, embracing a comprehensive approach is crucial. Alongside GHG-based indicators, a holistic dashboard of finance-related indicators, encompassing climate solutions’ scalability and resilience, can provide a nuanced perspective. Furthermore, assessing alignment from both mitigation and resilience angles and expanding coverage to underrepresented asset classes, including private equity and sovereign bonds, are vital steps in ensuring environmental integrity and policy relevance. As these methodologies evolve, clear guidance on emission reduction targets, offset treatment, and scenario variability is indispensable to strengthen their effectiveness and impact in navigating the financial sector towards climate goals.

Box 5: Paris Alignment Initiative

The Paris Alignment Initiative was launched by Switzerland and the Netherlands at the United Nations Secretary-General (UNSG) Climate Action Summit in 2019. It calls upon UN member states and financial institutions to pledge their commitment to assess and monitor the climate impact and alignment of their financial flows with the 1.5°C target of the Paris Agreement. The initiative aims for a minimum review of 50 percent of total portfolios, with the ultimate goal of achieving 100 percent coverage over time. A key component of this initiative is conducting climate impact assessments based on the open-source PACTA methodology and exchanging best practices. To date, several states and subnational actors have conducted PACTA tests[28], but only some are official members of the initiative[29].

[27] See also OECD (2022), “Assessing the climate consistency of finance: Taking stock of methodologies and their links to climate mitigation policy objectives”, *OECD Environment Working Papers*, No. 200, OECD Publishing, Paris, https://doi.org/10.1787/d12005e7-en.

[28] Austria, Brazil, Colombia, Denmark, Finland, France, Italy, Japan, Liechtenstein, Luxembourg, Mexico, Norway, Peru, Spain, Sweden, Switzerland, UK, State of California, New York State, and EIOPA.

[29] Denmark, Italy, Liechtenstein, Luxembourg, Netherlands, Norway, Spain, Sweden, and Switzerland.

4.5. Enhancing transition plan assessment with AI

Artificial Intelligence (AI), with strong safeguards and subject to the quality of data that is fed, could be used to scrutinise transition plans and climate-related commitments in the financial sector, and thus have a transformative impact on the financial sector. AI is increasingly recognised as a tool that can be used to scrutinise these essential documents. Recent initiatives, such as the collaborative project between WWF, the University of Zurich, and the University of Oxford, are positive examples of AI-driven innovation that aims to automate and refine the scrutiny of transition plans.

By harnessing advanced machine learning, data analytics, and natural language processing, AI can process large datasets, identify alignment with science-based targets, and gauge the feasibility of achieving net-zero emissions by 2050. It can be used as one tool to ensure that companies are not engaging in greenwashing.

Speed is another benefit of AI in this context. It can quickly assess numerous transition plans, enabling a more comprehensive analysis within the financial landscape. AI is also invaluable for market conduct authorities, offering automated tools to screen for misleading claims and statements. Financial supervisors can utilise AI to assess risk exposure at a granular level and push for more ambitious transition plans.

4.6. Conclusions and recommendations for further work

This section has provided an overview of approaches that can help evaluate the credibility, ambition, and progress of the private sector. While each approach has its own merits in assessing targets and transition plans, they also come with certain limitations of which stakeholders should be mindful. Here is an overview of key dimensions where gaps remain, indicating areas where further work might be warranted:

- **Comparability and consistency**: The ability to compare the ambition and progress across institutions, sectors and jurisdictions will remain at the core of any assessment of climate efforts. Disclosure requirements and standards, as well as verification, validation and assurance can contribute greater consistency in disclosures, but usually cannot ensure full comparability. Discrepancies between carbon accounting methodologies and the flexibility offered by target setting frameworks with respect to assumptions and methodologies also hinder full comparability. Promoting full transparency on methodological assumptions is therefore paramount. Initiatives such as the NZDPU, due to their easy-to-use interface, can promote greater comparability in a way that might allow for better assessments of the ambition of company targets. They are nonetheless strongly reliant on global efforts to ensure disclosure consistency or at least to map out discrepancies.

- **Coverage**: Many initiatives only allow for partial assessments of transition efforts, especially with respect to the type and number of institutions covered or the limited asset coverage (e.g. assets under management, types of financial assets). Policymakers have a role to play in promoting the active use of new data platforms such as the NZDPU, common methodologies for additional asset classes and disclosures more broadly.

- **Data quality**: Verification and assurance are important to ensure a minimum level of data quality and consistency. In line with Principle 8 of the 2022 IPSF Transition Finance Report, engagement among stakeholders – including verification providers, fund raisers, financial institutions – needs to be strengthened to collect the accurate data calculated with the appropriate methodologies. Efforts by the IAASB to develop standards that would ensure baseline sustainability assurance standards is a welcome step towards strengthening data quality.

- **Comprehensiveness**: Initiatives vary in terms of the breadth of indicators that they recommend. They also have tended to focus on emissions and emissions targets in a first step, but should also attempt to capture other useful indicators of commitment and ambition, even if they are of a more qualitative nature. Combining various indicators will also be important when assessing commitment credibility, ambition and progress.

- **Cost and accessibility**: Allowing for a wide range of stakeholders to mainstream climate considerations into their decision-making will be key to accelerating the transition. Easy and open access to climate data will be essential and will be facilitated by the NZDPU. Nonetheless, it will remain important to provide the necessary support, capacity building and proportional approaches to lower the disclosure burden for smaller firms and in developing country contexts.

- **Assessment of the ability to deliver**: Commitments and targets will need to be matched with more concrete strategies, plans and processes to be credible. Ensuring transparency at regular intervals with respect to transition plans will be essential to assess whether forward-looking commitments are accompanied with credible actions.

- **Progress tracking ability**: Initiatives that allow to track progress over time in an easy way and adequately take past efforts into account, notwithstanding potential restatements, will be important. The NZDPU will facilitate progress tracking, in particular for quantitative indicators such as emissions. Climate alignment assessments, notwithstanding their various methodologies, can help assess progress of institutions over time if such assessments are carried out at regular intervals.

