Network for Greening the Financial System

Technical document

Connecting Transition Plans: Financial and non-financial firms

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Executive Summary

The NGFS Stocktake published in May 2023 identified the information in non-financial firms' transition plans as potentially of use to financial institutions. The extent to which a financial institution can credibly develop and implement its transition strategy is largely dependent on the extent to which its counterparties can credibly develop and implement their strategy, which forms the basis of counterparties' and financial institutions' transition plans.

This document sets out further analysis of the interlinkages between real economy transition plans and financial institution transition plans[1]. In particular, the extent to which different types of information from real economy transition plans, particularly where that information is forward-looking, can: i) inform financial institutions' own climate-related risk management, and ii) facilitate transition finance.

As part of this study, the NGFS collaborated with the Institute of International Finance (IIF) on a survey[2] of financial institutions followed by roundtables to gather additional feedback on the preliminary findings.

Findings

There was no uniform approach towards the collection and use of information from non-financial firms' transition plans by financial institutions.

- Information collection and usage was typically focused on meeting financial institutions' own decarbonisation commitments, as reflected in greenhouse gas emission data being the most commonly collected data. Only around half of the financial institutions surveyed currently use this data for purposes related to risk management.
- The type and amount of data collected from financial institutions' client transition plans varies depending on characteristics of the client; in particular, small and midsize enterprises provide limited and no publicly disclosed data.

Many respondents who were not yet collecting data from their clients (or collecting it for certain activities) expressed an intention to do so in the future. This may signal that financial institutions have a desire to leverage such information, particularly forward-looking information, to support greater linking to, and relevance for other purposes, including risk management.

Financial institutions currently face challenges in obtaining and using information from non-financial firms' transition plans. These include data availability, comparability and consistency issues, insufficient risk-related information, inherently uncertain nature of information, difficulties in aggregation and nascent methodologies to utilise available information.

Nonetheless, only around half of financial institutions surveyed currently engage with their clients on the content of their transition plans to make them more decision-useful, while a small number plan to do so in the future.

Recommendations

Financial institutions could benefit from engagement on specific elements of non-financial firms' transition plans, depending also on the objective of the financial institution (e.g. risk management, monitoring progress on its own decarbonisation commitments, etc). Furthermore, **some elements could contribute to multiple objectives.** For example, evidence of robust governance as an indicator for the likelihood of non-financial firms' following through with their transition plans could contribute to informing risk identification as well as tracking financial institutions' own decarbonisation targets.

There are potential measures that can be taken by financial institutions, policymakers and standard setters to promote the development and quality of non-financial firms' transition plans.

1 This report is published alongside 2 other reports on Tailoring Transition Plans: Considerations for EMDEs and Credible Transition Plans: The micro-prudential perspective, which offer complementary perspectives on related topics and help to establish further foundational understanding on the relevance of transition planning and plans for micro-prudential authorities.

2 The NGFS-IIF Survey questions are presented in Annex 1.

- Standard setters could play an important coordination role in helping the non-financial sector converge on a standardized template for transition plans. Efforts should also be made to encourage all firms to cover different aspects of climate change, including adaptation, in their transition plans to ensure financial institutions can obtain information about the full suite of risks they are exposed to.
- Policymakers and standard setters should consider development of public goods like emissions databases to facilitate ease of access.
- To build capacity to develop high quality transition plans, there should be active promotion of best practices by governments, standard setters and financial institutions alike. Financial institutions can utilise their influence with their clients to improve non-financial firms' transition plans to better meet financial institutions' needs, such as through education/capacity building.

Financial sector regulators specifically need to consider both prudential considerations and the impact of their actions on the broader economy.

Some good practices that they may wish to consider include:

- Coordination of standards and timelines globally and across the real economy, ensuring interoperability of standards.
- Proportionate and flexible in individual financial institutions' application of standards to avoid unintended consequences (e.g. rigid application of rules could hinder access to capital for transitioning non-financial firms, which could result in risk build up and a disorderly or no transition).
- Recognise critical differences between non-financial firms and financial institution transition planning in terms of the degree of direct influence on actions taken. Financial institutions play a role as mobilisers of capital to enable the transition, but cannot drive the transition as they cannot force non-financial firms to act. This entails the need to recognise the critical link between non-financial firms' and a financial institution's transition planning – the former is a key input of the latter.

Financial authorities should be mindful that not all of a financial institution's transition plan will have a direct link to risk management as their key purpose will also be to govern a financial institution's strategy and commercial decisions. Authorities should thus calibrate any guidance (including in relation to the usage of non-financial firms' transition plans) to the financial industry accordingly, including not encroaching on financial institutions' commercial decisions without a risk basis.

Since non-financial firms' transition plans are the only source of climate forward-looking information at this time, they should be studied further by financial institutions and financial standard setters as their availability and maturity continue to improve. In particular, further work will be beneficial on how best to incorporate such information into financial institutions' business and risk processes, and how existing risk frameworks could accommodate the uncertainty inherent in forward-looking information.

1. Introduction

Further exploration of the relationship between financial institutions and their clients' and counterparties' transition plans is required.

The NGFS has been studying the role of transition plans to enable the financial system to mobilize capital and manage climate-related financial risks ("climate risks") and their relevance to microprudential supervision. This is in accordance with the NGFS's broader goal to enhance the capabilities of the financial system to manage risks and to mobilize capital for green and low-carbon investments in the broader context of environmentally sustainable development. It follows initial work published in the May 2023 NGFS Stocktake Report on 'Financial Institutions' Transition Plans and their Relevance to Micro-prudential Authorities'[3].

The NGFS defined "transition planning" and "transition plans" in the Stocktake report, which are adopted in this report: **"Transition planning"** is the internal process undertaken by a firm to (i) develop a transition strategy to deliver climate targets that firms may voluntarily adopt or that are mandated by legislation or the appropriate au-thority, and/or (ii) prepare a long-term response to manage the risks associated with its internal strategic planning and risk management processes undertaken by a financial institution to prepare for risks and potential changes in business models associated with the transition to a low emission and climate-resilient economy". **"Transition plans"** are a key product of the transition planning process and are an external-facing output for external audiences, such as investors, shareholders and regulators.

For the purpose of the NGFS work, transition planning and transition plans capture climate mitigation and adaptation. From the NGFS perspective, for completeness transition plans should reflect an entity's integrated approach to reducing its emissions **(climate mitigation)** and simultaneously adapting to the impacts of climate change that will arise even where the goals of the Paris agreement are met **(climate adaptation)**.

The NGFS noted the need for further exploration of the relationship between financial institutions[4] and their clients' and counterparties' transition plans (hereafter 'clients'). Initial findings set out in the Stocktake report noted a few areas outside the scope of the Stocktake, which required further analysis before progressing work on recommendations to support micro-prudential authorities. The report noted: *"the relationship between financial institution and counterparty transition plans is equally important to setting the stage for this phase of the NGFS's work on transition plans… financial institutions do not operate in isolation, and will be both users of transition plans from non-financial firms as well as preparers of their own transition plans."* Since climate change also affects the real economy, financial institutions are dependent on their clients to provide information to enable them to ascertain the overall climate impact that their financing activities will have, as well as implement desired changes in strategy. While financial institutions could utilise aggregate data like sector-level progress towards a low-carbon economy, such metrics would not be sufficiently granular for strategic decision making and making the risks of their individual portfolios.

This document explores how real economy transition plans could be useful for financial institutions in understanding clients' climate risk profiles and informing their role as facilitators of the transition.

This document sets out results of further analysis conducted by the NGFS to assess interlinkages between real economy transition plans and financial institution transition plans. The NGFS seeks to assess the extent to which forward-looking information from real economy transition plans can: i) inform financial institutions' own climate-related risk management, and ii) facilitate transition finance. These uses are not mutually exclusive as financial institutions can enable the transition both through managing the risks associated with the transition towards a climate resilient business model that is part of a low-emission economy and by identifying financing needs and opportunities.

3 https://www.ngfs.net/sites/default/files/stocktake_on_financial_institutions_transition_plans.pdf.

4 Consistent with the mandate of the NGFS Workstream on supervision, 'Financial institutions' are used to describe banks and insurers subject to micro-prudential supervision.

i) Climate resilient business model while transitioning to a low-emission economy

As financial intermediaries, financial institutions' transition planning will need to respond to the transition to a low-emission economy. They will need to manage and mitigate the risks associated with transition including their exposures to clients who are also preparing to respond to climate-related risks. Real economy transition plans of these customers may contain information about non-financial firms' forward-looking risk profiles and risk management strategies, that could feed into the financial institution's own measurement of risk, risk appetite, mitigation, risk management frameworks, capital adequacy and internal stress testing.

ii) Facilitating transition finance

Financial institutions such as banks and insurers facilitate financial transactions in the real economy – they invest in, lend to, and underwrite insurance for non-financial firms in all sectors. Transition finance is necessary to ensure a timely and orderly transition towards a low-emission economy towards sustainability, but it can also provide new investment opportunities for financial institutions. Forward-looking information contained in transition plans developed by non-financial firms will allow identification of such investment opportunities. This financing opportunity could support the long-term viability of firms' business models in a low-emissions climate resilient economy.

It is also important to recognize that there are limitations to the extent to which financial institutions can drive the real economy transition and influence clients to take the appropriate steps. For example, financial institutions would not be expected to finance a deal that did not make commercial sense, and in many cases there is still an absence of supporting policies, consumer demand or technology to support the transition.

