TOWARDS A GLOBAL BASELINE FOR

Net-zero Transition Planning

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GFANZ
Glasgow Financial Alliance for Net Zero

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Members of the seven financial sector-specific net-zero alliances comprising GFANZ have signed up to the ambitious commitments of their respective sector-specific alliances and are not automatically expected to adopt the principles and frameworks communicated within this report, although we expect all members to increase their ambition over time, so long as it is consistent with members' fiduciary and contractual duties and applicable laws and regulations, including securities, banking and antitrust laws.

A guide to GFANZ 2022 net-zero transition planning deliverables

This guide provides an overview of the voluntary, pan-financial sector net-zero transition planning tools and guidance developed by the Glasgow Financial Alliance for Net Zero (GFANZ)[1] in 2022, and how these resources can be used together to support financial institutions' efforts to develop and implement net-zero transition plans.

GFANZ is a coalition of seven net-zero alliances in the financial sector. GFANZ and the sector-specific net-zero alliances are dedicated to the vital role of the financial sector in supporting the global transition to net zero. The sector-specific alliances comprise over 550 financial institutions[2] from 50 jurisdictions. By their own initiative, all GFANZ alliance members have made ambitious science-based commitments to support the transition to net zero.[3]

Governments and private sector firms around the world have committed to achieving net zero with the goal of limiting global warming to 1.5 degrees C. At the time of writing, 137 countries, representing 91% of global GDP, have made net-zero commitments.[4]

To fulfill these commitments and drastically reduce greenhouse gas (GHG) emissions, real-economy[5] firms, with the support of governments and the financial sector, must decarbonize their business activities and scale climate solutions to replace GHG-emitting assets, products, and services. The scale of capital needed is significant: for clean energy alone, the International Energy Agency's net-zero pathway requires annual investments this decade to triple from current levels.[6] The ongoing energy crisis, precipitated by the Russian invasion of Ukraine, has only further highlighted the urgency to transition to a new energy system that supports both climate stability and an affordable and reliable energy supply for consumers and businesses. GFANZ — a coalition of over 550 financial institutions committed to achieving net zero by 2050 — was founded because investment of this scale requires mobilizing the entire financial sector.

1 For more background information on GFANZ, refer to Annex 1.

2 As of October 2022.

3 Each alliance sets minimum commitment criteria for its members in support of the goal of reaching net zero by 2050 and setting interim science-based targets for 2025 or 2030 reflecting maximum effort toward a fair share of the 50% global reduction in GHG emissions needed by 2030.

4 Net Zero Tracker. Overview of the 2,000 largest publicly traded companies in the world by revenue, October 2022.

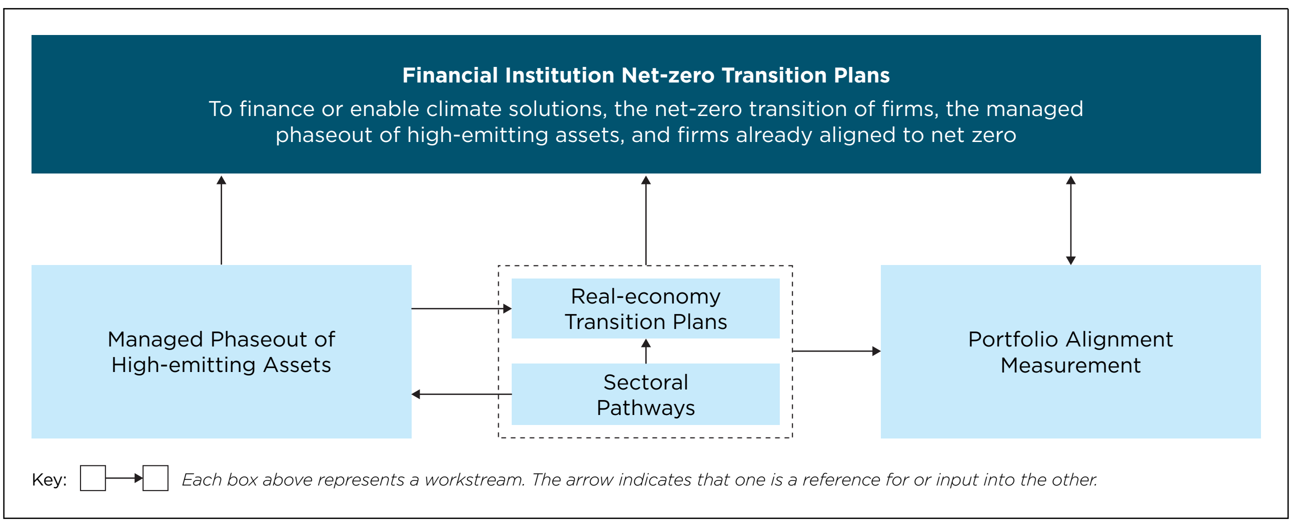
5 "Real-economy" refers to economic activity outside of the financial sector.