Notwithstanding the gaps and challenges highlighted, combining multiple approaches and leveraging the work of various initiatives can foster cross-pollination and strengthen the existing architecture for evaluating companies' transition efforts over time. It is essential, however, that these approaches are complementary, interoperable, and converge on a core set of metrics for disclosures. This will prevent global fragmentation and ensure comparability across assessments. For example, the guidance, recommendations, and best practices provided by different initiatives can be instrumental in defining robust indicators of best practices. These indicators and elements of credibility can then be integrated into the NZDPU.

II. Use cases and practical examples

The IPSF recognises the value of presenting use cases to demonstrate the practical application of transition finance. This interim report incorporates several initial use cases to exemplify real-world scenarios. These instances encompass the EIB Group's Paris Alignment for Counterparties (PATH) Framework, the EBRD's step-by-step approach to transition planning tailored for emerging and developing markets, and insights from Japan's Transition Finance Model Project.

In subsequent phases, following this interim report, the IPSF would aim to extend its efforts in exploring additional use cases and practical examples. This may include a more detailed examination of the orchestrated phase-out of coal[30] and further exploration of instrument-based examples for financing transition. Notably, the IPSF will ensure complementarity with the work of the G20 SFWG. This could involve a closer examination of various financial instruments such as green and transition bonds/lending (use-of-proceed type instruments), sustainability-linked bonds/lending (KPI-linked instruments), and equity-related instruments encompassing both active and passive strategies. The exploration may also touch upon blended finance mechanisms.

1. The EIB Group's Paris Alignment for Counterparties (PATH) Framework

Published in 2021, the EIB Group's PATH framework[31] considers the Paris alignment of the wider activities of its counterparties in addition to the Paris alignment of the operations financed by the EIB. The PATH framework focuses on high-emitting counterparties (including those in hard-to-abate sectors) as well as those exposed to a high degree of physical risk from climate change. It ensures that EIB counterparties are taking steps towards decarbonising their business activities and strengthening their resilience to climate change.

The PATH framework builds on (anticipated) regulatory requirements and promotes transparency by requesting its counterparties to develop and publish decarbonisation/resilience plans and reports in line with the TCFD recommendations if they do not already have them in place. Decarbonisation plans would need to contain short to mid-term quantitative emission reduction targets as well as options over a longer time horizon to achieve carbon neutrality towards mid-century, with pathways compatible with 1.5°C goal or with information on how the entity plans to adjust to get to such a pathway. This allows EIB to encourage and support its clients in ambitious decarbonisation, even in the hard to abate sectors, where low carbon solutions are not yet widely available. The PATH framework also identifies a number of incompatible activities, such as making investments in new thermal coal mines, where the EIB in general will not support a project with corporates that continue to engage in these activities.

2022 was the first full year of implementation of the PATH framework. During that year, 19 corporate clients and 64 financial intermediaries were screened in for further assessment of their alignment strategy and public disclosures, according to the PATH framework. Following the assessment, five of the corporates were contractually required to publish their decarbonisation plans and one to develop and publish its physical climate risk management capacity. Of the 64 financial intermediaries, 48 were contractually required to publicly disclose in line with the recommendations of the TCFD.

The EIB simultaneously provided advisory support for some counterparties. The first advisory assignments were initiated in the European Union, through the InvestEU Advisory Hub. These included supporting a leading Italian manufacturer of wood-based products in the development of a corporate decarbonisation plan, considering its additional corporate exposure to the chemicals sector (classified as high-emitting).

It is clear that the PATH framework will need to change over time, reflecting the changes in EU legislation, global

[30] In this context, the IPSF would take into account relevant initiatives, including the Coal Transition Accelerator (CTA) as announced at COP28.

[31] See link.

climate policies, latest scientific knowledge and the progress of EIB's counterparties against the goals of the Paris Agreement and stakeholder expectations, as well as lessons learned during the application of the framework – but it will remain core to supporting our clients in their transitions.

2. Step by step approach to transition planning for the emerging and developing market context

In 2021 the Board of Governors of the EBRD approved a commitment to align the EBRD's activities with the goals of the Paris Agreement. Engagement on transition planning with the EBRD's clients in the financial institutions sector is an important part of how EBRD aims to meet this commitment.[32]

The EBRD's diverse client includes banks of different sizes, spanning across different jurisdictions in emerging and developing countries. For this reason, the EBRD expects that the shape and form of transition plans of their partner financial institutions will depend on the organisation's transition stage. The EBRD's methodology differentiates between three stages of climate practices, labelled as "early stage", "developing practice", and "advanced practice". In their engagements with clients, they work on understanding the baseline level of climate practices of their counterparties, and then encourage banks to make realistic step-by-step improvements from this baseline.

The EBRD is still testing its approach, with a determination to adapt, based on early experiences with clients and developments in the external environment on transition planning. Their early engagement experiences have generally been with banks which are at very early stages of incorporating climate change in their business practices. They expect banks to (i) make a clear commitment to Paris alignment, (ii) put together an action plan outlining how they aim to improve their climate practices within two years, and (iii) disclose core elements of the plan. Consider Xac Bank, the EBRD's long-standing client in Mongolia. With the support of the EBRD's Corporate Climate Governance Facility, the bank is being supported by consultants in their transition planning, starting with understanding climate risks affecting them.

The lack of approaches to transition planning for emerging and developing countries is an obstacle for institutions in these regions in taking meaningful action on climate change. Most advice on climate risks and opportunities, and on transition planning, is made by and for large global banks and corporations. Faced with less knowledge on climate change, with less climate-related data, and also less capacity to generate this data, banks in emerging and developing countries need more guidance on what elements of transition planning they should prioritise immediately, and what elements can be tackled at a later stage. The debate on the credibility of transition plans will also need to be adjusted for emerging and developing countries, where transition plans are expected to be largely qualitative in the next years.

3. Japan's Transition Finance Model Project

In Japan, METI provides subsidies for the assessment costs for cases conforming to its Basic Guidelines, which serve as good models in issuing transition finance instruments through its Transition Finance Model Project. The project has certified 21 projects from various industries, such as steel, shipping and aviation, gas, power, and other hard-to-abate sectors. Combined with the creation of relevant guidelines and roadmaps, the cumulative amount of transition finance issued in Japan surpassed 1 trillion yen (approximately USD 6.7billion) in 2023.