Currently, however, non-financial firms' transition plans are still emerging and of variable quality, which may limit their use by financial institutions.

Transition plans are still emerging and non-financial firms face considerable challenges to produce adequate data, thus limiting the usefulness of their transition plans to financial institutions. Non-financial firms must adjust their business models to the climate-related transformation of the business environment (including suppliers, clients and consumer preferences, value chains, R&D, infrastructure), while maintaining profitability (i.e. considering capital and operational expenditures) and access to financing. In addition, non-financial firms face an increasingly challenging legislative and regulatory environment regarding compliance obligations, litigation and reputational risk. In some jurisdictions, there is also the necessity to consider additional environmental, social and governance factors (hereafter 'ESG') in their risk management.

The extent to which a financial institution can credibly develop and implement its transition strategy is dependent on the extent to which its clients can credibly develop and implement their own strategies. Ultimately, financial institutions also depend, to a certain degree, on the maturity of non-financial firms to have developed some kind of transition strategy, or at best, have a well-developed and credible transition plan in place. With this context in mind, the NGFS theorised several challenges for non-financial firms in planning for the transition and the resulting issues facing financial institutions as they seek to evaluate their clients' transition strategy, planning or plans and calibrate their own transition planning accordingly. These are summarised in Table A below.

Table A **Issues faced by financial institutions (FI) in utilising non-financial firm transition plans and their causes**

Lack of data	• Data collection process is too complex and costly for financial institutions • Not all non-financial firms, particularly small and midsize enterprises (SMEs), can provide adequate/relevant data – Lack of data from all upstream/downstream companies, especially more granular Scope 3 data – Lack of capacity to produce/assess data (technical skills, knowledge or understanding of expectations) – Lack of clarity on government policy and roadmaps (which may not be in place) and technological trends for industries (which may be uncertain) • Lack of data on exposure to physical or nature-related risks
Available data is not comparable	• No common definitions for non-financial firms' transition plans, albeit some jurisdictions are more advanced than others. For example, in the UK The Transition Plan Taskforce has published a sector neutral framework for the disclosure of transition plans and supporting guidance on preparing a disclosure, legal considerations and sectoral guidance on disclosure but this is currently voluntary. In the EU, binding rules such as the Directive (EU) 2022/2464 Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) may require financial and non-financial firms to develop and/or disclose plans to ensure transition with compatible business models and strategies but the detail of how comparable disclosure should be disclosed is yet to be set • No standardised physical risk or nature-related risk data sets
Uncertain reliability of data	• Where non-financial firms' transition plans do provide adequate information, this forward-looking information could become inaccurate due to non-financial firms' failure or inability to operationalise their plans or as a result of inaccurate underlying assumptions or uncertainties generally inherent in such data
Differing purposes of available data	• Information in non-financial firms' transition plans could be limited to a single climate scenario based on its strategy and may not provide information on sensitivities to varying states of the world which would be necessary for a more complete risk assessment by a financial institution

To support this work and test the theorised challenges, the NGFS assessed existing frameworks and standards and conducted a bespoke survey and roundtable discussions with financial institutions.

To support more informed conclusions about the interaction between non-financial firms in the real economy and financial institutions as users of transition plans, the NGFS (in collaboration with the Institute of International Finance (IIF)) surveyed[5] a range of financial institutions. These included small, medium and large banks and insurers with a variety of business models, operating across diverse jurisdictions, both in advanced economies and emerging markets and developing economies (EMDEs). The survey was followed by a series of virtual roundtables (in collaboration with IIF) with financial institutions from different geographical regions to gather feedback on the preliminary findings and develop these further.

Financial institutions surveyed were requested to disclose whether they collect information from non-financial firms' transition plans/planning when granting loans either to large non-financial firms or SMEs, and when entering into capital markets operations, or investments and underwriting activities. It is important to note that the findings from the survey and roundtables constituted a limited number of institutions, with a significantly larger proportion of banks to insurers. Results may therefore not be fully representative of all financial institutions. All results presented below are calculated on the basis of those who stated that they participated in particular activities (i.e. adjusted accordingly to remove those who responded that certain activities were not applicable to their institution). Nonetheless, efforts were made to ensure a diverse sample (as described in the prior paragraph).

5 The NGFS-IIF Survey questions are presented in Annex 1.

2. Existing guidance

There is limited existing guidance to support financial institutions' use of non-financial firms' transition plans.

There are no detailed global standards on transition plans for non-financial firms, posing challenges in data availability and use by financial institutions.

- **Existing global guidance for the real economy promotes the public disclosure of transition plans but does not identify them as required parts of disclosures.**
  - The International Sustainability Standards Board (ISSB) has issued two sustainability disclosure standards[6] that require firms to disclose their transition plans if they have any.
    - i) IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information requires an entity to disclose information about all sustainability-related risks and opportunities,
    - ii) IFRS S2 Climate-related Disclosures applies to climate-related risks to which the entity is exposed, which are: climate-related physical risks, climate-related transition risks; and climate-related opportunities.
  - The OECD non-binding Guidance on Transition Finance sets out elements of what it deems to be credible non-financial firms' climate transition plans which it views as necessary for investors to have confidence that non-financial firms raising transition finance are on a credible path to net zero.

- **At the country level, the policy position to implement mandatory disclosures of transition plans is evolving with varied approaches already emerging.** The UK and EU are examples of jurisdictions that are already highly committed in this area. As noted above in Table A, the EU CSRD and CSDDD may require all firms to develop and/or disclose plans to ensure transition with compatible business models and strategies. The UK requires transition plans for listed corporates per existing Task Force on Climate-Related Financial Disclosures (TCFD) guidance, and its Transition Plan Taskforce (TPT) has developed a sector-neutral Disclosure framework[7] and Implementation Guidance and is working on a suite of sector-specific guidance.

Sectoral pathways and technological roadmaps, where they exist, can help financial institutions to identify financing opportunities and benchmark current and planned progress in decarbonisation by non-financial firms, but suffer from some limitations. For example, not all sectors have credible pathways, particularly hard-to-abate sectors for which commercially viable technological solutions may not yet exist, or require further adaptation to geographical specificities. An example of a widely accepted sectoral pathway is the IEA Net zero pathway for the energy sector, but such global pathways may not be directly applicable for all jurisdictions due to their individual socio-economic circumstances.

Taxonomies, which set out criteria and transitional stages for activities aligned with net zero (e.g. ASEAN Taxonomy for Sustainable Finance or the EU Regulation 2020/852 on the establishment of a framework to facilitate sustainable investment), **may serve as alternatives to provide a reference against which financial institutions benchmark current and planned progress in decarbonisation by non-financial firms, supporting financial institutions in providing transition finance and avoid accusations of greenwashing.** However, there is no globally accepted taxonomy, and regional taxonomies may not be relevant in all jurisdictions or suitable for use as a reference for the transition. Such uses of taxonomy may need further exploration.

6 The Financial Stability Board has announced that the work of the TCFD has been completed, with the ISSB's Standards marking the 'culmination of the work of the TCFD'. Companies applying IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information and IFRS S2 Climate-related Disclosures will meet the TCFD recommendations as the recommendations are fully incorporated into the ISSB's Standards.

7 https://transitiontaskforce.net/wp-content/uploads/2023/10/TPT_Disclosure-framework-2023.pdf.

Just like actions taken to mitigate climate change, actions are also needed to adapt to its effects – but even less guidance exists for this. Until COP28[8], little progress has been made on defining and implementing the Global Goal on Adaptation[9] (GGA) since it was established under the Paris Agreement in 2015. Non-financial firms' transition plans may not include such information at all, making it difficult for financial institutions to obtain information about the physical risks they are exposed to. The NGFS is separately considering further exploratory work into the intricate interlinkages and relationships amongst the topics of adaptation finance, insurance protection gaps and the prudential risks that adaptation (or the lack thereof) could pose to the financial sector.

However, there is little international guidance or best practice aimed specifically at financial institutions to support their use of non-financial firms' transition plans. The NGFS has therefore sought to set out in this paper, current practices by financial institutions, including the information used by them, and how they are engaging non-financial firms to enhance their transition plans, as well as recommendations on how financial institutions can carry out such engagements, and how the broader ecosystem can support them in doing so.

8 At COP28 in December 2023, the parties agreed on targets for the GGA and its framework. Key targets to be achieved by 2030 include strengthening resilience to water-related climate hazards, attaining climate-resilient food production, and reducing the adverse effects of climate change on poverty eradication and livelihoods. A two-year work program has been kick started to establish indicators for measuring progress towards the goal's targets.

9 The GGA is meant to serve as a unifying framework that can drive political action and finance for adaptation on the same scale as mitigation. This means setting specific, measurable targets and guidelines for global adaptation action as well as enhancing adaptation finance and support for developing countries.

3. Findings around collection and usage of data from non-financial firm transition plans

The survey coverage is relatively limited but includes a well-balanced sample of balance sheet sizes

The survey enlisted the participation of 37 financial institutions, with 28 banks, 4 insurers, and 5 entities functioning as both banks and insurers (Figure 1).

The distribution of institutions in terms of total balance sheet size is well-balanced, with approximately one-third having total assets less than 25 billion, another third exceeding 500 billion, and the remaining third falling within the intermediate range (Figure 2). The majority of participating institutions are active in EMDEs (Figure 4)[10], encompassing both low and middle-income countries[11] (Figure 3).

