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Climate transition plans

Navigating (at least) two worlds

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From insight to impact.

The world of climate change mitigation (impact)

Mitigation-centered purpose of transition plans

Commission Recommendation (EU) 2023/1425, para. 2.3:

"Transition plan means an aspect of the undertaking's overall strategy that lays out the entity's targets and actions for its transition towards a climate-neutral or sustainable economy, including actions, such as reducing its GHG emissions in line with the objective of limiting climate change to 1,5 °C."

ESRS E1, Appendix B: Application Requirements, AR 1

"A transition plan relates to the undertaking's efforts in climate change mitigation. When disclosing its transition plan, the undertaking is expected to provide a high-level explanation of how it will adjust its strategy and business model to ensure compatibility with the transition to a sustainable economy and with the limiting of global warming to 1,5 °C (…)."

Background: European Climate Law

Objective:

Climate neutrality – i.e. net zero greenhouse gas emissions – by 2050

→ The relevant Union institutions and MS shall take the necessary measures at Union resp. national level to enable the collective achievement of the climate-neutrality objective

Intermediate Objective:

Domestic reduction of net greenhouse gas emissions by at least 55 % compared to 1990 levels by 2030

Implementation:

Commission reviews relevant Union legislation to enable the achievement of the climate targets and considers taking the necessary measures, including the **adoption of legislative proposals**

From voluntary to mandatory transition plans

Private initiatives re climate/environmental reporting

- TPT Disclosure Framework
- Net Zero Banking Alliance (NZBA)
- Global Reporting Initiative (GRI)
- Glasgow Financial Alliance for Net Zero (GFANZ)
- Science Based Targets Initiative (SBTi)
- Carbon Disclosure Project (CDP)
- Partnership for Carbon Accounting Financials (PCAF)

Recently implemented and upcoming (?) EU legislation

- Corporate Sustainability Reporting Directive (CSRD)
  - European Sustainability Reporting Standards (ESRS)
- Corporate Sustainability Due Diligence Directive (CSDDD)

Disclosing transition plans: CSRD

- The CSRD requires undertakings to disclose any transition plan **“they may have”**
- Art. 19a (or 29a for parent undertakings of a large group) re information to be included in the management report:

> “(a) a brief description of the undertaking’s business model and strategy, including:
>
> > (iii) the plans of the undertaking, including implementing actions and related financial and investment plans, to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1,5 °C (…) and the objective of achieving climate neutrality by 2050 (…);
>
> (b) a description of the time-bound targets related to sustainability matters set by the undertaking (…), a description of the progress the undertaking has made towards achieving those targets(.)”

→ However, the recitals of the CSRD (esp. rec. 30) provide that the **CSRD does not create an obligation for undertakings to adopt a transition plan**

Disclosing transition plans: ESRS

ESRS 1	General requirements
ESRS 2	General disclosures
ESRS E1	Climate change
ESRS E2	Pollution
ESRS E3	Water and marine resources
ESRS E4	Biodiversity and ecosystems
ESRS E5	Resource use and circular economy
ESRS S1	Own workforce
ESRS S2	Workers in the value chain
ESRS S3	Affected communities
ESRS S4	Consumers and end-users
ESRS G1	Business conduct

ESRS – as delegated acts to the CSRD – concretize the disclosure obligations as stated by Art. 19a, 29a CSRD

Reporting under ESRS E1 if climate change is material based on double materiality assessment

Disclosure Requirement E1-1 focused on **climate change mitigation**

Mandating transition plans? CSDDD draft agreement

Proposal for a DIRECTIVE OF THE EUROPEAN PARLIAMENT AND OF THE COUNCIL on Corporate Sustainability Due Diligence and amending Directive (EU) 2019/1937 (Text with EEA relevance)
2022/0051(COD)
DRAFT [CSDD 4CT Post ITM on 22-23.1.2024 (final)]
24-01-2024 at 20h39

Article 15
Combating climate change

1. Member States shall ensure that companies (…) adopt and put into effect a transition plan for climate change mitigation which aims to ensure, through best efforts, that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement and the objective of achieving climate neutrality as established in Regulation (EU) 2021/1119, including its intermediate and 2050 climate neutrality targets, and where relevant, the exposure of the company to coal-, oil- and gas-related activities. (…).

Mandating transition plans? CSDDD draft agreement (cont.)