In terms of the approval process, second-party opinion providers – who are consulted by the issuer – summarise the feature of a particular transition finance issuance and prepare the application for subsidies. Based on the application, a reviewing committee comprised of experts, such as university professors, evaluates its credibility. Subsidies are provided for expenses associated with second party evaluation for approved cases. METI

[32] For more details, see the *Methodology to Determine Paris Agreement Alignment of EBRD Investments* available here.

summarises and publishes the outline for approved cases to improve the quality of the transition finance market.

FY 2021

Companies	Industry		
1. Nippon Yusen Kabushiki Kaisha	Shipping	Overview	Second Party Opinion
2. Mitsui O.S.K. Lines, Ltd.	Shipping	Overview	Second Party Opinion
3. Kawasaki Kisen Kaisha, Ltd.	Shipping	Overview	Second Party Opinion
4. JFE Holdings, Inc.	Iron and steel	Overview	Second Party Opinion
5. Japan Airlines Co., Ltd.	Aviation	Overview	Second Party Opinion
6. Sumitomo Chemical Co., Ltd.	Chemicals	Overview	Second Party Opinion
7. Tokyo Gas Co., Ltd.	Gas	Overview	Second Party Opinion
8. JERA Co., Inc.	Power generation	Overview	Second Party Opinion① Second Party Opinion②
9. IHI Corporation	Heavy industry	Overview	Second Party Opinion
10. Osaka Gas Co., Ltd.	Gas	Overview	Second Party Opinion
11. Mitsubishi Heavy Industries, Ltd.	Heavy Industry	Overview	Second Party Opinion
12. Idemitsu Kosan Co., Ltd	Petroleum	Overview	Second Party Opinion

FY 2022

Companies	Industry		
1. Hokuriku Electric Power Co.	Power generation and retail	Overview	--
2. TOHO GAS Co., Ltd.	Gas	Overview	Second Party Opinion
3. Tokyo Gas Co., Ltd.	Gas	Overview	Second Party Opinion
4. Kirin Holdings Co., Ltd.	Foods	Overview	Second Party Opinion
5. Japan Airlines Co., Ltd.	Aviation	Overview	Second Party Opinion

III. Conclusions

This interim report provides a comprehensive description through the complex landscape of climate transition finance, unveiling the intricate challenges, the pressing needs, and promising opportunities it presents. It underscores the urgency of transitioning to a low-carbon, climate-resilient future while dissecting the nuances that underpin this transformative process.

Throughout this report, we have consistently referenced the Principles of the 2022 IPSF Transition Finance Report. These Principles have served as a foundational framework guiding our analysis. They have been key in shaping the structure and content of this new report, helping us address the critical elements of transition finance. By continually linking our findings to these Principles, we have maintained a strong connection to the work previously undertaken by the IPSF to advance transition finance.

Transition plans are emerging as pivotal in transition finance. As a part of corporate strategy, they can guide companies and financial institutions toward a more sustainable path. Transition plans embody commitment, transparency, and accountability in the journey to mitigate climate change. They offer a structured approach for organisations to navigate the complex challenges of the transition, outlining concrete strategies, targets, and actions that bridge the gap between intent and implementation. Importantly, they provide a credible basis for financial institutions to channel investments toward companies that need finance to reduce their carbon emissions, and empowers investors to evaluate the credibility and ambition of these efforts.

Moreover, the disclosure of transition plans fosters transparency. Emerging best-practice frameworks encourage financial institutions and companies within the broader economy to disclose their climate-related risks and opportunities, enabling stakeholders to make informed decisions. Transition plans are hence not merely a piece of the climate finance puzzle; they are a cornerstone.

Looking ahead, the development and implementation of transition finance frameworks will require collaboration among regulators, financial institutions, and businesses to overcome any challenges. As the report covers numerous sectors and jurisdictions, it reveals a multitude of emerging issues for further consideration. For example, challenges remain in quantifying emissions reductions, addressing the nuances of supporting the decarbonisation of hard-to-abate sectors, and accommodating differing regional contexts. Achieving international harmonisation in the structure and reporting of transition plan disclosure frameworks will be essential for fostering comparability and consistency. Furthermore, the development of disclosure frameworks must support a global transition, enabling the provision of finance to businesses of all sizes and in all regions. Special attention should be given to emerging and developing markets, where capacity building and tailored approaches will be vital in supporting climate action.

By continuously linking our discussions to the previously established Principles in the 2022 IPSF Transition Finance Report, we have ensured that the work presented in this report is firmly grounded within this framework of transition finance. This report not only builds on previous efforts by the IPSF but also identifies areas where the IPSF can further contribute to the advancement of transition finance, based on the evolving landscape and the challenges we have identified. It sets out the idea that the work is far from complete. To advance the discourse on transition finance, a number of potential areas for further work are laid out, in particular where the IPSF could make meaningful contributions to enable progress:

1. **Monitoring developments on tools and pathway approaches to setting climate ambition and benchmark against:** IPSF to monitor progress to develop guidance for corporates on the different tools and pathways available that inform climate ambition. In the absence of sufficient guidance, IPSF members may consider best practice guidance on how different tools can be used in conjunction, in a way that enables a whole-of-economy transition to net zero.
2. **Development of further international guidance to support comparability and consistency of transition plan disclosures:** We recommend that ISSB consider developing further guidance for the disclosure of transition plans as part of broader sustainability reporting, building on existing work. This

should help to promote comparability and consistency of disclosures.

3. **Empowering emerging and developing countries:** Recognising the particular challenges faced by emerging and developing countries, the IPSF could seek to develop tailored approaches to transition finance. This further work would look to identify, bring together and build on ongoing initiatives around approaches to transition plans and finance in emerging and developing countries, avoiding duplication of work.

4. **Developing frameworks that enable transition finance to scale with integrity:** IPSF will continue to monitor ongoing developments for frameworks that embed credibility within the transition finance process and consider where further guidance on core metrics and KPIs, and their use to support transition finance, might be necessary to enable it to scale with integrity and effectively.