Figure 1 **Type of institutions**

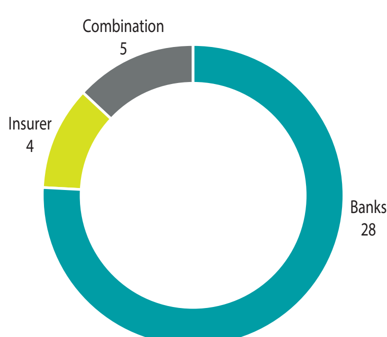


Figure 2 **Balance sheet size**

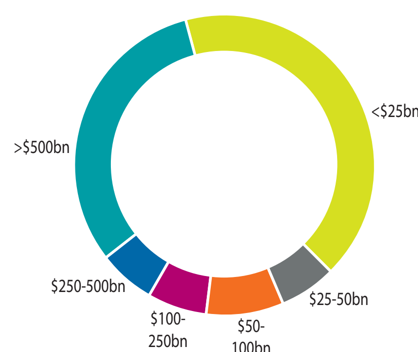


Figure 3 **HQ location**

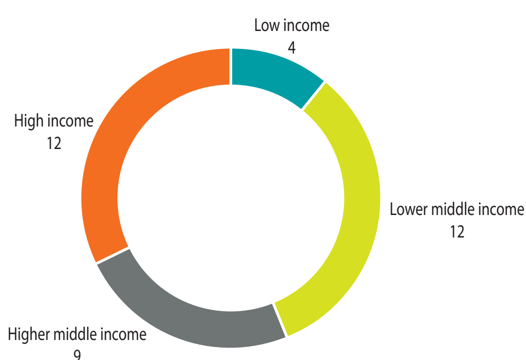
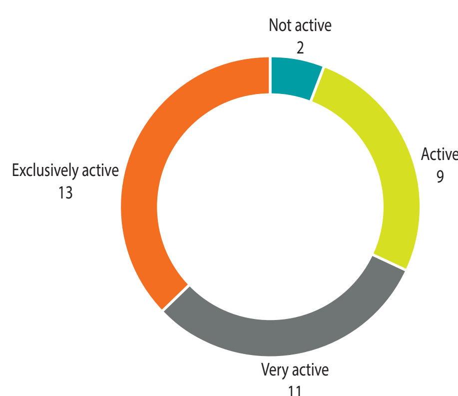


Figure 4 **EMDE presence**



10 In the context of the survey, the term active is defined in four categories ranging from not active (less than 5% of assets or revenue connected to EMDE) to exclusively active (nearly all assets located therein). Active and very active are defined as more than 5% and more than 50% of assets or revenue derived from business with EMDEs.

11 High-income countries are sometimes referred as AEs for the purpose of this report.

Finding #1 – Data collected – Most financial institutions currently collect a range of data relating to non-financial firm transition plans or transition planning.

Based on the NGFS findings, most financial institutions surveyed (62%) already collect information about the transition plans or planning for most of the companies they finance through various sources. This information is mainly collected through public disclosure and client engagement, which might take the form of a transition plan if available. If no plan is available, the information might come from the company website, ESG and Climate reports, investor presentations, or regulatory filings. While some data is also available through third party providers, this route was less utilised by survey respondents.

Point-in-time data on GHG emissions is the most frequently collected data by survey respondents across most types of activity. Nevertheless, the frequency of its collection varies according to the type of activity. Half of the financial institutions that grant loans to large non-financial firms surveyed collect point-in-time data on GHG emissions (typically such point-in-time data taken from climate disclosures will be historical data with a time lag and time stamped accordingly) – see Figure 5 row a. However, the proportion of financial institutions collecting point-in-time GHG emissions data falls to less than a third for financial institutions that participate in investments (32%), and a quarter for those participating in capital markets (24%). For firms participating in loans to SMEs and insurance underwriting activities, only around 20% collected data on GHG point-in-time data. This evidence supports the need for economy wide annual climate disclosures to improve availability of this data rather than relying on financial institutions' own data collection efforts.

Financial institutions' collection rates on future pathway data on GHG emissions are smaller compared with historical point-in-time data for all categories – see Figure 5 row b. Supplemental intelligence suggests that GHG emissions on pathway data (firms own projected future emissions) is collected less frequently as it is currently not easily available to financial intermediaries compared with point-in-time data.

After point-in time data on GHG emissions, the most frequently collected data by survey respondents that grant loans to large non-financial firms were: i) climate-specific targets, ii) vulnerability to physical risk and risk mitigating actions planned, iii) measures of Energy usage (average 38%). As shown in Figure 5 column of 'loans to large non-financial firms', the collection rate decreases to around 30% of the respondents included in the sample for other data such as: i) GHG Emissions pathway data (non-financial firms' own projected future emissions), ii) actions to meet climate targets, iii) transition planning assumptions and limitations,

Figure 5 **% of respondents that collected different data types across different business activities**[1]

	Loans to large non-financials	Loans to SMEs	Capital Markets	Investments	Underwriting
a. GHG Emissions point-in-time data	50	21	24	32	18
b. GHG Emissions pathway data (firm's own projected future emissions)	34	15	14	14	14
c. Climate-specific targets	38	7	17	17	10
d. Actions to meet those targets	32	11	13	14	7
e. Transition planning assumptions and limitations	32	14	10	17	14
f. Data to support assessment of likelihood of adherence to those plans	28	7	13	17	14
g. External dependencies to deliver actions in the plan	18	7	10	14	11
h. Vulnerability to physical risk and risk mitigating actions planned	41	30	17	21	21
i. Measures of Energy usage	37	19	13	13	14
j. Measures of other resources usage	28	15	7	13	14

1 For respondents participating in multiple activities, their responses are represented in each of the relevant columns of activity in the table.

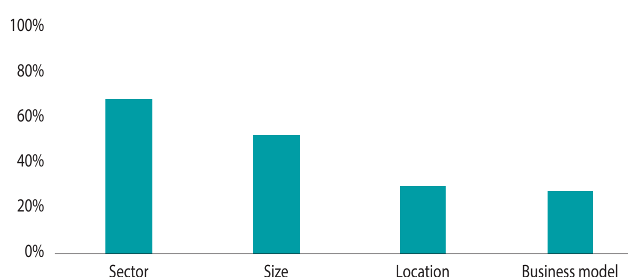
iv) data to support assessment of likelihood of adherence to transition plans; and v) measures of other resources usage. Finally, external dependencies (e.g. technological maturity dependencies) to deliver actions in the transition plan and other elements are the items least collected by survey respondents with around 18% collecting these elements from non-financial firms' transition plans, perhaps indicating a lack of availability of information about such 'known unknowns'. Other data collected by a very small sample of the respondents included social and governance metrics, use of carbon pricing, use of climate change scenario modelling, measures of production/activity data and ESG-related initiatives. It is likely that such data has lower rates of collection due to lower availability of this information.

Finding #2 – Data collected – The type and amount of data collected from financial institutions' clients' transition plans varies depending on characteristics of the client.

In the case of loans to SMEs, results of the survey show that data collected is significantly lower compared to large non-financial firms. As shown in Figure 5, vulnerability to physical risk and risk mitigating actions planned is the item most frequently collected data item by financial institutions (30%), this could perhaps be because SMEs are likely to be more vulnerable to physical risk events due to concentrations in business activity and less diverse locations of business operations. This is followed by GHG Emissions point-in-time data (21%) and measures of energy usage (19%), the latter of which could be used as a proxy for the former. Frequency of collection for the other elements drops to much lower rates of 15% or below. As with loans to large non-financial firms, external dependencies to deliver actions in SME's plans are collected by the fewest respondents, again suggesting lack of information in this area and linked to the likely higher exposure of SMEs to physical risk.

According to the survey findings, the sector in which the company operates is the most influential factor affecting the collection of data. Companies operating in high-emission sectors such as energy, mining, and transportation provide more details compared to companies in the service sector, this is likely due to their greater impact on their business from transition and potential exposure of risk and thus also greater awareness of the issues. One respondent noted that its targets are tailored by sector to address the sources of emissions needed for that sector to decarbonize.

Figure 6 **Factors identified by repondents as affecting granularity or detail of information collected**



The size of the company was another key influence on the amount of publicly disclosed information available for collection. Larger companies tend to disclose more detailed information, particularly where they are required to do so to comply with regulations and institutional investors' expectations. These can also be found in several different sources (public reports, external vendors, etc). In addition, financial firms are likely to have greater bilateral exposures to, and greater profitability and revenues from, larger firms. SME's generate less revenue and are less of a risk on a bilateral basis as financial institutions' exposure to them tends to be smaller as well. As a result, financial institutions collect more information and data from large non-financial firms than from SMEs due to both availability and prioritisation of this data. Greater precision, credibility, reliability or utility of large non-financial firms' information could be another explanation for greater data collection from these larger firms.

In terms of geographic location, financial institutions noted that European companies tend to publish more information due to advanced regulations related to transition and ESG disclosure in this region. As a result, the survey findings noted that there was less information disclosed by companies located in Asia, Americas and emerging economies.

Finding #3 – Usage of data – Non-financial firms' transition plans can inform a range of uses by financial institutions but are currently primarily being used to inform their own decarbonisation commitments.

