bankenverband

A Practical Overview of Businesses' Transition Plans for Banks

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Frederik Lange
Associate Director
Telephone: +49 30 1663 1563
E-mail: frederik.lange@bdb.de

Torsten Jäger
Director
Head of Sustainable Finance
Telephone: +49 30 1663 2160
E-mail: torsten.jaeger@bdb.de

Translation

Bundesverband deutscher Banken e.V.
Communications
Burgstraße 28
10178 Berlin
Telephone: +49 30 1663-1201 / -1202
bdb-pressestelle@bdb.de
bankenverband.de/newsroom

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Introduction

Initially, the EU sustainable finance framework focused on defining, through the EU taxonomy, which economic activities could be considered "green". Yet, over time, it became clear that this approach was not suitable to achieve our sustainability goals at the required pace. The current debate now focuses more on the transition itself, i.e. moving from the present situation to a more sustainable economy.

Given this shift, transition plans have become a key topic in the political, social and scientific discourse. They are now considered vital instruments for designing an effective and successful transformation. For example, in June 2023, the European Commission published a recommendation on transition financing. It recognised that transition plans were a key element in securing the financing needed for the transformation. The regulatory landscape is also referring increasigly to transition plans. Prominent examples include the Corporate Sustainability Due Diligence Directive (CS3D), the European Sustainability Reporting Standards (ESRS) of the Corporate Sustainability Reporting Directive (CSRD) and the regulatory requirements in the EU banking package. There are also the various voluntary frameworks, such as those from the Glasgow Financial Alliance for Net Zero (GFANZ) and the UK's Transition Plan Taskforce (TPT).

Nevertheless, in the current environment, a great deal of uncertainty still exists among businesses and financial institutions about the benefits of transition plans and how they should be structured. This paper aims to provide a comprehensive review of the current status of transition plans and to identify the key principles of a credible transition plan. The focus here is on the climate transition plans of businesses, which can provide banks with vital information for managing capital and assessing risks.

Translation

What are transition plans?

A climate transition plan is a time-bound action plan of a business, which outlines how the organisation intends to adapt its plants, workflows and its business model to comply with the current ambitious recommendations of climate science to limit global warming to 1.5° C. Depending on the structure, next to containing measures to reduce greenhouse gas emissions, plans also include the steps a business aims to take to achieve greater climate resilience. A transition plan therefore serves as a key strategic timetable for the net zero goals of a business.

A transition plan not only sets out climate goals (e.g. net zero by 2050), but also shows how these goals are to be achieved in the short, medium and long terms. It not only outlines a business's impact on the climate (inside-out perspective). It can also include an evaluation of a business's climate-related financial risks (outside-in perspective) and how the business intends to prepare for them.

As well as real-economy businesses, financial institutions can also use transition plans to communicate their business strategies with regard to the planned transition of their business to a low-carbon economy. Globally active financial institutions usually employ a global, group-wide approach to strategic transition planning. Banks pursue a proactive approach to implementing these plans through various sector-driven initiatives, including the Net-Zero Banking Alliance (NZBA) and the Glasgow Financial Alliance for Net Zero (GFANZ).

Definitions from the relevant bodies on climate plans vary somewhat. However, there is a general consensus among the major bodies, regulators and standard setters on the fundamentals of climate plans (Table 1).