5. **Monitoring for tangible impact:** In view of the importance of a comprehensive monitoring framework for transition finance, the IPSF could promote guidelines and best practices for monitoring the progress of transition plans and the flow of capital to companies that are transitioning. IPSF members will continue discussing and sharing views on possible local or international measures that may be influencing the ability of firms to access finance.

This report hence outlines a number of areas for advancing the field of transition finance and setting the agenda for the IPSF.

Moving through the dynamic terrain of transition finance, this report highlights the important role of sustainability reporting, climate data platforms, and comprehensive transition plans. Collaboration among various initiatives and frameworks is paramount to prevent fragmentation and ensure a united front in assessing climate efforts. In the face of the global climate crisis, transition finance plays a crucial role in bridging the gap between ambition and action. Transition finance, anchored by robust and credible transition plans, holds the promise of aligning economic prosperity with environmental sustainability. This report serves as a guide, providing insights for the road ahead and contributing to a more sustainable, climate-resilient future. It serves as a resource for stakeholders in the financial, regulatory, and corporate sectors, offering insights to navigate the evolving landscape of climate transition finance.

IV. Annexes

Annex 1: Credible transition finance process steps

	Process step		Relevant content	Comments/Gaps/Questions
Credibility	**Opportunities**	*Assessing transition needs, considering how to respond to, prepare for and contribute to a rapid and orderly whole-of-economy transition to net zero*	Principles: G20 (2022; 2023); IPSF; OECD Frameworks: ACT; CBI; CSL; SBTi; CDP; JETP; EU PSF Reports: IPCC AR6 Credible use of credits/offsets: VCMI	*Is there sufficient Government action / direction? If not, what should corporates 'respond to'? And how should corporates 'have regard to' Paris if they lose confidence that 1.5°C is achievable?* *International Fora/collaborators: G7, G20, OECD, CBI*
	Ambition	*Setting climate ambition with regard to the Paris Agreement and relevant national commitments*		
Disclosing	**Planning**	*Developing and disclosing a robust transition plan as part of mainstream financial reporting*	Frameworks for disclosure: - TCFD; TCFD guidance on metrics, targets and transition plans - ISSB (ED of S2) - ESRS - TPT (Disclosure Framework guidance) - NZPDU	*We should be able to rely on standards/initiatives such as ISSB, ESRS, TPT to deliver a coherent framework for transition plan disclosures. That said, are there areas in which we should encourage more sector-specific guidance, including in respect of metrics/KPIs?* *International Fora/Collaborators: ISSB, GRI, ESRS/EFRAG, TPT, NZPDU*
	Performance	*Reporting on performance against the plan on an ongoing basis*		
Assessing and financing	**Instruments**	*Issuing credible transition finance instruments to meet financing needs identified in the transition plan*	Credible instruments: - ICMA: Transition Finance Handbook - ICMA: SLB Principles - LMA: SLL Principles - Portfolio scoring (e.g Swiss Climate Scores) - EU GBS	*How can regulators work with industry to design/ensure the availability of credible transition finance instruments and practices that: (i) can scale with integrity; and (ii) align with regulators' and investors' needs and expectations?* *Collaborators: ICMA*
	Expectations	*Meeting investors'/lenders' needs and expectations*	Investors'/lenders' expectations: - IIGCC - ClimateAction100+ - GFANZ (cfr. the following report) - TPI - WBCSD Guidance on avoided emissions	*Can we identify the appropriate pathways/metrics/KPIs that should be used to benchmark performance and give investors confidence to invest in the transition?* *Collaborators: GFANZ; IIGCC; TPI, EIB*
	Benchmarking	*Benchmarking performance against relevant sectoral pathways*		

Annex 2: Implications of IPSF transition finance delivery principles for the credible transition plan content and implementation

Theme	Principle	Sub-principle	TP Content: implication for reporting entity		TP implementation: implications for building the ecosystem
			Success factors for 'ambition' process step	**Success factors for 'plan' and 'performance' process steps**	
Targets	1. The (collective) goal is to keep global warming to 1.5°C	1.1. Scientific community sets 1.5°C aligned criteria that companies and financial market participants can benchmark their KPIs against	Internal targets should be set with reference to/benchmarked from external targets		Top-down sector targets are needed to enable entities to align targets with sector pathway
		1.2. Recognition of regional differentiation in transition target setting			
		1.3. Tailoring transition targets and metrics by use(r)			
	2. Targets must embed deep, rapid and sustained change	2.1. Targets will be differentiated by sector			
		2.2. Targets extend to 2050	Targets should extend to 2050 and include interim targets		
		2.3. Targets will be differentiated according to transition technologies	Need to describe the overall impact of existing age/technology profile on targets		Sector targets should be clear on the age/technology profile benchmark used
		2.4. Transition targets should address all material emissions	target setting should include all material scope 1, 2 and 3 emissions		Further guidance needed on overcoming practical challenges on calculating scope 3 emissions
		2.5. Verified/certified offsets are for last mile emissions	Transition targets should focus on reducing emissions rather than relying on offsets.		A need for high-quality and credible carbon offsets
	3. Transition is all-encompassing	3.1. All material economic sectors need transition targets			All sectors must produce transition plans
		3.2. Challenge is for everyone			All entities have a part to play in the transition, irrespective of their current transition status
		3.3. Recognise different stages of	TP should enable users to identify		An agreed taxonomy is needed to

Theme	Principle	Sub-principle	TP Content: implication for reporting entity		TP implementation: implications for building the ecosystem
			Success factors for 'ambition' process step	Success factors for 'plan' and 'performance' process steps	
		transition	which stage of transition the reporter is at		standardise reporting of progress against sector pathways
	4. The climate mitigation transition must be compatible with other environmental and social goals	4.1. Transition criteria can marry multiple objectives	TP objectives should, at a minimum, avoid harming the achievement of other objectives (including social and environmental)		
		4.2 The transition has to be just			
Delivery	5. The transition plan is sufficiently comprehensive to be credible	5.1. Plan provides sufficient information to assess delivery capability		Transition plans need to include both concrete transition targets and a credible strategy to meet those targets	
		5.2. The transition plan has no material omissions		All material activities should be covered by the TP	
		5.3. The transition plan covers the short-, medium- and long-term		the TP should cover the full timeframe	
	6: Put in place strong internal governance	6.1. Board level oversight		TP should describe board level oversight	
		6.2. Internal policy alignment		TP should describe how internal polices support transition	
		6.3. Internal monitoring and correction mechanisms in place		the TP must be a living strategy, subject to regular re-evaluation and updating	
	7: Promote active external engagement to create enabling environment	7.1. Supply chain engagement		The TP should describe external engagement with key stakeholders, including supply chain partners	
		7.2. Client engagement by financial market participants		Financial sector reporters should describe client engagement in their TP	
	8: External reporting	8.1. Comparable transparency		Organisations should publicly	