The majority of survey respondents either use, or have plans to use, non-financial firms' transition plan data for some purposes. These were related to (i) the fulfillment of their own decarbonization commitments, (ii) the definition of their business strategy and to support transition finance, and for (iii) risk management purposes.

However, survey results show strong heterogeneity of how, and for which purposes, transition plan data from clients is being used, or planned to be used, by responding financial institutions. This might be related with the nascent nature of transition plans and the limited experience of financial institutions in dealing with this type of data. At the roundtables, participants noted that the nature and content of transition plans are still in flux given the evolving regulatory requirements.

Most often, transition plan data is used as a leading indicator to assess the ability of the financial institution to fulfil its own decarbonization commitments (62%). This is to be expected given that 68%[12] of respondents had made, or are planning to make, public decarbonisation commitments**.** Institutions named a range of GHG emission information they retrieve for these purposes – including both quantitative information, such as past emissions and future emissions (targets and interim targets), and qualitative forward-looking information, such as planned mitigation measures, scenarios used by non-financial firms and emission trajectories. In utilising such information, financial institutions may need to consider the potential for carbon lock-in (particularly for long dated assets/ transactions located in EMDEs) which could impede their ability to fulfil their own decarbonization commitments.

Transition plans are also useful because, unlike backward-looking disclosures, they disclose a company's future ambition, articulate a forward-looking strategy and help to identify the necessary initiatives. As Figure 7 shows, in about half the institutions surveyed (48%), the data is used to identify climate positive or climate negative projects. 50% also use transition plans to identify investment opportunities and 40% used the data as a leading indicator of potential change in the business profile of the clients. Commitments made in transition plans on transition and strategic reorientation were given as examples of such information. Only a few institutions reported to assess capital expenditure (CapEx) based on information from non-financial firms' transition plans. As transition plans could inform forward-looking investment decision, information on CapEx and trajectories are expected to become more relevant as a use for financial institutions going forward.

Figure 7 **Respondents uses for information gathered from a client's transition plan/planning**

	Using now	Planned	Sum
As a leading indicator for the ability of your institution to fulfil its own decarbonisation commitments (if any)	57%	39%	96%
As a means to fulfil FI's own internal reporting and/or disclosure obligations	56%	41%	96%
As an input into the institution's risk management process – due diligence	54%	39%	93%
As a means to identify investment opportunities	50%	38%	88%
As a means for financial institutions to identify climate-positive projects, and/or transactions that may result in elevated financed emissions	48%	44%	93%
As a means though which the institution can engage with its clients that could lead to additional financing opportunities	46%	39%	86%
As a leading indicator of potential change in the business profile of companies to which the financial institution provides services	40%	44%	84%
As an input into the institution's risk management process – stress testing	33%	59%	93%
As a means to inform financial product pricing decisions	16%	56%	72%

Note: all % figures in table have excluded NA or blank responses from the denominator.

12 Of the remaining respondent that had made public decarbonization commitments that did not indicate use of corporate transition plans to monitor its own ability to fulfil those commitments, additional information was provided to indicate that such information was collected only in certain regions for this purpose.

Around half the institutions surveyed use this data for some risk management purposes (54% in the due diligence process and 33% for stress testing purposes). This view was corroborated in the roundtables, with participants indicating that transition plans are not primarily seen as a risk management tool, but rather to support them in fulfilling their own decarbonisation commitments and for client engagement purposes (i.e. for business development). Furthermore, more than half of respondents (56%) use information on transition plans for their own reporting. These findings indicate that there are currently different expectations between micro-prudential authorities and financial institutions on the uses of non-financial firm transition plans, suggesting that further thinking and recommendations on how to better support financial institutions in feeding through client transition data to inform their own transition planning and risk management frameworks would be useful.

Finding #4 – Usage of data – Financial institutions recognise the importance of collecting client data but may need more support in utilising it fully and with confidence, particularly with greater availability of forward-looking data to inform a greater range of uses beyond their own decarbonisation goals.

Almost all respondents indicated that the information collected from non-financial firms' transition plans was "Quite important" or "Very important", with the end use of the information influencing the degree of importance attached to it.

- **When used to fulfil the financial institution's own internal reporting and/or disclosure obligations, half of respondents (50%) stated this information was 'Very important'.** As noted above, this is potentially a reflection of the number of institutions requiring emissions data (often not available through other means) to fulfil their own public decarbonization commitments. In this regard, feedback from the roundtables indicated that disclosure of non-financial firms' transition plans are useful to financial institutions.

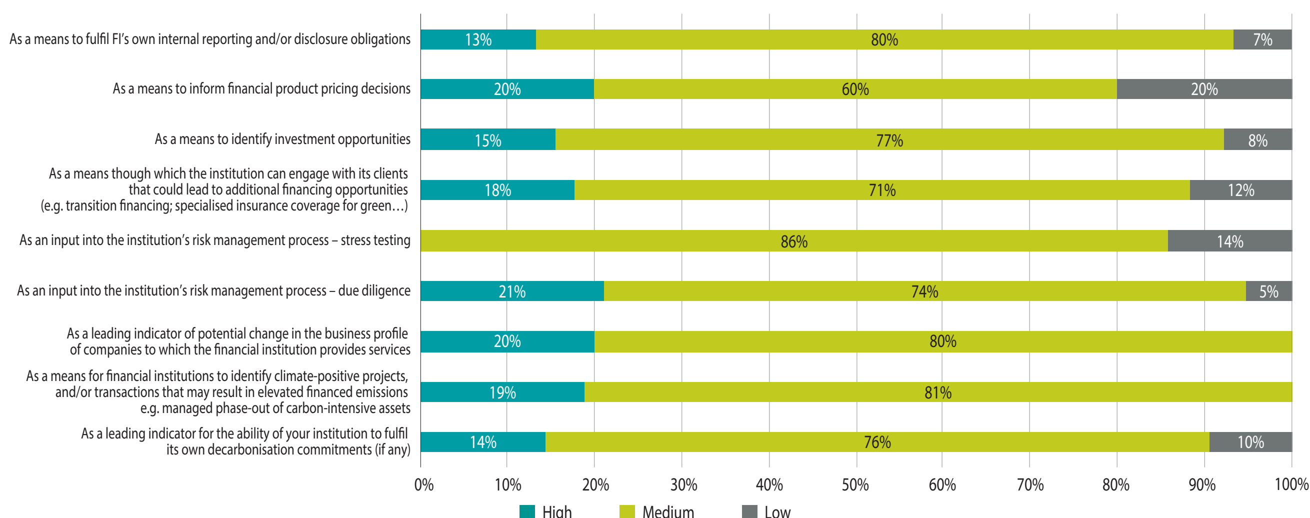
- **When used for risk management purposes, the same amount indicated it was only "Quite important".** Financial institutions also deem non-financial firms' transition plan information less helpful in assessing the risks of non-financial firms under different scenarios. This is potentially due to the fact that climate-related information available in transition plans only forms part of a firm's risk profile, and financial institutions might be able to assess a firm's risk profile based on other material risk factors through the existing due diligence process.

Figure 8 **Attribution of importance of different types of data by respondents who are currently using or planning to use that data**

	Very	Quite	Sum
As an input into the institution's risk management process – due diligence	38%	50%	88%
As a leading indicator for the ability of your institution to fulfil its own decarbonisation commitments (if any)	44%	41%	85%
As a means though which the institution can engage with its clients that could lead to additional financing opportunities (e.g. transition financing; specialised insurance coverage for green technologies)	42%	42%	83%
As a leading indicator of potential change in the business profile of companies to which the financial institution provides services	43%	38%	81%
As a means for financial institutions to identify climate-positive projects, and/or transactions that may result in elevated financed emissions e.g. managed phase-out of carbon-intensive assets	44%	32%	76%
As a means to identify investment opportunities	35%	35%	70%
As a means to fulfil FI's own internal reporting and/or disclosure obligations	50%	15%	65%
As an input into the institution's risk management process – stress testing	24%	40%	64%
As a means to inform financial product pricing decisions	17%	39%	56%

Note: all % figures in table have excluded NA or blank responses from the denominator.

Figure 9 **Attribution of confidence in different types of data by respondents who currently use, plan to use or do not use that data**



Note: all % figures in table have excluded NA or blank responses from the denominator.

Very few respondents indicate having "High confidence", for the different purposes assessed. Most felt that the confidence in the data was "Medium" (73-92% range across the various categories). Moreover, many institutions could not ascribe any level of confidence and left their assessment for different purposes blank.

It is likely that financial institutions lack suitable methodologies to use or interpret non-financial firms' transition plan information. This may be partly due to non-standardisation or varying levels of quality, which also would result in the data collected not meeting the high bar required in terms of validation for use in risk models (particularly where these may be scrutinised as part of the supervisory process).

The findings above also suggest that while historical point-in-time data is most widely available, financial institutions would benefit from greater availability of forward-looking information. Access to data on future projections in non-financial firms' transition plans (e.g. timing and extent of planned changes in business profile) would likely increase the collection and utility of these plans in informing financial institutions risk management and other uses beyond their own decarbonisation goals.

4. Challenges raised by financial institutions in using information in non-financial firms' transition plans

Challenge #1 – Information from non-financial firms' transition plans is currently less decision-useful due to limited data availability as well as comparability and consistency issues.