6 IEA. World Energy Outlook 2021, October 2021.

GFANZ 2022 net-zero transition planning work program

GFANZ established an ambitious 2022 work program to develop a series of pan-sector voluntary tools and guidance to support financial institutions' efforts to translate their net-zero commitments into action. The voluntary recommendations and guidance published by GFANZ aim to support financial institutions — including, but not limited to, members of the sector-specific net-zero alliances — in developing and implementing credible, high-ambition net-zero transition plans. GFANZ hopes this work can inform future public policy to ensure high standards in private-sector net-zero action.

Figure 1: GFANZ 2022 Net-zero Transition Planning Work Program



Source: GFANZ

As part of the broader 2022 work program, GFANZ also produced resources and worked with complementary initiatives to support increased mobilization of capital to emerging markets and developing economies and to encourage the acceleration of public policy needed to support the net-zero transition. Further details on the full GFANZ work program are available in the GFANZ 2022 Progress Report.

NET-ZERO TRANSITION PLANNING AND TRANSITION FINANCE

As part of the GFANZ recommendations and guidance for financial institution net-zero transition plans, four key financing strategies have been identified that collectively define transition finance. These strategies are inclusive of financing, investment, insurance, and related products and services that are critical to delivering real-economy emissions reduction in support of an orderly[7] net-zero transition of the global economy, and are defined as:

1. financing or enabling the development and scaling of **climate solutions**;
2. financing or enabling entities that are already **aligned** to a 1.5 degrees C pathway;
3. financing or enabling entities that are **aligning** to a 1.5 degrees C pathway; and
4. financing or enabling the accelerated, **managed phaseout** of high-emitting physical assets.

As the global community progresses toward net zero, GFANZ expects the availability of transition finance opportunities to grow and the allocation of portfolios to these four key financing strategies to increase correspondingly.

GFANZ's work on financial institutions' net-zero transition plans provides resources and considerations for financial institutions to develop credible, ambitious, and measurable transition plans. Together with the deeper guidance on the use of sectoral pathways, real-economy transition plan disclosure, managed phaseout, and portfolio alignment measurement, the financial sector can increase transition finance with a high level of rigor and accountability.

The suite of transition planning tools and guidance developed by GFANZ in 2022 can be used together to support financial institutions' efforts to develop and implement credible net-zero transition plans that finance and enable the transition in the real economy, in line with the four key financing strategies.

Financial Institution Net-zero Transition Plans

To translate net-zero commitments into action, GFANZ recommends financial institutions develop a "net-zero transition plan" that articulates their commitment, transition targets and objectives, the specific actions they will take, and the accountability mechanisms they will implement to ensure their plans are credible.

The *Financial Institution Net-zero Transition Plans* report[8] provides a voluntary,[9] global, pan-sector framework for developing credible net-zero transition plans (the Framework) that translate net-zero commitments into action. The work builds and expands on the existing body of work on climate change in the financial sector, particularly the Task Force on Climate-Related Financial Disclosures (TCFD) framework for disclosure of climate-related risks and opportunities as well as guidance on elements of transition planning developed by net-zero alliances and civil society organizations.

The Framework includes ten core transition plan components, grouped into five themes: Foundations, Implementation Strategy, Engagement

7 GFANZ uses the term "orderly transition" to refer to a net-zero transition in which both private sector action and public policy changes are early and ambitious, thereby limiting economic disruption related to the transition (e.g., mismatch between renewable energy supply and energy demand). For reference, the Network for Greening the Financial System (NGFS), which develops climate scenarios used by regulators and others, defines "orderly scenarios" as those with "early, ambitious action to a net-zero GHG emissions economy," as opposed to disorderly scenarios (with "action that is late, disruptive, sudden and / or unanticipated"). In an orderly transition, both physical climate risks and transition risks are minimized relative to disorderly transitions or scenarios where planned emissions reductions are not achieved. This explanation applies to all mentions of the term "orderly transition" in this document.

8 Published in three documents: 1) Executive Summary, 2) Fundamentals, Recommendations and Guidance, and 3) Supplemental Information

9 These recommendations should not be seen as superseding jurisdictional requirements on transition planning, contractual requirements (including mandates with clients), or climate-related financial disclosure where such requirements exist.