Theme	**Principle**	**Sub-principle**	**TP Content: implication for reporting entity**		**TP implementation: implications for building the ecosystem**
			Success factors for 'ambition' process step	**Success factors for 'plan' and 'performance' process steps**	
	and engagement	over transition plans		disclose their transition plans in a way that makes them comparable External reporting on those plans should be done on annual basis	
		8.2. Verification			An ecosystem of verifiers and standardised approach to verification is needed
		8.3. Interactive communication mechanism between stakeholders			Need engagement between all stakeholders to develop and share best practice
	9: Credible assessment mechanisms	9.1. Transparent and consistent assessment mechanism/certification schemes are needed			Consistent assessment methodologies to reduce subjectivity is needed

Annex 3: Mapping of Transition Plan success factors against relevant transition plan frameworks

	Relevant process step	EU ESRS adopted by the European Commission on 31 July 2023	UK Transition Plan Taskforce Disclosure Framework (October 2023)	OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)	EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)
Internal targets should be set with reference to/benchmarked from external targets	Ambition	ESRS do not contain substantial requirements for companies to adopt transition plans or to set targets. (ESRS are disclosure requirements). However, if a company has adopted a transition plan it shall provide disclosures to understand its mitigation efforts to ensure that the company's business model and strategy are sustainable and compatible with the Paris Agreement and the objective of achieving climate neutrality by 2050 in relation to European Climate Law. (ESRS E1 para 16) sets out detailed disclosure requirements on transition plans and para 34 specifically on targets, which should be gross GHG emission reduction targets.	The framework includes disclosure requirements and does not specify a level of ambition. It is designed to build on and supplement IFRS S2. It uses the concept of a 'Strategic Ambition' (which should be anchored in corporate strategy) as the basis for internal target setting. The framework requires disclosure of the extent to which the entity's Strategic Ambition is aligned with "*any external requirements, commitments, science-based targets, transition pathways, roadmaps, or scenarios*" and alignment of metrics and targets with latest agreements on climate change.	Element 1: a corporate transition plan will set out its net-zero targets, in line with the temperature goal of the PA. Targets will specify the underlying assumptions and methodologies, and in particular how they relate to the selected global temperature goal. Targets are set based on science, i.e. in a manner consistent with the IPCC Special Report on Global Warming of 1.5°C, to ensure no or limited overshoot of 1.5°C globally above pre-industrial levels. The plan will include an explanation as to how the targets compare to the relevant NDC and national net-zero target, if any.	Para 4.10 requires a mid-term, rolling, quantitative emission reduction target. Para 4.11 states that in order to be on track, decarbonisation should take place at 4.2% on an annual linear basis. (Global emissions need to fall by that rate from 2020 in order to limit the annual mean global temperature increase to 1.5°C)
Targets should extend to 2050 and include interim targets		ESRS E1 article 34 (e): GHG emission reduction targets shall at least include target values for the year 2030 and, if available, for the year 2050. From 2030, target values shall be set after every 5- year period thereafter. Moreover, the company shall	Does not specify target dates but includes a requirement to disclose target dates including short, medium and long term targets.	The target dates for achieving net zero may vary by sector and jurisdiction, as achieving net zero by 2050 globally can entail different levels of effort by different sectors and industries, and commitments by national jurisdictions vary. It is important for companies that choose a below 2°C scenario to	The EIB PATH Framework requests the following two elements in a decarbonisation plan: 1. A mid-term, rolling, quantitative emission reduction target (e.g. 5 to 10 years into the future – i.e. aligned to the typical financial

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		disclose its current base year and baseline value, and from 2030 onwards, update the base year for its GHG emission reduction targets after every five year period thereafter.		provide a reasoned and detailed justification to explain why being consistent with a 1.5°C scenario is not possible for them. Long-term targets should be accompanied by interim (e.g. 3/5 years) quantifiable, detailed and time-bound targets, which should reflect the need for global GHG emissions to peak by 2025.	relationship through an EIB corporate loan); 2. Options over a longer time horizon to achieve carbon neutrality towards mid-century.
Target setting should include all material scope 1, 2 and 3 emissions and activities		ESRS E1 para 34 (b): GHG emission reduction targets shall be disclosed for Scope 1, 2, and 3 GHG emissions, either separately or combined. The undertaking shall specify, in case of combined GHG emission reduction targets, which GHG emission Scopes (1, 2 and/or 3) are covered by the target, the share related to each respective GHG emission Scope and which GHGs are covered.	Requirement to disclose any targets for scopes 1,2 and 3 emissions reduction. The framework also requires disclosure of non-GHG targets including operational and engagement targets.	Credible targets will cover emission scopes 1, 2 and, as a rule, 3.	Guidance to counterparties indicates that targets should cover 95% of scope 1 and 2 emissions for all counterparties and in addition two thirds of scope 3 emissions for counterparties in airports, commercial vehicles, passenger cars and integrated oil and gas. (SBTi Corporate Manual Version 2.0 December 2021)
TP should enable users to identify which stages of transition the reporter is at, including the impact of its current technology profile		Since ESRS are about the disclosures on companies' sustainability impacts, risks and opportunities in an annual sustainability statement. ESRS disclosure requirements are not linked to / limited to those in climate change transition plans, which would be too narrow. For example ESRS2	The framework requires comprehensive disclosures to enable the user to assess their stage of transition compared to their own Strategic Ambition. This includes requirements to disclose implications on business model, and actions an entity is taking or plans to take in its business operations and	The transition plan will articulate the transition risks and opportunities that the company expects to face in the short-, medium- and long-term, as well as any foreseen limitations, constraints, and uncertainties to the achievement of the plan's targets. Assessing the	Transition plan has to be made public which would provide information to users on what stage of the transition the entity is at.