Best-efforts obligation (“obligation of means”; rec. 50) to supplement disclosure obligation of the CSRD

Large companies and companies in high-impact sectors

- Financial services: Only the upstream not the (more important) downstream part of their activities is covered (rec. 19); review after two years (rec. 70, Art. 29(1))
- But: Financial services seem to be subject to the requirement to draft transition plans!

Targeting **climate change mitigation** actions (incl. GHG emission reduction)

“Appropriate policy” to promote the implementation of the transition plan (Art. 15(3b))

Commission to issue guidelines with practical guidance on transition plans (Art. 13(1a)(b))

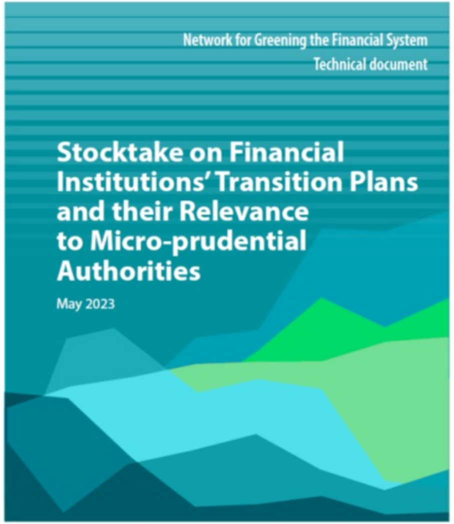
The world of climate change adaptation (risk management)

Transition as a prudential risk

- ESG factors, including those arising from the climate transition, pose risks to banks' balance sheet
- > 80% of euro area banks have concluded that transition risks have a material impact on their strategies/risk profiles
- But: their integration in the prudential framework is challenging (longer time horizons, forward looking…)

→ ECB's Frank Elderson:

"The best thing banks can do is putting in place Paris-aligned transition plans."



Transition plans as a risk management tool: CRD

Art. 76(2) CRD compromise text **mandates** banks to develop and monitor **prudential transition plans**:

Member States shall ensure that the management body develops and monitors the implementation of specific plans, quantifiable targets and processes to monitor and address the financial risks arising in the short, medium and long-term from ESG factors, including those arising from the process of adjustment and transition trends towards the relevant Member States and Union regulatory objectives and legal acts in relation to ESG factors in particular those set out in Regulation (EU) 2021/1119 (European Climate Law), as well as, where relevant, third country objectives and regulations.

→ Consistency with the transition plans under the CSRD, where they exist, in particular regarding the business model and strategy of the bank.

Transition plans as a risk management tool: relevance for supervisors

Bank supervisors will assess transition plans and targets as part of the Supervisory Review and Evaluation Process (**SREP**)

They will be allowed to "require institutions to reduce the risks arising in the short, medium and long term, from ESG factors (…) through adjustments to their business strategies, governance and risk management for which a reinforcement of the targets, measures, and actions included in their plans (…) could be requested." (proposed **Art. 104 CRD**)

(Draft) EBA Guidelines on management of ESG risks

EBA underlines the **prudential nature of transition plans under the CRD**:

“[transition plans] constitute a new risk management tool through which institutions should understand, assess and manage the risks stemming from their activities and exposures in view of the process of adjustment towards the regulatory sustainability objectives (…)” (no. 13)

- Key principles
- Governance
- Metrics and targets
- Climate and environmental scenarios and pathways
- Transition planning

Reconciling the different worlds?

Overview regulatory requirements reg transition plans

CSRD/ESRS	CSDDD (draft)	CRD IV (draft)	ITS on ESG risks
Voluntary	Mandatory	Mandatory	Mandatory
Corporate disclosures ("if")	Substantive requirements ("obligation of means"; rec. 50)	Substantive requirements	Pillar 3 disclosures
Large undertakings and "public-interest entities"	Large companies and companies in high-impact sectors	Credit institutions (proportionality clause)	Largest credit institutions
Predominantly climate change mitigation	Climate change mitigation	Climate change adaptation (risk management)	Predominantly climate change adaptation
External audit (limited assurance)	Assessment by "supervisory authority"	Assessment by banking supervisor	Assessment by banking supervisor

Do we know what we talk about?

- Reconciling the worlds of climate change mitigation and adaptation might be challenging for banks. They may need further guidance on how to do so.
- The meaning of any substantive obligations to disclose or adopt a transition plan remains subject to further debate and exploration.
- The content of transition plans may adapt and evolve depending on (future) use cases.

Thank you very much.

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Banks as users and producers of transition plans