Table 1: Definitions of transition plans from selected bodies

Body	**Definition**
Task Force on Climate-related Financial Disclosures (TCFD)	A transition plan is an aspect of an organisation's overall business strategy that lays out a set of targets and actions supporting its transition toward a low-carbon economy, including actions such as reducing its GHG emissions.
International Sustainability Standards Board (ISSB), IFRS S2	A climate transition plan is an aspect of a business's overall strategy that lays out the business's targets, actions or resources for its transition towards a lower-carbon economy, including actions such as reducing its greenhouse gas emissions.
Transition Plan Taskforce (TPT)	Definition based on IFRS S2, which serves as the basis for the recommendation for a good practice transition plan.
CDP (originally: "Carbon Disclosure Project")	A climate transition plan is a time-bound action plan that clearly outlines how an organisation will achieve its strategy to pivot its existing assets, operations, and entire business model towards a trajectory that aligns with the latest and most ambitious climate science recommendations, i.e., halving greenhouse gas (GHG) emissions by 2030 and reaching net-zero by 2050 at the latest, thereby limiting global warming to 1.5° C.
Corporate Sustainability Reporting Directive (CSRD)/European Sustainability Reporting Standards (ESRS) E1	General reference to the plans and capacity of the undertaking to adapt its strategy and business model, in line with the transition to a sustainable economy and to contribute to limiting global warming to 1.5° C.
Glasgow Financial Alliance for Net Zero (GFANZ)	A transition plan articulates a company's overall approach to the net-zero transition, including information regarding its climate objectives, targets, actions, progress and accountability mechanisms, and helps define that company's overall role and level of ambition in the transition.

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What is the purpose of transition plans?

Transition plans for businesses

The transition plans of businesses have diverse applications and can be used to pursue several goals at once:

- By developing transition plans, business can **translate their net-zero goals into operational steps**. They subdivide usually very comprehensive corporate projects into manageable steps and map them along medium and long-term paths.
- In addition, **the systematic evaluation of risks and opportunities**, which are linked to the transition to net zero, simplifies the planning process (e.g. regulatory changes, market shifts and extreme weather conditions).
- Businesses can also **lend substance and credibility to their voluntary commitments and targets, both internally and externally**, by underpinning the goals they have set with concrete implementation plans.
- In future, drawing up transition plans will likely increasingly serve to **meet regulatory requirements** for certain businesses.
  - For example, in the **Corporate Sustainability Due Diligence Directive (CS3D)**, EU member states are called upon to ensure that businesses within the scope of the directive adopt and implement climate transition plans.[1] Transition plans must be updated every 12 months and include a description of the progress made. In addition, the directive also specifies overarching requirements of such plans.
  - The E1-1 climate standard in the **European Sustainability Reporting Standards (ESRS)**, which specify the content of reporting requirements determined by the Corporate Sustainability Reporting Directive (CRSD), also contain disclosure requirements for transition plans. If a business subject to reporting requirements does not have a transition plan, then it needs to state whether and when it will draw up a plan of this kind.
  - The **EU Green Bond Standard** also contains a link to transition plans. Before issuing an EU Green Bond, issuers must publish a European Green Bond Factsheet, which is checked by an external auditor before being issued. If the issuer has already published a transition plan when the bond is issued, then the issuer must state in the factsheet how and to what extent the revenue from the bond is to contribute to the transition plan. The issuer should also provide a link to the published transition plan.
- Businesses can also use their transition plans to **clarify** their **demand for financial resources** for transitioning their activities and business models. This enables investors and financial institutions to use transition plans from businesses for their investment decisions and to assess transition risks in their portfolios. Conversely, plausible and credible transformation plans help businesses to improve their creditworthiness and financing conditions and increase their long-term competitiveness.

According to the Transition Plan Taskforce, **important stakeholders** that use transition plans include:

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With their forward-looking focus, businesses' transition plans therefore offer an important additional source of information to current sustainability data. Transition plans can be both strategy-focussed and risk-focussed. Businesses can use them to explain how they intend to achieve their goals and commitments in the area of climate mitigation and sustainability and what progress they have already made. Transition plans thus act as a link between the real economy, the financial markets and the supervisory authorities in order to channel capital flows towards climate neutrality and can play a key role in shaping the transition to a net zero future.

Transition plans for financial institutions

Financial institutions can be both authors and users of transition plans at the same time. They use businesses' transition plans for their financing decisions, as outlined above. They can also author their own transition plans, which are based on the plans of their corporate customers.