	Relevant process step	EU ESRS adopted by the European Commission on 31 July 2023	UK Transition Plan Taskforce Disclosure Framework (October 2023)	OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)	EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)
		para 48 (b) is relevant here but it is not included in a transition plan: a company shall disclose: the current and anticipated effects of its material impacts, risks and opportunities on its business model, value chain, strategy and decision-making, and how it has responded or plans to respond to these effects, including any changes it has made or plans to make to its strategy or business model as part of its actions to address particular material impacts or risks, or to pursue particular material opportunities.	products and services to achieve their Strategic Ambition.	likelihood of achieving the plan's targets using multiple climate-related scenarios, whenever feasible, will increase the plan's credibility.	
Transition targets should focus on reducing emissions rather than relying on offsets.		In ESRS, "GHG emission reduction" is a defined term and is gross without any offsetting. (Offsetting can only be considered in relation to net-zero targets or GHG climate neutrality claims (see ESRS E1 para 60 and 61). Definition GHG emission reduction in Annex II of the Delegated Act: Decrease in the undertaking's Scope 1, 2, 3 or total GHG emissions at the end of the reporting period, relative to emissions in the base year. Emission reductions may result from, among others, energy efficiency, electrification, suppliers' decarbonisation, electricity mix	The framework advocates a 'strategic and rounded approach' to transition planning, including an explanation of how- an organisation will meet climate targets and contribute to the economy-wide climate transition. It also requires detailed disclosures about any carbon credits used. The framework also states that "good practice transition plans… should prioritise decarbonisation through direct abatement over purchasing carbon credits".	A credible transition plan will not consider carbon credits and offsets as an alternative to cutting a company's emissions today or as a reason for delayed mitigation action, but rather as part of the portfolio of solutions to accelerate the pathway to net zero. Best practices for transition plans that do consider the use of offsets include explicitly describing any intended use of carbon credits and offsets, the basis for their carbon removal, the applicable verification or certification scheme, the quality criteria to be used to assess credibility of offsets, and	According to para 4.13 *"The role of offsetting in the plan should be clearly presented, in particular where reliant on the voluntary carbon market. In line with good practice, corporate plan should clarify whether offsets are used to supplement, rather than substitute for, reductions in emissions within the corporate value chain – and the impact of offsetting on the proposed target. Plans should be clear about the criteria/approach to be used to source offsets."*

	Relevant process step	EU ESRS adopted by the European Commission on 31 July 2023	UK Transition Plan Taskforce Disclosure Framework (October 2023)	OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)	EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)
		decarbonisation, sustainable products development or changes in reporting boundaries or activities (e.g., outsourcing, reduced capacities), provided they are achieved within the undertaking's own operations and upstream and downstream value chain. Removals and avoided emissions are not counted as emission reductions.		considering not including them in the GHG inventory and as a contribution to GHG targets. Best practices also include providing an explanation of the additionality and permenance of the offsets, the extent to which they are being used as a last resort and clearly stating the share of emissions to be mitigated using offsets (which should decline over time) and their explicit role in the company's mitigation strategy.	
TP objectives should, at a minimum, avoid harming the achievement of other objectives (including social and environmental)		ESRS is much broader than a climate change transition plan. ESRS cover all ESG sustainability matters. Therefore, an ESRS sustainability statement provides disclosures about all material impacts, risks ad opportunities of all material ESG matters.	Includes requirements to disclose "*whether and how the entity is pursuing these objectives and priorities in a manner that captures opportunities, avoids adverse impacts for stakeholders and society, and safeguards the natural environment*", including the process by which these impacts have been identified, assessed and taken into account.	A transition plan should consider not only mitigation targets but also adaptation and other environmental and social objectives. Credibility can be increased by articulating how the company intends to apply the DNSH Principle, both at activity- and entity-level.	Do No Significant Harm to Adaptation is covered if counterparties screened in for high physical climate risk are required to develop a resilience plan. For the time being, compatibility with other environmental & social objectives not specifically required however many elements covered by EIB's Environmental & Social Standards.
Transition plans need to include both concrete transition targets and a credible strategy to meet those targets	Plan and Performance	Climate TP needs to include GHG emission reduction targets, an explanation of how the undertaking's targets are compatible with the limiting of global warming to 1.5°C in line with the Paris Agreement. Disclosure Requirement E1-4	Requirement for the TP prepared to disclose any targets they have and describe in detail the planned actions to meet those targets. This includes implementation actions and engagement actions to support the Strategic	A credible transition plan will set out a clear strategy on the path the company intends to take to achieve its targets. To be credible, a transition plan will set out concrete actions to be taken to achieve the defined targets and the capital	Para 4.10 requires a mid-term, rolling, quantitative emission reduction target. Para 4.11 states that in order to be on track, decarbonisation should take place at 4.2% on an annual linear basis (Global emissions need to fall by that

	Relevant process step	EU ESRS adopted by the European Commission on 31 July 2023	UK Transition Plan Taskforce Disclosure Framework (October 2023)	OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)	EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)
		specify further disclosures on targets related to climate change mitigation and adaptation. Regarding actions ESRS E1-3 requires the company to disclose its climate change mitigation and adaptation actions and the resources allocated for their implementation. Specific disclosures in ESRS E1 para 29 including current and planned key actions and their expected outcome in terms of GHG emission reductions.	Ambition.	investments needed. Connected to the previous point, the plan also will describe any strategy and process for the responsible retirement for high-emitting corporate assets.	rate from 2020 in order to limit the annual mean global temperature increase to 1.5°C). Para 4.12 states that where this is not the case, the company should explain/motivate its existing targets and make reference to future actions on options to accelerate decarbonisation. Specifically, para 4.18 states that corporates would be contractually required to create and publish an alignment strategy, or revise their existing alignment strategy to address the points set out in paras 4.10 to 4.12 and report to EIB accordingly
TP should describe board level oversight		Again, this is part of the broader ESRS remit and not part of a climate change transition plan. The ESRS 2 mandatory GOV(ernance) disclosure requirements including role and responsibilities, incentive schemes, reporting, etc. For the climate change transition plan ESRS E1 para 16 (i) requires to disclose if the transition plan is approved by the administrative, management and supervisory	Requirement to describe Board-level governance of TP	The plan will be subject to board and senior management approval and oversight.	PATH framework does not set out governance requirements apart from TP being made public