Non-financial firms are at different stages of readiness and many are unable to provide data as their transition plans and associated information do not yet exist or are in progress. This can be due to lack of resource or capability to develop such plans and collect such information, and/or unwillingness to do so. Certain sectors, such as those subject to more climate or environmental-related regulations (e.g. energy), may be more advanced. The extent of development of non-financial firms' transition plans varies by the type of company, with the largest or public listed companies most advanced. Scope 1 and 2 emissions are more readily available than Scope 3. The granularity of data available also varies across companies.

Financial institutions also face difficulties obtaining information from non-financial firms as their clients are not incentivized to provide this data. This may vary by jurisdiction as regulatory requirements for non-financial firms' disclosures differ between countries and may be more nascent in EMDEs. Non-financial firms may also be concerned about litigation risks and greenwashing should they publish a transition plan.

Information obtained from non-financial firms' transition plans is not comparable even within the same industry due to a **lack of standardisation in carbon accounting methodology** (e.g. automobile manufacturers may consider different lifespans for their vehicles when conducting an assessment on the lifecycle emissions). **Estimations are also not consistent due to differences in forward looking assumptions** that are made on the cost, feasibility, and efficiency of technology such as carbon capture.

The ability of non-financial firms to access high quality data on their own emissions also varies depending on the type of emissions. In most cases, real economy industries have greater control over their upstream emissions, and they are able to calculate this with greater accuracy as compared to downstream emissions. Downstream emissions depend on usage, where greater uncertainty exists. Since downstream emissions form part of Scope 3 emissions, the accuracy of figures including downstream emissions figures will have an impact on the credibility of non-financial firms' transition plans. For example, IBM has stated "the assumptions that must be made to estimate Scope 3 emissions in most categories do not enable credible, factual numbers" (We Need Better Carbon Accounting. Here's How to Get There).

Challenge #2 – Non-financial firms' plans may be primarily focused on business strategy and may not include all information necessary for risk management.

Non-financial firms' transition plans are generally for the purpose of business strategy rather than risk management *per se*. While such plans may not provide the full range of information directly useful for a financial institution in making risk assessments, the information retrieved from clients through them can be useful to inform such assessments.

Forward-looking information contained in non-financial firms' transition plans is often limited to a single scenario. Non-financial firms' transition plans are often primarily focused on non-financial firms' decarbonisation goals, and lack information needed by financial institutions to assess risks of non-financial firms under different scenarios (e.g. hothouse world).

Little mention was made about assessing the ability of non-financial firms to follow through on their transition plans which was hypothesised as an area of potential focus. This could be a second order concern given the aforementioned challenges in obtaining any useful information at all.

Challenge #3 – Any forward-looking information has a high degree of uncertainty and climate transition planning is no exception, thereby impacting the ability of financial institutions to use this information in their own climate transition plans.

Uncertainty can stem from within the non-financial firm. This includes the accuracy of its own working hypotheses and assumptions on decarbonisation levers and business pathways, as well as the ability of the non-financial firm to follow through on its plan.

Uncertainty can also stem from external factors. This can include policy uncertainty and market developments. For example, carbon pricing mechanisms, public support of products, economic conditions (which can affect ability to invest), etc.

Sector-specific developments (e.g. in technology) are expected to precipitate changes in sectoral pathways and result in moving targets. This means that financial institutions will need to constantly evaluate transition plans against a moving benchmark, creating assessment burden as well as a need for flexible datasets and data infrastructure.

Challenge #4 – Information in non-financial firms' transition plans may be difficult to aggregate and compare due to heterogeneity of financial institutions' portfolios.

Data availability varies significantly and may not be comparable. Non-financial firms may be at different levels of maturity (e.g. some do not even have any transition strategy), which may contribute to different levels of data availability. Underlying assumptions (e.g. in terms of technological developments) may also vary. Jurisdictions may also progress at a different pace (e.g. some have clear sector roadmaps).

Sub-sector firm specificities may not translate well into portfolio-level figures. For example, it may not be meaningful to compare emissions intensity based on production of 1 unit of steel vs 1 unit of copper. This may make it difficult to use this information to make high level decisions.

The use of proxy data may increase the likelihood of deviations from estimates. As baseline performance is unknown, financial institutions may need to adjust their assessments to incorporate newly available data.

Challenge #5 – Financial institutions may not be ready to use information in non-financial firms' transition plans for credit risk evaluation processes at this stage.

Methodologies to translate climate-related factors[13] into the credit risk assessment process have yet to mature. Some risks may materialise beyond the credit rating horizon, or even the loan or insurance horizon. Also, climate-related risks may not be key driving factors for the credit assessment.

13 E.g. where client stands vis-à-vis the portfolio trajectory, the client historical emissions, current carbon intensity, forecast intensity (based on public targets).

5. Engaging on non-financial firms' transition plans

Some elements by non-financial firm clients in their transition planning frameworks are or could be utilised by financial institutions.

The elements set out in Table B have been identified through the results of the survey and roundtable discussions and could be priority engagement areas for financial institutions.

An increasing number of financial institutions are engaging clients on the content of their transition plans to make them more decision-useful.

Around half of respondents (46%) currently engage with their clients on the content of their transition plans to make them more decision-useful, while a small amount plan to do so in the future. The evidence suggests however that client engagement for this purpose is not systematic and still evolving, particularly with smaller clients. One example of how firms also use client engagement is by using relationship managers to engage directly with clients to complete their ESG assessment where the required information is not publicly available in a client's disclosure. A small number of survey respondents have plans to actively engage with clients on financing and strategy based on clients' transition plans, but none of them does so currently.

While responses indicate limited *current* experience with transition plans, many respondents who were not yet collecting data from their clients or for certain activities expressed an intention to do so in the future. This may signal that financial institutions have a requirement for more information, particularly forward-looking information of sufficient reliability for risk management purposes. It also might indicate that there is an expectation from financial institutions that the disclosure of transition plans would provide this information in future for their use.

Financial institutions generally engaged with clients that had no transition plans either directly through focused engagements or indirectly (through the due diligence/risk assessment process), with the objectives of (i) obtaining information that might otherwise be included in non-financial firms' transition plans; and (ii) building capacity among non-financial firms to develop transition plans. Such information might include transition activities, CapEx planning/future investment opportunities. Larger financial institutions with a broader span of activities are more likely to engage with clients to enhance the level of knowledge regarding their ESG profile, including their transition activities and related strategies, and may have a more targeted engagement process. For instance, one of the institutions reporting an annual turnover above $500bn reports that it actively engages with customers from critical segments to specifically help them create robust transition plans and set clear emission reduction targets. However, where engagement is reported, various approaches have been identified in terms of how respondents conduct said engagement.

The existence of this supplementary client engagement process to obtain information and build capacity implies that a unified transition plan containing the sought information would be valuable and that capacity within both financial institutions and their non-financial firm clients was lacking. If and where engagement with clients is reported under a transition umbrella, financial institutions highlighted exchange mostly on stages *before* actual transition planning, namely, encouraging customers to recognise climate risk in the first place, encouraging disclosure (where it is not mandatory) and set themselves up for transition planning in the future.

Respondents expected to increase the intensity of engagement when and where transition planning does become recommended or required as part of the overall regulatory framework. This could be the case for the EU, where transition plans may become mandatory for many non-financial firms under the CSDDD and CSRD; and the UK, where the Sustainable Finance Roadmap plans a consultation on mandatory transition plans.

Among the limited sample composed mainly of banking institutions, differentiation between financial institution business models was not pronounced. Institutions that combine banking and insurance activities were among the leaders of the whole sample in terms of getting involved in initiatives aimed at enhancing client data and/or their awareness on issues pertaining to the transition planning spectrum, irrespective of their size. On the contrary, the

responses given by insurers demonstrated a less advanced level in taking such initiatives.

Based on the sample, it is difficult to grasp the exact influence of the location of financial institutions' headquarters and activities on the extent of engagement by financial institutions with those clients, if any. The institutions with the widest range of reported initiatives related to the transition planning of their clients have headquarters in advanced economies, irrespective of the main location of their activities – but it should be noted that these are also large institutions. Furthermore, no clear pattern emerges among the responses from the institutions based on the main location of their activities.

Table B **Elements of non-financial firms' transition plans potentially of use to financial institutions**

<table>
<tr><th colspan="2">Purpose</th></tr>
<tr><td>Risk management</td><td>Resilience of non-financial firm to transition and physical risks: The extent to which a non-financial firm's business model, assets and operations are resilient to transition and physical risks, as well as how the non-financial firm plans to manage the risk over time (e.g. transition its business model) will play directly into a financial institution's risk assessment of that non-financial firm. As the availability of forward-looking data increases, such plans can become more useful to financial institutions as a leading indicator of potential change in the business profile of non-financial firms and its future viability.

