

OECD Guidance on Transition Finance

Ensuring Credibility of
Corporate Climate Transition Plans

POLICY HIGHLIGHTS

OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans

Achieving rapid and deep greenhouse gas (GHG) emission reductions across all sectors globally, and especially in energy-intensive and hard-to-abate sectors, is paramount to achieving the goal of the Paris Agreement of limiting the average global temperature increase to 1.5 °C. Importantly, financial flows for decarbonisation measures must reach emerging markets and developing economies (EMDEs) to ensure that the transition is truly global. Yet, existing sustainable finance approaches do not always include all relevant sectors and consequently may leave EMDEs behind.

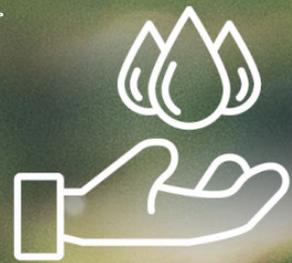
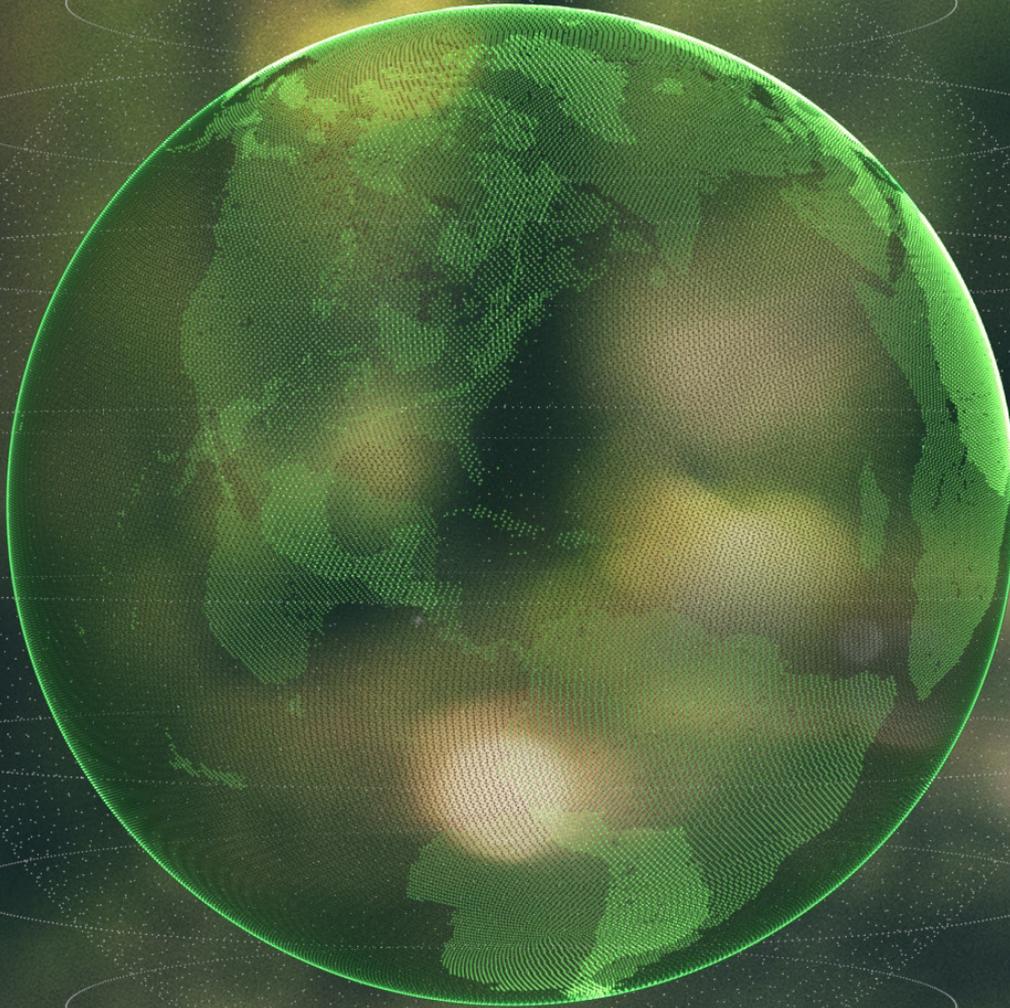
The emerging concept of transition finance aims to address these shortcomings by proposing a more inclusive approach, both in terms of sectors and geographies. However, there is a risk that inclusiveness comes at the cost of environmental integrity, increases greenwashing, and leads to carbon-intensive lock-in. The OECD Guidance on Transition Finance presents a way forward that focuses on credible corporate climate transition plans, based on the assumption that to ensure the environmental integrity of transition finance, transactions must be supported by credible entity-wide company transition plans. To help promote the development and assessment of such plans by market actors, and the development of relevant policy frameworks by policymakers and regulators, the Guidance presents ten key elements of credible corporate transition plans.