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		bodies.			
TP should describe how internal polices support transition		Again, as ESRS are broader than a climate change transition plan. For an ESRS sustainability statement the company shall under ESRS E1 para 22 describe its policies adopted to manage its material impacts, risks and opportunities related to climate change mitigation and adaptation. The disclosure required by paragraph 22 shall contain the information on the policies the undertaking has in place to manage its material impacts, risks and opportunities related to climate change mitigation and adaptation.	Requirement to disclose any policies and conditions that an entity uses or plans to use in order to achieve the Strategic Ambition of its transition plan.	A credible transition plan will be integrated into the corporate business plan and will make direct reference to the company's financial plan and be done concurrently with financial reporting. The transition plan will be linked to the company's purchasing plan for engagement with suppliers, the marketing/sales plan for the engagement with customers as well as be linked to the policy/advocacy plan, for the engagement with trade unions, industry associations, and policymakers.	PATH framework does not set out specific requirements
The TP must be a living strategy, subject to regular re-evaluation and updating		Requirement for explanation of the undertaking's progress in implementing the transition plan. Companies subject to ESRS must publish every year a sustainability statement covering all material ESG related impacts, risks, and opportunities. Specifically on climate change related disclosures ESRS requires updating of GHG targets and baseline values.	Recommendation to update after significant changes or at the latest every three years. Material information should be included in the annual report, and additional periodic stand-alone reports are regarded as best practice.	A credible plan will clearly define a process and responsibilities for regular monitoring and reporting of progress towards targets, as well as for any timely and regular revision and update of this plan (e.g., on an annual basis), to take stock of lessons learnt, revisit assumptions, and identify levers for action, especially in areas that may be falling behind.	The mid-term targets are supposed to be "rolling" and the plan must be public, which implies a "living document". No specific re-evaluation and update

	Relevant process step	EU ESRS adopted by the European Commission on 31 July 2023	UK Transition Plan Taskforce Disclosure Framework (October 2023)	OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)	EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)
The TP should describe external engagement with key stakeholders, including supply chain partners		Stakeholder engagement is a defined term in ESRS. ESRS 2 para 43: The undertaking shall disclose how the interests and views of its stakeholders are taken into account by the undertaking's strategy and business model. Para 44 The undertaking shall disclose a description of: (a) its stakeholder engagement, including: i. the undertaking's key stakeholders; ii. whether engagement with them occurs and for which categories of stakeholders; iii. how it is organised; iv. its purpose; and v. how its outcome is taken into account by the undertaking.	Requirement to disclose engagement with stakeholders including the value chain, industry, government, public sector, communities and civil society.	A whole-of-entity approach will be essential in both the design and implementation of the transition plan, involving all relevant stakeholders (workers, suppliers, consumers, impacted communities, if any, etc.).	According to para 4.14, *"the plan should also indicate to the extent possible how the proposed alignment strategy takes into account of the interests of stakeholders, including in particular social partners. Disclosure on these issues can help inform and shape measures to ensure a just transition."*
Financial sector reporters should describe client engagement in their TP		ESRS do not yet have sector specific standard but the general disclosures on stakeholder engagement would include clients. Stakeholders are a defined term in ESRS and include business partners.	The framework is sector neutral but includes a requirement to disclose engagement with value chain. It specifies that for financial services entities, this includes engagement and, where relevant, other stewardship activities, with investee companies, loan clients and relevant financial market intermediaries. This is supported by guidance for financial services sectors which provides further details on relevant disclosures and signposts sources of additional	Not covered (the Guidance focuses on non-financial corporates)	PATH framework requires financial institutions to report in line with TCFD but does not lay out specific client engagement

	Relevant process step	**EU ESRS adopted by the European Commission on 31 July 2023**	**UK Transition Plan Taskforce Disclosure Framework** **(October 2023)**	**OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans (October 2022)**	**EIB - The EIB Group PATH Framework - Supporting counterparties on their pathways to align with the Paris Agreement (version 1.1 October 2022)**
			guidance.		
Organisations should publicly disclose their transition plans in a way that makes them comparable External reporting on those plans should be done on annual basis		TP publicly disclosed as part of annual sustainability statements prepared under ESRS to target audiences (including affected stakeholders) for each financial year under harmonised EU rules, ensuring comparability of TP.	The framework is intended to enable comparability by providing a set of consistent disclosure requirements which is consistent for all entities. Recommendations to publish transition plan as a standalone document and report against it annually, with material information (including annual progress updates) in general purpose financial reports.	A credible transition plan will contain company commitments to regularly disclose targets (and underlying assumptions) and progress towards their achievement, to both internal and external stakeholders. The company will pursue third-party verification of its plan and related targets.	Decarbonisation plans, resilience plans and TCFD reports need to be made public. External reporting on an annual basis is not requested

Annex 4: Key elements of transition finance frameworks

In October 2022, the **G20 Sustainable Finance Report** introduced a transition finance framework along with recommendations to enhance the credibility of commitments made by private sector financial institutions. Of particular relevance to target-setting by financial institutions are two recommendations:

- **Recommendation 3** – Accompany end-date targets to achieve net zero with science-based, time-bound interim targets that are benchmarked against credible tools, pathways, and frameworks. These interim targets should demonstrate a feasible path towards net zero and ideally include a thorough baseline analysis of current portfolio emissions performed at the time the commitment is made (within two years of making a net-zero commitment). Additionally, adopting an emissions target to be achieved within a certain timeframe, such as a mid-term five-year target, is encouraged. Commitments and targets should be science-based and ideally verified by a third party.
- **Recommendation 7** – Provide publicly available, consistent, and comparable information on metrics, scenarios, methods, and benchmarks used to set targets. Financial institutions that have committed to a net-zero target should disclose a consistent and comparable range of metrics to assess progress in implementing their net-zero strategy and priorities. This may include targets for GHG emissions or intensity reductions, support for climate solutions and sustainable finance, transparency on engagement strategies, and metrics related to portfolio alignment, such as implied temperature rise, internal implementation, and, where relevant, retirement of GHG-intensive assets. The information provided should be interpretable, supported by up-to-date science, transparent in terms of methodology, and consistent over time.