Strategy, Metrics and Targets, and Governance. The report provides recommendations, guidance, and illustrative examples for each component. Collectively, these components provide a common framework for how financial institutions can implement their net-zero commitment across their businesses, focusing on using the four key financing strategies to support real-economy emissions reductions. The report was developed in a practitioner-led process, including a public consultation.

The practice of developing net-zero transition plans will mature as commitments are adopted across nations, real-economy companies, and financial institutions, and as action plans are developed and implemented. GFANZ encourages all financial institutions to use the recommendations and guidance in the report as they develop and implement transition plans. GFANZ also encourages policymakers and regulators to reference this framework and support global consistency when considering policy around net-zero transition planning and disclosures.

The GFANZ net-zero transition planning recommendations and guidance are voluntary and take into account related efforts from the sector-specific net-zero alliances and their associated networks. Given the urgency needed to achieve near-term climate commitments, GFANZ encourages sector-specific alliance members to develop, implement, and publish transition plans as soon as possible.

Sectoral Pathways and Real-economy Transition Plans

Sectoral pathways are models that detail potential roadmaps for a given sector to reduce emissions to a defined level in a specified timeframe. They include assumptions about changes in technologies, business models, economics, and other considerations that can be used to build narratives and benchmarks for how a sector transitions to net zero, rather than as forecasts. Financial institutions use them to set targets, assess whether activities are aligned with net zero, and monitor progress. Financial institutions can use pathways to understand which activities can be considered transition finance in line with the four key financing strategies.

To effectively use these pathways, financial institutions must understand the model composition, assumptions, use cases, and limitations of the various pathways for a given sector.

The [Guidance on Use of Sectoral Pathways for Financial Institutions] report articulates an assessment framework to enable financial institutions to understand and select sectoral pathways suitable for their individual net-zero transition planning processes. This provides users with a consistent set of questions to gain an understanding of the scope and ambition of the pathway, the underlying assumptions that explain how the pathway is achieved, and the credibility and feasibility of the pathway. Comparisons are given for a sample of publicly available 1.5 degrees C-aligned net-zero pathways, illustrating how the framework can provide insights into the similarities and differences between pathways. The analysis also highlights how pathway developers could address limitations to increase their usefulness for the financial sector.

Further, to finance and enable the transition to net zero and effectively implement their net-zero commitments, financial institutions will have to work with and support clients and portfolio companies as they develop and implement their own transition plans.

The Real-economy Transition Plan workstream's report on [Expectations for Real-economy Transition Plans] presents the transition plan disclosures from non-financial ("real-economy") companies that net zero-committed financial institutions will be looking for to inform their transition finance decision-making. The expected disclosures are drawn from the landscape of existing public guidance and methodologies, rather than creating a new framework, to encourage both consistency and uptake of the use of these frameworks by real-economy companies. Clear, comparable real-economy transition plans that are robust, pathway-aligned, and properly implemented will enable financial institutions to evaluate whether their financing decisions and other services are in line with their own transition objectives and inform their engagement with clients and portfolio companies.

Over the course of 2022, the workstream developed a set of three *Net-zero Pathways Analysis and Expectations for Transition Plans reports on Steel, Aviation, and Oil & Gas*[10] to apply the workstreams to these key sectors. These documents will dive deeper into the assumptions, scale, and timing of the decarbonization of levers in 1.5 degrees C-aligned, net-zero pathways for these sectors; provide key implications for financial institutions; and highlight the priority, specific transition plan disclosure elements for these high-emitting sectors drawn from existing frameworks for real-economy transition plan components. The reports will be published in early 2023.

Managed Phaseout of High-emitting Assets

The GFANZ transition finance definition includes financing or enabling the managed phaseout of high-emitting assets. Managed phaseout provides a path for early retirement of high-emitting assets in alignment with an orderly and just transition to net zero.

The Managed Phaseout of High-emitting Assets report sets out Managed Phaseout as a net-zero aligned strategy for an asset, or as part of a company's strategy. Importantly, this approach supports a role for financial institutions to responsibly steward high-emitting assets out of the economy over a defined timeline consistent with the net-zero transition. This can avoid potential unintended consequences of financial institutions simply withdrawing finance or ownership from activities or companies that may be vital for the economy in the short-term, only to be financed or acquired by those with less climate ambition. The report provides a high-level approach to support the identification of assets where Managed Phaseout could be appropriate, offers an overview of potential financial mechanisms that could support Managed Phaseout, and includes initial guidance on the features of a credible asset-level Managed Phaseout plan. It sets out nine actions for further development that build on these initial frameworks and help support Managed Phaseout as a credible net zero-aligned strategy.