The Guidance considers transition finance as intended for the *dynamic process of becoming sustainable or reaching net zero*, rather than for *already sustainable or net-zero activities*, based on a point-in-time assessment. The aim is to mobilise financing and provide forward-looking

solutions for a whole-of-economy decarbonisation, while avoiding static views limited to what is already sustainable today. The latter has traditionally been the focus of sustainable finance initiatives that do not explicitly cover the transition dimension. That can be insufficient to facilitate the GHG emission reductions necessary to achieve the temperature goal of the Paris Agreement, which would require a mainstreaming of transition considerations in the planning and decision-making of corporates across all sectors of the economy.

Informed by an OECD Industry Survey on Transition Finance, and extensive bilateral consultations with jurisdictions and market actors active in the space, the Guidance makes the following key contributions:

- A comprehensive mapping and comparison of the main existing approaches in transition finance, including an overview of the relevant financial instruments to date.
- An analysis of the key challenges and barriers to mainstreaming transition considerations in financial markets and the real economy, especially in EMDEs.
- An overview of ten key elements of credible corporate transition plans, building on and complementing existing approaches. The overview draws from available sustainable finance tools and frameworks and introduces new elements that are currently underexplored by existing approaches but can increase the credibility, environmental integrity, and inclusiveness of transition finance.



What is transition finance?

No commonly agreed definition of transition finance currently exists, but market actors and jurisdictions have put forward different approaches and frameworks and issued financial instruments relevant to transition finance. Because they vary significantly in their level of environmental ambition and prescriptiveness, they have limited comparability and may increase uncertainty and transaction costs for international investors. The development and use of credible climate transition plans by corporates globally and across sectors can help address these problems by providing robust entity-wide decarbonisation strategies as a basis for related financial instruments.

With respect to environmental ambition, some jurisdictions pursuing transition finance approaches consider alignment with Nationally Determined Contributions (NDCs) to be sufficient, while others do not rely on NDCs since these are often insufficient to meet the Paris Agreement temperature goal. To identify transition finance opportunities, market actors who responded to the OECD Industry Survey on Transition Finance indicated that they mainly use the International Capital Markets Association's (ICMA) Principles and Handbook, Climate Bonds Initiative's (CBI) frameworks, the EU Taxonomy, or frameworks developed internally.

The majority of respondents to the Industry Survey also indicated that debt-related instruments currently play, and will continue to play, the most prominent role in transition finance-related transactions. This is reflected in existing issuances, with sustainability-linked bonds and loans currently being the most relevant and prominent financial instruments in transition finance, along with a small emerging market segment of transition bonds. However, the debt market alone will not be sufficient to mobilise enough capital for the net-zero transition. Private equity and venture capital as well as hybrid