While financial institutions can generally pursue similar goals as businesses with their own strategy-related transition plans, prudential transition plans also play a role for financial institutions. Supervisory authorities are also an important stakeholder for financial institutions and can use transition plans to assess transition risks. This includes the goal of microprudential supervision to monitor the security and robustness of financial institutions as well as other goals relating to financial stability and market integrity. As a result, prudential transition plans can make a contribution to climate risk analysis, which requires a forward-looking assessment. In particular, banks within the scope of the Capital Requirements Directive (CRD) VI are required to implement transition plans with a supervisory focus on managing climate-related risks. The details are determined by the European Banking Authority (EBA) and the plans are reviewed by the competent authority.

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What is good practice in the drafting of transition plans?

The various advantages of climate transition plans are evident. What is less evident is how to compile them and what information should be included in a credible and robust transition plan. In the following, we outline what guidance already exists and what good practice measures might look like for non-prudential transition plans. We then take a deep dive into the recommendations of the UK's Transition Plan Taskforce (TPT), which is sometimes referred to as the gold standard for transition plans.

What guidance is there already?

There are already numerous initiatives, which outline the requirements for and provide guidance on formulating transition plans. These initiatives can be roughly divided into three categories: regulatory initiatives, standard setters and market-driven initiatives. The following table summarises selected initiatives.

Type	Name	Content
Regulator	Corporate Sustainability Due Diligence Directive (CS3D), Article 15	- Member states are called upon to ensure that businesses within the scope of the directive publish climate transition plans. - This should be done on a 'best-effort' basis and ensure that the business model and strategy of a business comply with statutory climate goals. - It also sets out four general requirements for the design of the plans.
Regulator	Corporate Sustainability Reporting Directive (CSRD), Article 19a	- The CSRD requires businesses within its scope to disclose their plans, including implementation measures and associated financial and investment plans to ensure that their business models and strategies comply with statutory climate goals.
Regulator	Capital Requirements Directive (CRD), Articles 76 & 87a	- Article 76 of the CRD states that member states should ensure that management bodies develop specific plans, quantifiable goals and procedures to monitor and mitigate against the risks arising from short, medium and long-term ESG factors, including risks arising from the transition. - Article 87a states that the competent authorities should evaluate and monitor the development of practices of institutions relating to their ESG strategies and their risk management, including plans to be complied in accordance with Article 76. Furthermore,

		the European Banking Authority (EBA) should draw up guidelines for the content of these plans.
Regulator	Capital Requirements Regulation (CRR), Article 449a	- Article 449a states that institutions must disclose their climate goals and transition plans, including absolute goals for reducing carbon emissions, as set out in Article 76 of the CRR, as well as progress achieved through their implementation.
Regulator/ standard setter	UK Transition Plan Taskforce Disclosure Framework & Guidance	- In October 2023, the Transition Plan Taskforce (TPT) published its final disclosure framework and associated guidelines designed to help businesses develop, disclose and implement their climate transition plans. - According to government representatives, information disclosed on the basis of the TPT standards will be mandatory in the UK in future. They are currently still voluntary.
Regulator/ standard setter	NGFS	- In April 2024, the NGFS published several papers on transition plans. - The paper entitled "Connecting Transition Plans: Financial and non-financial firms" looks at how different information from real economy transition plans provides useful data for the climate-related risks of financial institutions and facilitates transition financing. It highlights, among other things, elements of transition plans of non-financial businesses that could be useful for financial institutions. - The paper entitled "Credible Transition Plans: The micro-prudential perspective" examines the credibility of the transition plans and transition processes of financial institutions from a micro-prudential perspective. It makes, among other things, suggestions about elements of credible transition plans and the credible transition planning of financial institutions, which NGFS believes are important for the supervisory authorities at the micro level.
Standard setter	EFRAG European Sustainability Reporting Standards (ESRS) E1-1	- The ESRS E1-1 climate standard contains a disclosure requirement for transition plans. - This includes ten criteria on information which EFRAG believes should be included in a transition plan.