Examples (due diligence)[1]:

• [Currently used] Absence/shallowness of transition plans as a warning sign triggering enhanced due diligence

• [Currently used] Transition readiness for a low-carbon economy as a leading indicator of potential change in business profile

• [Planned] Trajectory (e.g. CapEx, technologies and product mix, project impact)

Examples (stress testing):

• [Currently used] Absence/shallowness of transition plans as a potential input to credit stress testing

• [Currently used] GHG emissions profile (historic emissions and carbon intensity)

• [Planned] Net zero commitments (emission targets, including interim targets)

• [Planned] Default rates incorporating climate risk assessment/vulnerability assessment

Examples (leading indicator of potential change in business profile):

• [Currently used] Time-bound commitments

• [Currently used] Strategic reorientations (e.g. through CEO foreword)

• [Currently used] Readiness for low-carbon economy</td></tr>
<tr><td>Progress on FI's own decarbonization targets</td><td>Reporting on financial institutions' own greenhouse gas (GHG) emissions profile and planned transition pathway: Financial institutions may as part of their own transition planning processes choose to set climate targets privately or publicly or be required to align with jurisdictional climate targets. Respondents noted that until transition plans were made mandatory for a greater number of non-financial firms of all types and size, there were insufficiently available non-financial firm transition plans to use them in a structured way. A number of respondents planned to utilise non-financial firms' transition plans where they are available to monitor progress on their own decarbonisation targets.

Examples of information in use by financial institutions:

• [Currently used] GHG emissions profile (historic emissions and carbon intensity)

• [Currently used] Net zero commitments (emission targets, including interim targets)

• [Currently used] Geographical considerations (e.g. jurisdictional differences in net zero timelines)

• [Currently used] Trajectory (E.g. CapEx, technologies and product mix, project impact, scenario)

• Planned] Project-level impact on ability to follow through on financial institutions' own transition plan

Such information may feed into client engagement by financial institutions.

Examples of information in use for financial institutions' own disclosure obligations:

• [Planned as existing non-financial firm disclosures are inadequate] GHG emissions profile (historic emissions and carbon intensity)</td></tr>
</table>

1 Examples have been classified into those 'currently used' or 'planned' based on survey responses in these categories, and may not be representative of all financial institutions.

Likelihood of non-financial firm's follow through with transition plan (this can be used for risk identification or financial institutions' own decarbonisation targets)	**Robustness of governance:** Robust governance processes can serve to align and drive organisational behaviour towards desired outcomes and business strategies. In the context of non-financial firms' transition plans, financial institutions should understand how their clients incorporate consideration of climate risk into their governance processes, including the tone from the top, as this can influence the resources channelled towards the non-financial firm's transition plan. Examples of information in use by financial institutions: • [Currently used] Enterprise-wide approach including governance and incentives • [Currently used] Transparency, verification and accountability; mandatory disclosures can enhance reliability of available information
	Presence of actionable milestones: The presence of short- and medium-term metrics and targets could be indicative of a non-financial firm's commitment to taking action and could increase the likelihood of a non-financial firm successfully operationalising its transition plan. Examples could include a corporation's transition plan related CapEx, technology profile and planned product mix. Examples of information in use by financial institutions: • [Currently used] Interim targets and their level/changes in ambitions • [Currently used] Current and projected energy mix/usage • [Currently used] Transition plan related CapEx • [Currently used] Technology profile/planned product mix
	Identification of dependencies: As transition plans can span a long time frame, this introduces greater uncertainty. Examples could include information about the extent of a non-financial firm's reliance on unproven technologies to implement its plan. Examples of information in use by financial institutions: [Currently used] Technology profile
Financing/investment/insurance opportunities	**Transition Finance:** Financial institutions can utilise non-financial firms' transition plans to gather information on areas and timings where additional financing or insurance is required (e.g. planned CapEx). Examples of information in use by financial institutions: • [Currently used] Net zero commitments (emission targets, including interim targets) • [Currently used] expected revenues from new products/services • [Currently used] Trajectory (E.g. CapEx) • [Currently used] Project-level impact on portfolio emissions • [Planned] Structured client engagement program based on assessment results One institution said that existing engagement on non-financial firms' strategy and needs was more helpful than relying on transition plans at this time.
	Tailored product offerings: A financial institution mentioned that information from non-financial firms' transition plans was a factor in offering sustainability-linked products (e.g. to identify or monitor sustainability KPIs).
	Investment: While a number of respondents said that they used non-financial firms' transition plans as a means to identify investment opportunities and attributed it as 'very' or 'quite' important, only two respondents elaborated on the type of information they used. Examples of information in use by financial institutions: • [Currently used] Presence of decarbonisation targets (e.g. Net zero by 2050, interim targets) • [Currently used] Trajectory (E.g. CapEx) • [Currently used] Customer's existing emissions intensity relative to scientific pathways aligned with their targets

6. Recommendations

Figure 10 **Recommendations to enhance connections between non-financial and financial institution transition plans**

1. Financial institution can improve their own transition planning by targeted engagements with non-financial firms in the following areas:

Risk management	Financing, investment and insurance opportunities	Collect input to measure progress on FI own decarbonization targets	Credibility by assessing the likelihood of non financial firm's **follow through with transition plan**

2. Facilitation of the development of non-financial firms' transition plans and their availability to financial institutions

National climate and adaptation strategies; Real economy sector roadmaps	Active **capacity building** through the promotion of best practices	Use of **international frameworks** and consistent climate disclosure standards	**National emissions database** as an example of a common public goods/infrastructure

3. Policy considerations for financial sector regulators

Coordination on standards, timelines and standards of credibility across the real economy, while remaining proportionate and flexible in individual FI application	Recognition of **critical differences between non-financial firms and financial institution** transition planning	Recognition that financial institutions' transition planning can encompass **aspects that extend beyond a focused prudential remit**

6.1 Areas in which financial institutions can engage with non-financial firms to improve non-financial firms' transition plans to better meet financial institutions' needs and purposes

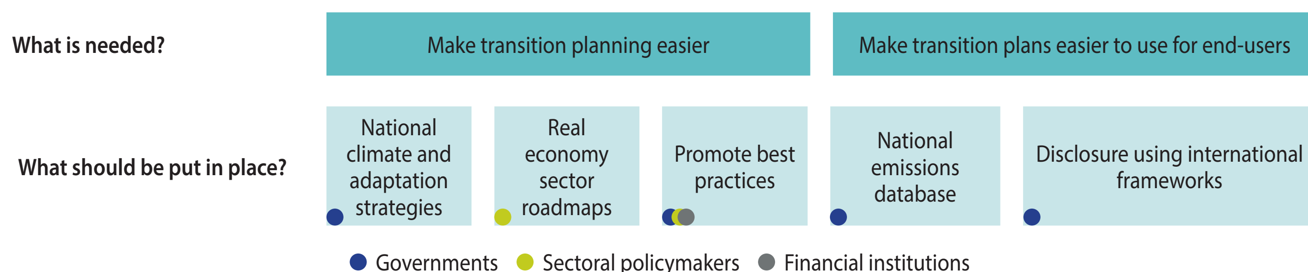
Non-financial firms' transition plans can be an important source of business and risk information for financial institutions, who are thus incentivised to engage with said firms to improve said transition plans.

It is thus in financial institutions' interest to engage with non-financial firms to encourage development of transition plans and to make firms' transition plans more useful for financial institutions. That said, the degree of influence of financial institutions over a firm's business strategy is necessarily limited, and engagements may focus on specific priority areas for financial institutions.

Table C **Recommendations on areas for financial institutions to engage with non-financial firms to improve the availability and useability of non-financial firms' transition plans**

Financial institutions' informational needs	Recommendations on areas to engage with non-financial firms on their transition plans
For risk management	• Engage and incentivise clients to take climate risk mitigation actions e.g. flood adaptation measures • Raise awareness – when possible – on how to develop and implement a transition plan e.g. sharing best practices • Streamline engagement with clients to reduce data collection burden (e.g. through automated collection processes to supplement tailored engagement) • Increase likelihood of non-financial firms' successful implementation (see below)
Financing/investment/insurance opportunities	• Engage non-financial firms on their transition plans and their financing/insurance needs in order to implement said plans, including potential opportunities to extend funding or insurance to their upstream and downstream (e.g. suppliers) in relation to both decarbonisation as well as adaptation opportunities
Progress on FI own decarbonization targets	• Introduce ongoing continuous engagement • Stimulate the measurement and reporting of GHG emissions • Engage with clients to refine public disclosure of their transition plans • Recognize there is no 'one size fits all' solution. Support real economy transition planning efforts e.g. establishing dialogue with industry associations and other relevant stakeholders such as regulators and governments • Incentivise emissions reduction actions by clients e.g. sustainability linked loans • Increase likelihood of non-financial firms' successful implementation (see below)
Likelihood of non-financial firm's follow through with transition plan (this can be used for risk identification or financial institutions' own decarbonisation targets)	• Collect information on robustness of governance and encourage process enhancements where necessary • Collect information on presence of actionable milestones and consider incorporation into financial institutions' own processes e.g. when setting KPIs for sustainability linked financing instruments • Raise risk awareness by encouraging non-financial firms to identify their transition plan dependencies (e.g. technological and/or policy developments)

6.2 Areas where global and national actors, beyond microprudential authorities, can play a role to facilitate development of non-financial firms' transition plans and their availability to financial institutions



Making transition planning easier for firms by providing clarity around road ahead and capacity building

a) Creating clarity around the road ahead for the real economy – National climate and adaptation strategies (including supporting industrial and fiscal policy levers) at jurisdiction and sector level (i.e. sector roadmaps) are important enablers for the real economy and the finance sector to develop and implement credible transition plans.