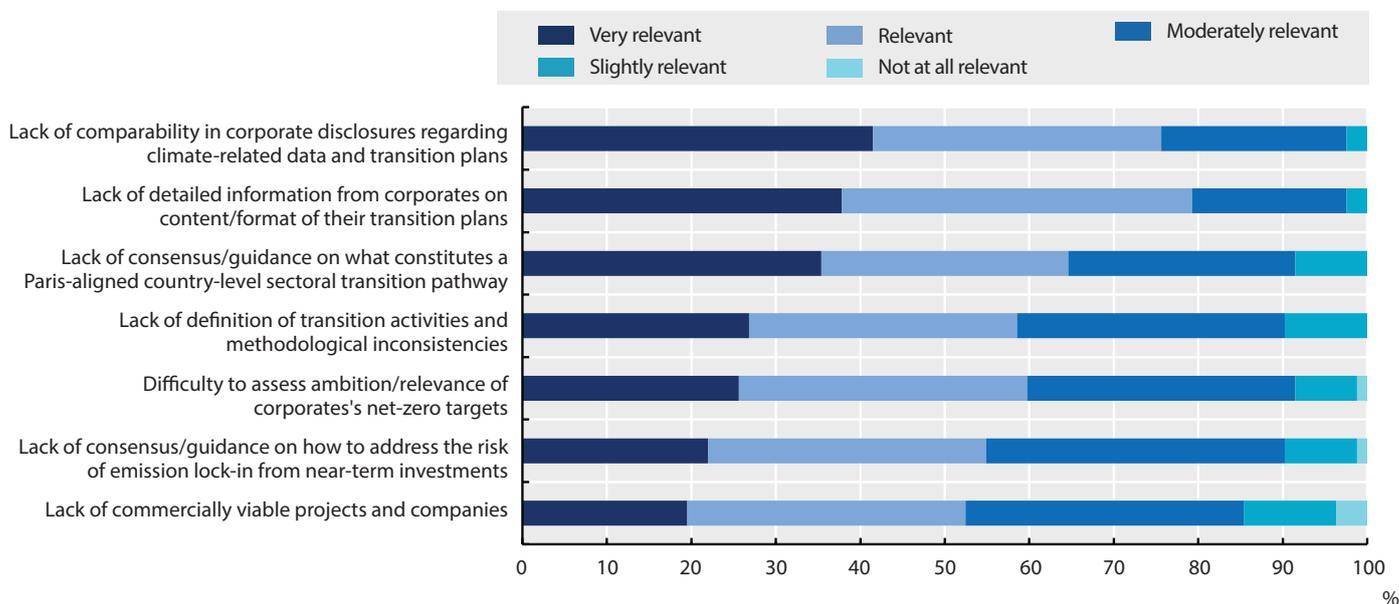
instruments could play a much more prominent role in the future, for example to finance breakthrough low-emission innovations.

However, financial market participants and civil society have raised concerns regarding possible greenwashing by corporates issuing such instruments. Credible transition plans, which set out a company's targets, commitments, and implementation actions, can help financial market participants assess the economic and environmental integrity of the business strategy of a corporate trying to raise finance to transform its business model, operations, assets and relationships towards net-zero and climate-resilient pathways, in line with the Paris Agreement. To date, only few companies are developing and publishing credible transition plans that allow an assessment of their alignment with the Paris Agreement (CA100+, 2022; CDP, 2022; IGCC, 2022; TPT, 2022). However, an increasing number of initiatives are setting out disclosure frameworks and other types of services, such as validation and assessment, data collection and analysis, and others, to guide and support the development and disclosure of such plans.





Information gaps and a lack of comparability of relevant data are key obstacles to identifying companies that are committed to a credible net-zero transition



Note: Financial market participants' views on obstacles to identifying companies or projects committed to a transition along low-emission pathways and towards Paris Agreement temperature goals, as % of respondents.

Source: 2022 OECD Industry Survey on Transition Finance.

What are the key challenges in transition finance?

To mainstream transition considerations in the strategies of corporates and scale up transition finance across sectors and regions, transition finance approaches must respond to the challenges encountered by market actors in this space. The challenges of corporates in EMDEs, and of micro-, small- and medium-sized enterprises (MSMEs) deserve special attention. The Guidance identifies the key challenges in transition finance and finds that credible corporate climate transition plans and increased transparency by corporates can address some of them, while others have additional, broader implications for policymakers and require the use of complementary tools, including through effective coordination of governments with donors, Multilateral Development Banks (MDBs), and private investors.