The **OECD Guidance on Transition Finance** outlines ten elements of credible corporate climate transition plans, some of which are relevant to target setting. This guidance emphasises the importance of anchoring transition finance transactions, such as sustainability-linked bonds (SLBs) and transition bonds, in entity-wide net-zero plans that align with the temperature goal of the Paris Agreement. By doing so, the risk of greenwashing in transition finance can be significantly reduced, instilling confidence in investors and promoting market scalability. The guidance recognises the role of existing tools and frameworks in both transition and sustainable finance, such as taxonomies, sectoral pathways, technology roadmaps, and sustainability reporting standards. Leveraging these tools can enhance the credibility and comparability of corporate transition plans, maximising their impact and environmental integrity.

The ten elements of credible corporate climate transition plans identified in the OECD Guidance are as follows:

1. Setting temperature goals, net-zero, and interim targets: Net-zero and interim targets should be science-based, consistent with an IPCC 1.5°C reference scenario, and cover all relevant GHG emissions. Interim targets should reflect the need for global GHG emissions to peak by 2025. In certain justified circumstances, companies may choose reference scenarios consistent with limiting warming to below 2°C.
2. Using sectoral pathways, technology roadmaps, and taxonomies: Net-zero and interim targets should be based on available sectoral pathways, technology roadmaps, and, where possible, taxonomies. The plan should clarify how future operating and capital expenditures will be allocated to achieve these targets.
3. Measuring performance and progress through metrics and KPIs: Climate change mitigation-related metrics and KPIs should cover lifecycle GHG emissions and be measurable and externally verifiable. Targets and reporting should include scope 3 emissions as a rule, and any omissions should be limited, justified, and clearly explained.
4. Providing clarity on the use of carbon credits and offsets: The use of carbon credits and offsets should be limited and carefully explained to mitigate the risk of undermining the credibility of transition plans.
5. Setting out a strategy, actions, and implementation, including preventing carbon-intensive lock-in: A clear strategy and concrete actions should be outlined to achieve the company's targets, including addressing

transition risks and opportunities over time. The plan should assess the risk of carbon-intensive lock-in, provide a responsible retirement plan for high-emitting assets where relevant, and establish mechanisms to prevent lock-in for existing and future assets and infrastructures at risk.

6. Addressing adverse impacts through the DNSH Principle and due diligence for Responsible Business Conduct (RBC): Transition plans should consider not only mitigation goals but also other environmental and social objectives, ensuring no harm is done to them. Conducting risk-based due diligence based on the OECD Due Diligence Guidance for Responsible Business Conduct (RBC) can operationalise the DNSH Principle within transition plans. This helps companies identify, prevent, mitigate, and account for actual and potential adverse impacts associated with their operations, supply chain, and other business relationships.
7. Supporting a just transition: Measures should be taken to mitigate negative impacts on workers, suppliers, local communities, and consumers, in line with relevant International Labour Organisation (ILO) and OECD principles and guidelines. Credible transition plans involve regular, continuous, and inclusive stakeholder engagement and social dialogue.
8. Integrating with financial plans and ensuring internal coherence: The transition plan should be integrated into the corporate business plan, making explicit reference to the company's financial plan. Both plans should be developed concurrently, ensuring coherence.
9. Ensuring sound governance and accountability: A whole-of-entity approach should be adopted to monitor and report on the design and implementation of the transition plan. The plan should be subject to senior management approval and oversight and involve all relevant stakeholders.
10. Transparency and verification, labelling, and certification: Progress on targets should be regularly disclosed, and third-party verification of the plan and its targets should be ensured.

Annex 5: Credible use of high-quality carbon credits, when appropriate and permitted

As mentioned in the 2022 IPSF Transition Finance Report, verified/certified offsets should be used only for last mile emissions and not as a primary part of a decarbonisation strategy.

The Voluntary Carbon Market Integrity Initiative (VCMI) released in June 2023 its Claims Code of Practice which aims to give companies a rulebook to follow for making credible climate claims using carbon credits on their path to net zero. The Claims Code has three tiers of claims that companies can make – Platinum, Gold and Silver, each of which recognises investment in GHG emission reductions and removals above and beyond corporate action to meet their science-aligned targets. These tiers reflect the level of ambition of companies: on the Silver tier, companies purchase high-quality credits for between 20 and 60 percent of remaining emissions after making progress towards decarbonisation targets; the Gold tier requires purchasing between 60 percent and 80 percent of emissions, and a Platinum tier purchase offsets 100 percent or remaining emissions. The steps that a company must undertake to make a VCMI Claim:

- It must first meet VCMI's Foundational Criteria, which serve as the backbone of an ambitious and robust climate strategy.
- It must then select which VCMI Claim to make (Platinum, Gold or Silver).
- To make the claim, the company must select carbon credits which meet stringent quality thresholds in line with the Integrity Council for Voluntary Carbon Markets (IC-VCM) Core Carbon Principles (CCPs).
- The company must disclose information to support its claim and conduct independent validation and assurance in line with the VCMI MRV and Assurance Framework (to be published in November 2023).
- Finally, disclosure and reporting on how a company uses, or plans to use carbon credits to achieve its climate ambition will be an important part of ensuring credible use of carbon credits.

While VCMI focuses on the integrity of the claims made by individuals and businesses buying carbon credits, other initiatives (e.g. The Integrity Council for the Voluntary Carbon Market) stress and look into the integrity of the carbon projects and carbon credits themselves, as only high-quality offsets should be used, following strict quality criteria, no double-counting and requirements regarding additionality as well as measures to address impermanence.