Clear, consistent and stable policy signals relating to decarbonisation goals from the government can give non-financial firms more certainty in their development of transition plans. Governments can consider developing national climate strategies that communicate a trajectory clearly and transparently with the real economy, underpinned by decision-useful information, such as short and long-term climate targets and the initiatives (to be) undertaken to achieve those targets. Such initiatives could include: carbon taxation, regulated cap and trade/carbon emissions trading systems, phasing out fossil fuel subsidies, raising awareness of national decarbonisation strategies and commitments, and building capacity across sectors on strategies for mitigating and adapting to climate risks.

Likewise, governments could consider greater transparency in the timelines and scope of their national adaptation plans. This will allow non-financial firms and financial institutions to take the benefits of such risk mitigation into account e.g. continued long term financing availability for properties otherwise vulnerable to sea level rise in the absence of sea walls.

At a sectoral level, policymakers can develop standardised real economy sectoral decarbonisation pathways that reflect regional and national circumstances to guide transition planning by non-financial firms. Achievement of non-financial firms' decarbonisation commitments depends to some extent on the external policy environment, as such, supportive and complementary industrial and fiscal policies are necessary. Specific to the financial sector, such pathways can inform the development of consistent sector specific scenarios which can be used by supervisors to assess the impact of transition planning on long term assets and liabilities, and hence the solvency of financial institutions, and to work with supervised entities to ensure adequate capital buffers are maintained.

b) Active capacity building through the promotion of best practices by governments, standard setters and financial institutions will support development of transition plans.

While financial institutions can engage non-financial firms on their transition planning, this should be situated as part of broader capacity building efforts. Governmental outreach could have a strong signalling effect ahead of policy changes and hasten action by non-financial firms. Likewise, sectoral standard setting bodies would have greater domain expertise to give specific guidance to non-financial firms.

Making transition plans easier to use for end-users through supporting data availability and comparability

a) Use of international frameworks and globally consistent climate disclosure standards can enhance data availability, quality and comparability.

International climate disclosure standards such as ISSB S1 and S2 improve data availability, quality, consistency and comparability, and require entities, including financial institutions, to measure and report on GHG emissions and emissions reductions targets. Any jurisdictional disclosure framework should build upon and be interoperable with international reporting standards. This can help overcome the challenges that non-financial firms face to produce and provide the necessary data, and lower the cost to produce such information.

b) National emissions database as an example of a common public goods/infrastructure can support usage of transition plans.

Supporting development of public climate goods or infrastructure is an area where governments and policymakers could play a role. This could include development of a national emissions database and a national approach for the use of internationally recognised carbon accounting methodologies (e.g. as used in the European Emissions Trading Scheme (ETS))

to drive and monitor progress on decarbonisation. These public climate goods or infrastructure can be hosted on a platform that is endorsed and used by government and relevant ministries, the finance sector, regulatory bodies, and research and academia to ensure alignment across the national ecosystem.

6.3 Policy considerations for financial sector regulators

Policy considerations for financial sector regulators			
Objectives	Safety and soundness of FIs	Financial stability/ orderly transition	Ability of FIs to fulfil role as mobilisers of capital
Considerations	• Coordination on standards and timelines globally and across the real economy, while remaining proportionate and flexible in individual FI application to avoid unintended consequences • Recognition of critical differences between non-financial firms and FI transition planning • Recognition that FI transition planning can encompass aspects that extend beyond a focused prudential remit		

Coordination on standards and timelines globally and across the real economy, while remaining proportionate and flexible in individual financial institutions application to avoid unintended consequences

a) Guidance on transition planning and plans should consider global best practices and allow for flexibility and individualisation in the transition planning process.

Sectoral standard setters, including financial sector standard setters, should promote use and development of global best practices for transition planning and plans. Sector specific guidance or standards should be utilised for sectors where they exist, and else development thereof encouraged.

Policymakers should consider a principles-based approach to transition plan guidance or standards to ensure sufficient clarity on key expectations while allowing firms to apply flexibility and agility to adapt and execute their global decarbonisation strategies.

In particular, where financial authorities set supervisory expectations around transition planning, they should avoid a prescriptive approach to setting business strategy of financial institutions (in the absence of clear concerns over the long-term viability/sustainability of business model), and allow for flexibility and individualisation in the transition planning process subject to meeting core expectations. This is in recognition of differences in financial institutions' business and risk profiles, as well as possible changes in the operating environment (e.g. unexpected changes in policy). Financial authorities need to be mindful that changes in financial institutions' portfolios do not necessarily translate to changes in the real economy; if financial authorities wish to set granular or prescriptive targets, these have the potential to hamper financial institutions' ability to pivot in response to changes and/or finance/insure clients' transition. However, supervision and/or regulation should be calibrated such that financial institutions are incentivised to make the changes necessary for their business model to remain viable in the long term.

b) Coordination between standard setters across jurisdictions on transition plan frameworks is necessary to avoid fragmentation, duplication and compliance burden and support a level playing field.

Coordination on transition plan frameworks by standard setters (should they decide to develop them) is critical to ensure consistency and avoid fragmentation, duplication of reporting and excessive compliance burden. This is particularly

important for financial institutions that operate across multiple jurisdictions. Where jurisdictional initiatives such as the EU CRSD and CRD have very specific and precise requirements, cooperation by international standard setting bodies to ensure interoperability will provide clarity to non-financial firms and allow financial institutions access to more comparable transition plan disclosures.

c) Micro-prudential, and other financial authorities' expectations around financial institutions' usage of non-financial firms' transition planning and related disclosures should be coordinated with real economy policy frameworks for transition planning and data availability.

Unintended consequences could result from introducing top-down sustainable finance regulations and supervisory expectations on transition planning and related disclosures in the absence of synchronised bottom-up policy frameworks to support real economy transition. Financial institutions under pressure to meet decarbonisation targets may withdraw capital in an indiscriminate manner from certain sectors and clients. The resultant lack of access to capital by higher emitting sectors and companies (particularly SMEs) will hinder their ability to transition, increase financial risks from disorderly or no transition[14], and potentially create price volatility for consumers and erode public support for climate policies. This effect is exacerbated if financial regulations are based on advanced economy transition pathways whilst real economy policy measures reflect emerging market conditions of relatively slower transition.

Financial regulators should consider the potential interactions between financial institutions' transition planning and disclosure-related requirements and the pace of the real economy, and coordinate with relevant agencies within a jurisdiction. For example, requiring portfolio-level disclosures by financial institutions may not be meaningful without non-financial firms first undertaking transition planning and disclosures; financial regulators may instead consider phasing in such requirements (e.g. starting with material exposures) so as to encourage transparency while balancing against compliance costs (i.e. reducing data collection costs for financial institutions) and data reliability (i.e. reducing likelihood of a heavy reliance on proxy data).

Financial authorities should distinguish between the internal process of transition planning and the external communication (such as public disclosure) of transition plans. The former can require more granular information to be provided to supervisors (as per the usual supervisory engagement process) than the latter, where financial institutions may be exposed to reputational or litigation risks. For example, a supervisor could reasonably engage with regulated financial institutions on the assumptions used, but may not expect them to disclose such assumptions in the same detail.

d) Micro-prudential, and other financial authorities' expectations around financial institutions' usage of non-financial firms' transition planning and related disclosures should consider the potential impact of those expectations on financial institutions' cross border exposures.

Applying uniform expectations around the pace of transition planning efforts may be counterproductive, particularly for operations in EMDEs. The pace at which non-financial firms transition may be particularly dependent on the pace of transition and the development of related regulations in the jurisdictions in which they operate. Authorities should be aware of such differences as they refine their expectations for the internationally active financial institutions they supervise – failure to incorporate proportionality and flexibility could hamper financial institutions' ability to facilitate cross border financing in certain markets (e.g. EMDEs). For example, relatively poorer data availability and transition planning capacity in EMDEs coupled with strict informational requirements could reduce availability of transition finance and/or creation of stranded assets.

14 For example, a delayed transition could entail higher physical risks for real economy companies, while a disorderly transition could have implications for the transition risks faced by real economy companies, including for green investments facing an operating environment not developing as expected. These could increase risks for financial institutions, particularly if adverse events occur in a correlated manner for their portfolio companies.

Recognition of critical differences between non-financial firms and financial institution transition planning

Standard setters and financial authorities should recognise that while the necessary elements of a credible transition plan by non-financial and financial firms may overlap in many cases, there are critical differences that should shape regulations and expectations to avoid certain risks arising.

a) **Degree of influence:** Non-financial firms have direct control over their own emissions (including some limited influence over their upstream and downstream Scope 3 emissions) and some control over their vulnerability to transition and physical risks. Financial firms are however dependent on a multitude of non-financial firms who they finance, insure or invest in, to make commercial decisions for the transition to a low-carbon, climate-resilient economy. While they can support such non-financial firms by providing financing/insurance/investment and/or building awareness/capacity, the degree of their influence on a non-financial firm is necessarily less than that firm's own influence on its own operations (e.g. in terms of Scope 1 and 2).

b) **Role of financial institutions as mobilisers of capital:** Financial institutions play an important role in the financial system as mobilisers of capital. An inability to provide such financing, such as if financial institutions are constrained by prescriptive requirements for information to be obtained from non-financial firms' transition plans, may result in reduced availability of transition/adaptation finance and a delayed and disorderly transition. As an example, financed emissions could go up temporarily due to a new loan that would enable a bank's customer to transition. This temporary increase in emissions may thus not always reflect elevated transition risk on the part of a bank (as this could reflect a longer-term reduction in exposure to carbon taxes by the customer), whereas an increase in a real economy firm's Scope 1 and 2 emissions due to increase in carbon-emitting revenue generating activity might be viewed more negatively.