Among the challenges noted in the OECD Industry Survey, respondents view information gaps and a lack of comparability of relevant data as key obstacles for financial markets to identify companies that are committed to a credible net-zero transition.

Of financial markets respondents to the Industry Survey, 80% view the lack of detailed information from corporates on the content and format of their transition plans as a key obstacle. In addition, 76% consider a lack of comparability of relevant data and transition plans as a key challenge.

Variations in countries' net-zero commitments and NDCs compound existing data challenges. As a result, international investors and financial institutions struggle to compare the level of environmental integrity of company strategies in different jurisdictions. Similarly, in the absence of sectoral pathways at national level, companies are often unable to develop robust, long-term climate transition plans.

80%

of financial markets participants view the lack of detailed information as an obstacle

76%

consider a lack of comparability of relevant data and transition plans as a key challenge

Almost two-thirds of financial markets respondents hesitate to provide transition financing because of a lack of clarity on how to assess companies' alignment with the temperature goal of the Paris Agreement.

In addition to data challenges, there are still several gaps and drawbacks in the enabling environment (i.e., the policy, legal and institutional framework at country or regional level), which would need to be addressed to fully support a low-emission transition. Respondents to the OECD Industry Survey cite a lack of fiscal incentives, such as inadequate carbon pricing or public investments, and a lack or fragmentation of the applicable policy frameworks for the real economy as major gaps. Applicable policy frameworks for the real economy may include the prohibition or limitation of the use

of polluting technologies, relevant environmental impact assessments, as well as tendering and procurement procedures.

Lastly, a key challenge in transition finance is the risk of carbon-intensive lock-in and asset stranding. This risk is particularly pronounced with respect to the installation of unabated fossil fuel infrastructure, which, according to the Intergovernmental Panel on Climate Change (IPCC), will lock in GHG emissions for the future (IPCC, 2022). In light of this risk, the question of whether fossil fuel investments, including abatement technologies, should be part of transition finance approaches, continues to be the subject of fierce debate.

Guidance on credible corporate transition plans can address some of these challenges, especially those related to information and data gaps, and, to an extent, the risk of carbon-intensive lock-in. Others, such as those relevant to the enabling environment, require coordinated interventions between the concerned governments, donors, MDBs and private investors at the level of policy and regulation. Such interventions are needed to provide finance and investment, technical assistance, and capacity-building, including through blended finance interventions.

Almost **2/3**
consider a lack of
comparability of relevant
data and transition plans
as a key challenge

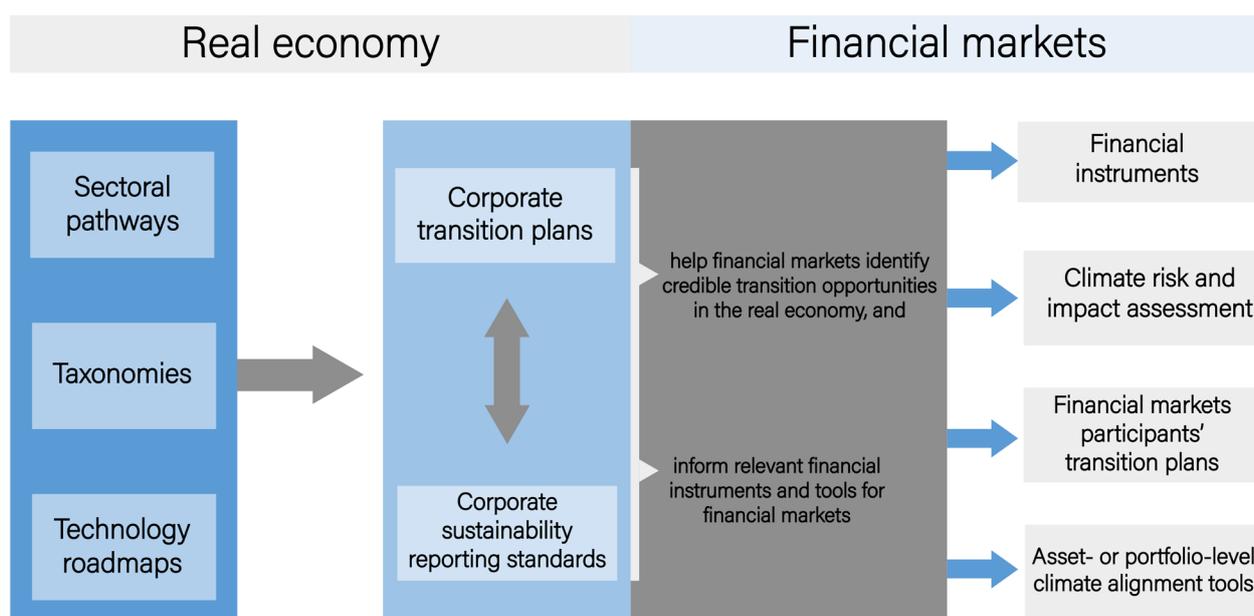
Transition plans as part of the broader sustainable finance toolbox