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Standard setter	TCFD Guidance on Metrics, Targets, and Transition Plans	- The guidance was published in October 2021 and contains a chapter with notes on disclosing transition plan information, and also provides some examples. - It also emphasises the features of effective transition plans.
Standard setter	CDP, Climate Transition Plan: Discussion Paper	- In November 2021, CDP published a discussion paper on climate transition plans, which identifies eight key elements for a credible transition plan.
Standard setter	OECD	- The OECD guidance on transition finance outlines the elements of credible transition plans. According to the OECD, these are required so that investors can have confidence that non-financial businesses that receive financing are on a credible path to net zero.
Market participants	GFANZ Guidance	- In September 2022, GFANZ published guidelines for real-economy businesses on compiling transition plans and on disclosing progress related to these plans. - In November 2022, GFANZ published voluntary, cross-sectoral, globally applicable recommendations on the elements of a climate transition plan for financial institutions with accompanying guidelines, examples and case studies.
Market participants	CBI	- The Climate Bonds Initiative (CBI) has expanded its Climate Bonds Standard & Certification Scheme to include the certification of companies on the basis of their transition plans. - In September 2023, the CBI published an introductory guide to help stakeholders understand the basic characteristics of a credible transition plan. However, it points out that this cannot replace a thorough, independent review and certification.

What are the features of good practice for transition plans?

A key question in the design of transition plans is: what best practices are there that businesses can follow. Although it should be noted that the requirements may vary depending on the benefits and economic, political and geographical circumstances, there are already some meta-studies that highlight the general elements of a robust and credible transition plan. A selection can be found in the following:

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According to a review by the Climate Policy Initiative (CPI)[2] of the leading benchmarks and frameworks, **six key elements** should be included in transition plans:

- Quantitative, detailed and time-bound interim targets for emissions that support net zero by 2050: The transition plan contains progress benchmarks on emissions reductions that are clearly outlined for defined timeframes and are consistent with 1.5° C no or low overshoot pathways.
- Implementation: The transition plan sets out how the business will deliver on its climate commitments - both to reduce its own risks as well as in support of climate action - through policies, products, tools, services and relationships.
- Whole-institution approach: The transition plan covers the whole organisation, builds capacity in-house and is integrated into the overall business strategy, including budgeting and investment plans.
- Sustainability: The transition plan sets out context-specific sustainability targets and attempts to ensure that there are no negative externalities to the environment or communities.
- Transparency, verification and accountability: The transition plan sets out a framework for transparently reporting on progress, assumptions, monitoring and accountability.
- Flexibility, responsiveness and rapidly escalating ambition: The plan is reviewed and revised regularly and updates the level of ambition based on progress.

According to the Organisation for Economic Co-operation and Development (OECD)[3] most current approaches for transition plans include the following elements:

- net-zero and interim targets;
- performance metrics and Key Performance Indicators (KPIs);
- carbon credits and offsets;
- actions towards implementation;
- internal coherence with the company's business plan;
- governance and accountability and
- transparency and verification.

According to the OECD, other elements are largely underdeveloped in current approaches. These include:

- consideration of non-climate-related sustainability impacts;
- integration of transition plans with other sustainable finance tools and tools for Responsible Business Conduct (RBC);
- just transition aspects;
- information on prevention of carbon-intensive lock-in and, where appropriate,
- tailored approaches for micro, small and medium-sized enterprises (MSMEs) and certain companies in emerging markets and developing economies (EMDEs).

In order for transition plans to provide the optimum benefits at EU level, the **Sustainable Finance Advisory Committee (SFB)** of the Federal Government[4] recommends that they:

Translation

[2] Climate Policy Initiative (2022). "What Makes a Transition Plan Credible? Considerations for financial institutions"

[3] OECD (2023). "Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans".

[4] Sustainable Finance Advisory Committee (2023). Discussion paper "The benefits of and necessity for meaningful transition plans".