Recognition that financial institutions' transition planning can encompass aspects that extend beyond a focused prudential remit

Financial authorities should be mindful that the cross cutting strategic nature of transition plans means that they have ramifications beyond a firm's risk profile and calibrate any guidance (including in relation to the usage of non-financial firms' transition plans) to the financial industry accordingly. Financial institutions' transition plans touch on commercial considerations and strategies, which may not be within the prudential remit, while also affecting a firm's risk profile, including its long-term business model sustainability, which fall within the prudential remit[15]. Financial authorities, particularly those with a narrow prudential mandate, should thus consider any potential regulatory requirements or expectations around transition planning in the context of that mandate (particularly those that do not directly relate to its risk profile and management thereof).

15 The Basel Core Principle (BCP) 8 indicates that "An effective system of banking supervision requires the supervisor to develop and maintain a forward-looking assessment of the risk profile of individual banks and banking groups, proportionate to their systemic importance; identify, assess and address risks emanating from banks and the banking system as a whole; have a framework in place for early intervention; and have plans in place, in partnership with other relevant authorities, to take action to resolve banks in an orderly manner if they become non-viable."

Specific measures that could be considered by policymakers and standard setters

Following are measures that various stakeholders can take to make real economy transition plans more 'usable' by financial institutions:

Table D **Measures that could be taken to support development of decision-useful non-financial firms' transition plans**

	Directly support development of non-financial firms' transition plans	Indirectly support development of non-financial firms' transition plans through enabling environment	Support comparability of non-financial firms' transition plans
Governmental and sectoral policymakers	• Incentivise transition actions when developing policies or regulations • Mandate implementation of transition plan standards • Endorse or build on existing industry-led transition plan frameworks for real economy companies	• Develop enabling environment e.g., sectoral pathways and taxonomies • Set clear and consistent commitment to science-based net zero goals • Set appropriate carbon prices • Regulate carbon markets to support GHG emissions reporting	• Coordinate actions with financial regulators and accounting standard-setting bodies to ensure proper sequencing of transition plan disclosures • Mandate implementation of transition plan disclosures
Standard-setters	• Raise awareness of real economy non-financial firms on why it is important for them to take climate risk mitigation and adaptation measures	• Allow for uncertainties in any standards issued to recognise that firms' transition plans rely on external factors that are not within their control • Ensure standards issued are interoperable with existing industry-led standards or guidance • Promote and promulgate industry best practices, such as directly through guidance or indirectly through industry bodies	• Provide standards on climate-related disclosures to improve data availability, comparability, consistency and granularity, particularly measurement and reporting of GHG emissions • Issue standards to harmonise transition plans for major sectors such as energy

6.4 Further study needed to better utilise information in non-financial firms' transition plans

While non-financial firms' transition plans (where available) currently have a number of limitations, but as the only source of forward-looking information at this time, they should be studied further by financial institutions and financial standard setters

Financial institutions should be encouraged to further study how best to utilise the information in non-financial firms' transition plans for business and risk purposes. While most financial institutions acknowledge that they are a potential source of information, more progress is needed to incorporate them into business and risk processes in a structured manner. Examples of risk processes could include means by which such plans are risk scored (e.g. likelihood of operationalisation as planned), as well as how to meaningfully integrate such information at portfolio level into decision-useful information (e.g. as part of stress testing). Examples of business processes could include conscious identification of potential investment/financing/insurance opportunities as part of a structured client engagement process.

Financial regulators should study how existing risk frameworks could accommodate the uncertainty inherent in forward-looking information. They need to understand and accept that the precision and availability of forward-looking information is far less than that of historical backward-looking data that has thus far underpinned regulatory requirements. They will need to develop new ways in which to assess the reasonableness of financial institutions' usage thereof, with necessarily a greater tolerance for uncertainty in realised outcomes (unlike traditional model validation).

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Annex 1 – NGFS-IIF Survey Questions

These survey questions are presented for transparency and to provide further information on the methodology used by the NGFS. The main results of the survey are presented in the reports. All other specific data, related to the survey, survey results and not included in the reports, will remain confidential.

The NGFS-IIF Survey questions are presented below in a shortened version.

Section A: Information about the surveyed institution

1. Is your firm a supervised banking institution or insurer, or do you have activities in both areas?

1.a. [For banks only] Where does your financial institution derive material revenue (i.e. at least 10% of revenue, approximately) from?

1.b. [For insurers only] Where does your financial institution derive material revenue from, including through reinsurance?

1.c. What is the total size of your balance sheet, in USD, as at year-end 2022?

1.d. To which income group does the jurisdiction where your institution's headquarters are located belong?

1.e. In which of the following geographic regions is your financial institution active?

2. Is your institution actively involved in emerging markets and developing economies (EMDEs)?

2.a. If you responded to Question 2 that your institution is active in EMDEs, is this mainly in lower income, middle income, or upper income countries?

3. Has your institution made public decarbonization commitments?

4. Has your institution conducted a transition planning exercise? Has your institution developed a transition plan (published or otherwise)?

5. Does/will your institution's transition plan cover climate-related objectives only, or broader sustainability objectives as well? If the latter, please specify the additional objectives it includes.

6. Does/will your institution's transition plan encompass both mitigation and adaptation actions?

7. What are the key metrics your institution considers important for its transition plan?

8. Does your institution's transition plan refer to an existing framework to inform the setting or selection of targets, objectives, metrics and contents (e.g. GFANZ, SBTi, CDP)? If so, please provide details.

9. How would you rate your institution's capacity (including expertise and resources) to develop and implement a transition plan on a scale of 1 (no capability) to 5 (high capability)? Please provide further details explaining your chosen rating.

Section B: Information about the institution's home jurisdiction

10. Does the jurisdiction in which your institution's group headquarters are located ("home jurisdiction") have a national policy framework (e.g., Nationally Determined Contribution, Climate Change Strategy, National Adaptation Plan) that addresses climate change and related risks, including clear targets and timelines (e.g., national time-bound net zero target)?

11. If you responded "Yes" to question 11, to what extent does your institution's transition planning align with the goals and objectives of that national policy framework?

12. Are there any regulatory or policy frameworks in your home jurisdiction that incentivize or require financial institutions to undertake transition planning/develop a transition plan?

Section C: Understanding of the approach and barriers to EMDEs vs. AEs

13. In your view and based on your internal assessment, please rate the perceived level of physical and transition climate and nature-related financial risks faced by your institution's business activities in aggregate, differentiating between AEs and EMDEs, on a scale of 1 (not relevant) to 5 (highly relevant).

14. What specific challenges does your financial institution face, or anticipate facing, in developing a transition plan in relation to your business activities in AEs or EMDEs? Please rate from 1 (not relevant) to 5 (highly relevant).

15. In your view, what should be the building blocks (e.g., specific tools, key elements, metrics) of transition planning by FIs in EMDEs to address the specific challenges faced by EMDEs?

16. In your view, as more financial firms embark on transition planning, would you anticipate any positive or negative consequences for financial flows to EMDEs?
17. In your view, could there be any additional repercussions of financial institutions' transition planning in EMDEs beyond its effects on financial flows transition? Do those repercussions warrant regulatory intervention from financial regulators?

Section D: Information about non-financial firms' (e.g., client, counterparty) transition plans/planning

18. Does your institution collect information about the transition plans/planning of some/all the companies it finances (with loan/loan equivalents) or offers other financial services to (e.g. insurance underwriting)? Such information could include how a company plans to align its core business with a specific strategic climate outcome and/or to identify and implement necessary actions to adapt to and mitigate climate change?

18.a. If you responded 'Yes' to Question 18, is this information provided by the counterparties via a transition plan? If no, please specify how your institution collects such information.

19. What information does your institution collect from non-financial firms' transition plans/planning, split by the type of activity you conduct?
20. How does the information gathered, as described in Question 20, differ in granularity or detail depending on any of the following factors related to the non-financial firm?

Section E: Views on key information and data needed from non-financial firms' transition plans/planning to inform financial institution transition planning and extension of transition finance

21. How does your institution utilize information gathered from a counterparty's transition plan/planning? Please rank them in order of importance
22. In what ways are the transition plans of your clients and counterparties not able to fulfil your institution's needs at this time?

22.a. What are some concrete steps that can be taken to alleviate the issues identified in 22? Please identify who should take which steps, e.g. your institution, your counterparty, policymakers, prudential supervisors. For example, policy makers should issue guidance/rules to standardize transition plans in strategic sectors (energy, car manufacturing etc.).

23. Does your institution currently engage with your clients/counterparties on the content of their transition plans/planning to make them more decision-useful (e.g. risk management, identifying business opportunities)?
24. Are there opportunities for greater engagement on such plans/planning that would allow your institution to better identify financing/underwriting/investing opportunities or risk management actions?
25. Are there areas where your institution would benefit from sharing of best practices in relation to using non-financial firms' transition plans as an input to a financial institution's own transition planning?
26. Are there things that financial regulators and supervisors should take note of as they engage with financial institutions on transition planning, and potentially develop policies in this area? For instance, whether certain policies and/or supervisory engagement could have unintended consequences.

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