The Guidance recognises the role and importance of existing tools and frameworks, both in transition and sustainable finance. Tools like taxonomies, sectoral pathways, technology roadmaps, and sustainability reporting standards are all relevant to and can increase the credibility and comparability of corporate transition plans. In a complementary manner, by building on and making use of existing sustainable finance tools, transition plans can help to promote the credibility of whole-of-entity transition strategies and minimise the risk of greenwashing in transition finance, ultimately encouraging the sustainable finance market to grow with integrity.

Sectoral pathways, taxonomies, and technology roadmaps are important inputs for the development of credible corporate transition plans. For example, all credible corporate transition plans will include elements that are also required, with varying levels of stringency or prescriptiveness, by existing sustainability reporting standards (such as performance metrics and KPIs). Conversely, only a

sub-set of sustainability reporting standards currently require the development of corporate transition plans. However, corporate transition plans and related corporate sustainability disclosures are crucial inputs for financial market participants, as they make the link between real economy and financial markets that is needed to help market actors identify credible transition investments.

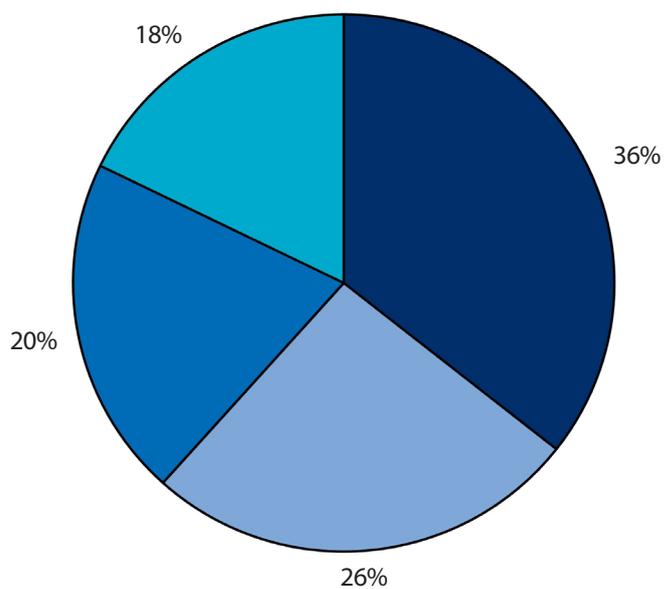
Non-exhaustive overview of relevant tools and frameworks in transition finance, and the role of corporate climate transition plans



Source: Authors.



Do you hesitate to provide transition financing because of insufficient clarity on how to assess credible corporate alignment with a pathway that is in line with the Paris temperature goals?



Source: 2022 OECD Industry Survey on Transition Finance.