- follow basic principles and coherent guidelines,
- effectively bundle current EU reporting requirements,
- have a clear benefit for investors and companies,
- contain concrete measures and
- that they are internationally compatible.

In general, a transition plan should certainly (1) include climate obligations and time-bound goals in line with the 1.5° C target, (2) explain how the goals fit strategically with the business's corporate strategy, (3) describe with what concrete measures and which areas of responsibility the goals are to be operationalised and (4) explain how the business's climate strategy is to be implemented.[5]

Deep Dive: UK Transition Plan Taskforce

The UK Transition Plan Taskforce (TPT) was founded in April 2022 in order to develop a gold standard for the climate mitigation transition plans of the private sector and to support the British government's commitment to achieving net zero by 2050.

On 9 October 2023, the TPT published its **final disclosure framework and accompanying guidelines**. The TPT's recommendations are the result of a collaborative effort drawing on expertise from finance, business, political decision-makers, regulatory bodies and civil society in various countries. They build on the work of the International Sustainability Standards Board (ISSB) and support compliance with IFRS S2. The TPT's Disclosure Framework is also aligned with the transition plan guidance developed by the Glasgow Finance Alliance for Net Zero (GFANZ). As a result, it supports international convergence on what makes a transition plan robust and credible, and promotes global applicability.

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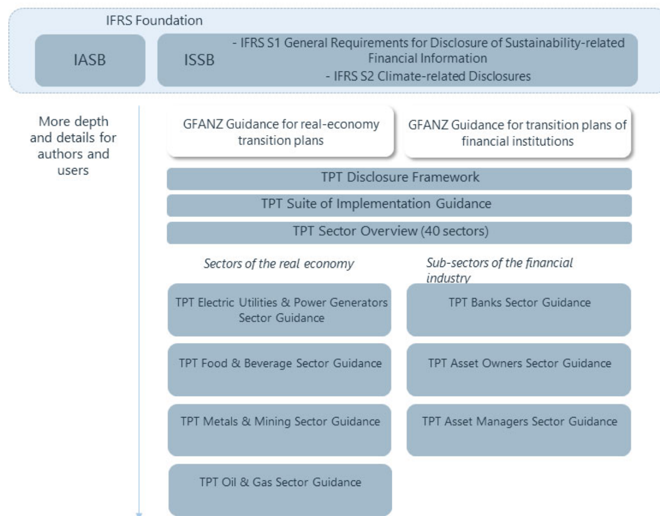
[5] See also PwC (2024), "Net Zero Transitionspläne: Regulatorische Vorgaben und praktische Guidance", Sustainable Finance Webcast (in German only).

The TPT maps the **disclosure landscape** as follows:



The TPT's Disclosure Framework applies **three guiding principles**:

- **"Ambition":** Good practice transition plans should reflect the urgency to act, arising from the observed changes in the climate and the latest scientific findings about climate change. The TPT therefore recommends that, in setting its strategic ambition, a business take a "strategic and rounded" approach. That is, the business should consider the actions that it can take now to capture opportunities, minimise future risks and protect and enhance its long-term value. Applying a strategic mindset, the business can also design its transition plan in a way that will protect and enhance long-term value for the stakeholders.
- **"Action":** A transition plan should translate ambitious objectives and priorities into concrete steps to be taken in the short, medium and long-term. It should emphasise in its disclosure a roadmap of planned actions that will contribute to meeting its strategic ambition. The TPT also notes that good practice transition plans should consider Scope 1, 2 and 3 emissions and should prioritise decarbonisation through direct abatement over purchasing carbon credits. Businesses should ensure that their planned actions are underpinned by appropriate resourcing plans. They should assess the sensitivity of their plan to changes in key assumptions and external factors.
- **"Accountability":** A transition plan is integral to a business's wider corporate strategy. Delivery of a transition plan should therefore be fully integrated into the business's organisational processes for business and financial planning, and for governance. A business should define clear roles and responsibilities for the delivery and oversight of its transition plan and should take steps to align culture and incentive structures with the strategic ambition set out in the plan. A business should report material information about its transition plan within its general purpose financial reports, including annual reporting on progress against quantified and time-bound metrics and targets. Furthermore, transition plans should be regularly reviewed and updated.

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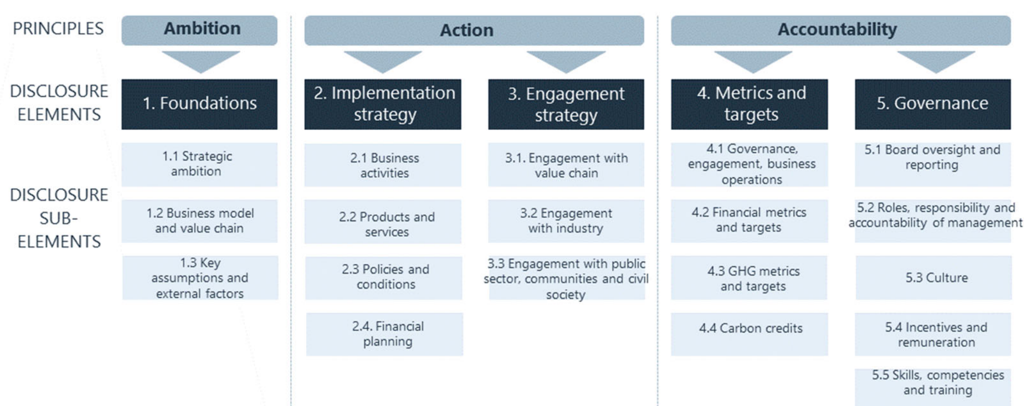
Building on these principles, the TPT framework is divided into **five elements** that draw on transition plan components identified by GFANZ:

- **Foundations:** A business shall disclose the strategic ambition of its plan. This shall comprise the business's objectives and priorities for responding and contributing to the transition towards a low-GHG emissions, climate-resilient economy. It shall also set out whether and how the business is pursuing these objectives and priorities. Under this element, a business should also disclose the high-level implications that this transition plan will have on its business model and value chain, as well as the key assumptions and external factors on which the plan depends.
- **Implementation strategy:** A business shall disclose the actions it is taking within its business operations, products and services, and policies and conditions to achieve its strategic ambition, as well as the resulting implications for its financial position, financial performance and cash flows.
- **Engagement strategy:** A business shall disclose how it is engaging with its value chain, industry peers, government, public sector, communities and civil society in order to achieve its strategic ambition.
- **Metrics and targets:** A business shall disclose the metrics and targets that it is using to drive and monitor progress towards its strategic ambition.
- **Governance:** A business shall disclose how it is embedding its transition plan within its governance structures and organisational arrangements.

The TPT's Disclosure Framework breaks these elements down into **19 sub-elements**, each of which is supported by a series of disclosure recommendations. The following diagram outlines the **overall framework**.



Conclusions

Even though public and private initiatives are now providing initial indications of what robust and credible transition plans look like, the transformation of the economy will remain a major challenge in the coming years. A key task for businesses is to develop a growth strategy that simultaneously contributes to reducing greenhouse gas emissions and achieving the net zero target.

Transition plans may act as an important anchor for the strategic planning of businesses undergoing change and support the systematic evaluation of risks and opportunities linked to the transition to climate neutrality. In addition, for banks and financial institutions, transition plans for the real economy are an important source of information for making financing decisions and assessing risks.

It is important to recognise here that the capability of the financial sector to finance and facilitate the transformation depends largely on the existence of real economic transition opportunities in which to invest. In turn, the transition opportunities in the real economy depend to a large extent on the framework conditions set by policy-makers to promote the economic attractiveness of net zero technologies and clean energy. It is also crucial for globally active financial institutions that frameworks for transition plans are internationally compatible and as standardised as possible in order to facilitate and promote sustainable financing decisions.

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