Ten key elements of credible corporate transition plans

Transition plans allow corporates to explain their goals, commitments, actions and progress towards climate action and sustainability, as well as how they maintain financial performance and competitiveness during their transition. Credible corporate transition plans also provide financial market participants with a sufficiently robust basis to make informed investment decisions, thereby reducing the risk of greenwashing, and to better manage their own transition risks while harnessing transition opportunities. The Guidance identifies ten key elements of credible corporate transition plans, building on emerging practices and approaches for transition finance and transition plans. It also includes areas that are currently underdeveloped by existing approaches.

1

Setting temperature goals, net-zero, and interim targets

Net-zero and interim targets are science-based, consistent with an IPCC 1.5°C reference scenario, and cover all relevant GHG emissions. Interim targets reflect the need for global GHG emissions to peak by 2025. In limited and well-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 as based on available sectoral pathways, technology roadmaps, and, where possible, taxonomies. The plan clarifies how and for which technologies future operating and capital expenditures will be used to achieve targets.

3

Measuring performance and progress through metrics and KPIs

Climate change mitigation-related metrics and KPIs cover lifecycle GHG emissions, are measurable and externally verifiable. Targets and reporting include scope 3 emissions as a rule, and omissions are limited and clearly justified and explained.





4

Providing clarity on use of carbon credits and offsets

Given the risk that carbon credits and offsets can pose to the credibility of transition plans, their use is limited and carefully explained.

5

Setting out a strategy, actions, and implementation, including on preventing carbon-intensive lock-in

There is a clear strategy and concrete actions to achieve the company's targets, including transition risks and opportunities over time, and an assessment of the likelihood that targets will be achieved. The risk of carbon-intensive lock-in is assessed, a plan for responsible retirement of high-emitting assets provided where relevant, and mechanisms put in place to prevent lock-in for any existing or future assets and infrastructures at risk.

6

Addressing adverse impacts through the Do-No-Significant-Harm (DNSH) Principle and due diligence for Responsible Business Conduct (RBC)

Credibility can be increased by also considering not only mitigation goals but also other environmental and social objectives, including by ensuring no harm is done to them. A useful way to operationalise the DNSH Principle as part of transition plans, is to conduct risk-based due diligence based on OECD Due Diligence Guidance for Responsible Business Conduct (RBC) (OECD, 2018), which 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 are taken to mitigate negative impacts on workers, suppliers, local communities, and consumers, considering relevant ILO and OECD principles and guidelines. Credible transition plans are developed through a process that ensures regular, continuous, and inclusive stakeholder engagement and social dialogue.

8

Integrating with financial plans and internal coherence

The transition plan is integrated into the corporate business plan, makes direct reference to the company's financial plan and is done concurrently with financial reporting.

9

Ensuring sound governance and accountability

A whole-of-entity approach ensures that the design and implementation of the transition plan is subject to regular monitoring and reporting, subject to senior management approval and oversight, and involves all relevant stakeholders.

10

Transparency and verification, labelling and certification

Progress on targets is regularly disclosed and third-party verification of the plan and its targets ensured.

This Policy Highlights is based on the OECD publication *OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans*

To achieve the Paris Agreement goal of limiting the average global temperature increase to 1.5°C, finance for decarbonisation measures must reach all parts of the global economy, and especially hard-to-abate sectors. Yet, existing sustainable finance approaches do not always include all relevant sectors and may leave emerging markets and developing economies behind. The concept of transition finance proposes a global whole-of-economy approach that is inclusive of both sectors and regions. However, inclusiveness can come at the cost of greenwashing, which is a common criticism of transition finance. To prevent greenwashing and carbon-intensive lock-in, the OECD *Guidance on Transition Finance* sets out 10 key elements of credible corporate transition plans, which should form the basis of transition finance transactions. Importantly, plans should be aligned with the temperature goal of the Paris Agreement, while acknowledging that no one size fits all: different country and sector contexts will require different responses and financing solutions.

For more information:

For further reading, see the following report on which this Policy Highlights is based:

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

 oe.cd/transition-fin

 www.oecd.org/cgfi
www.oecd.org/climate-change/theme/finance

 elia.trippele@oecd.org and valentina.bellesi@oecd.org

 @OECD_ENV

 OECD Environment