Portfolio Alignment Measurement

To effectively implement net-zero transition plans, financial institutions should monitor progress towards targets and objectives. This includes measuring alignment of portfolios of investment, lending, and underwriting activities across the four key financing strategies with the objective of limiting warming to 1.5 degrees C. The process of measuring portfolio alignment is underpinned by key decisions (or "design judgements") which gauge companies' emissions against future net-zero pathways informed by science-based scenarios and allow for aggregation at the sector or portfolio level. This process is forward-looking in nature and takes into account companies' future projected emissions. Portfolio alignment metrics are thus important tools to help financial institutions track progress toward net zero and inform their own transition plans and allocations across the four key financing strategies.

10 These sectors were highlighted given emissions profiles and abatement potential.

The Measuring Portfolio Alignment: Driving Enhancement, Convergence, and Adoption report builds on the 2020 and 2021 work of the Portfolio Alignment Team. With the help of institutional use cases and case studies, the report provides a practitioner perspective on how portfolio alignment methods and metrics are used today and provides refined guidance for five key design judgments. One central enhancement recommended by the report is an illustrative credibility framework to assess corporates' emissions reduction targets and transition plans in order to project their future GHG emissions. With the enhancements proposed, the report seeks to address current gaps in portfolio alignment measurement and accelerate progress toward the wider adoption of portfolio alignment metrics among net zero-committed financial institutions. The report was developed in a practitioner-led process, including a public consultation.

OTHER GFANZ INITIATIVES

For more information on other GFANZ programmatic activities, including details on the Mobilizing Capital and Net-zero Public Policy workstreams, as well as GFANZ regional networks and the climate transition-related data work supported by GFANZ, see the GFANZ 2022 Progress Report.

Appendix

ANNEX 1: ADDITIONAL INFORMATION ON GFANZ

GFANZ is a global coalition of leading financial institutions committed to mainstreaming the decarbonization of the world economy and reaching net-zero emissions by 2050. GFANZ brings together seven financial sector net-zero alliances, representing more than 550 members, into a global strategic coalition to address common challenges and elevate best practices across the sector. The financial sector net-zero alliances include the Net Zero Asset Managers initiative (NZAM), the Net-Zero Asset Owner Alliance (NZAOA), the Net-Zero Banking Alliance (NZBA), the Net-Zero Insurance Alliance (NZIA), the Net Zero Financial Service Providers Alliance (NZFSPA), the Net Zero Investment Consultants Initiative (NZICI), and the Paris Aligned Asset Owners (PAAO). GFANZ core areas of work are practitioner-led and advised by leading technical civil society organizations. GFANZ exists to provide the tools and analytics to help financial institution members of sector-specific alliances operationalize their commitments, working closely with the sector-specific alliance secretariats.

GFANZ is governed by a Principals Group that consists of representatives of alliance signatories from global firms from all sectors and regions, the UNFCCC Executive Secretary Simon Stiell, High Level Champion Mahmoud Mohieldin, and Network for Greening the Financial System Chair Ravi Menon. The Principals Group is chaired by the UN Secretary General's Special Climate Envoys Mike Bloomberg and Mark Carney, who report on the work of GFANZ to the United Nations Secretary General.

The GFANZ Steering Group, consisting of representatives of Principals Group firms and net-zero alliance secretariats, ensures connectivity and collaboration across workstreams and alliance secretariats. The GFANZ Advisory Panel chaired by Nili Gilbert, consisting of climate experts from NGOs, academia, and civil society, provides valuable expertise and challenge on the work and output of GFANZ.

For more information on GFANZ, please visit gfanzero.com.

ANNEX 2: MOTIVATIONS TO DEVELOP TRANSITION PLANS ACROSS THE PRIVATE AND PUBLIC SECTORS

Just as the private sector increasingly adopts and benefits from the voluntary disclosure of climate-related financial risks and opportunities,[11] there is growing recognition of the utility of transition planning by financial institutions and real-economy companies. For example, in developing and disclosing a transition plan using a globally-consistent framework, firms can:

- translate their net-zero commitments into transparent, comprehensible strategies and actions;

11 For example, the Taskforce on Climate-related Financial Disclosures (TCFD) had over 4,000 supporters from over 100 jurisdictions as of October 2022.

- ensure that their staff, clients, portfolio companies, and other stakeholders (e.g., supply-chain partners) who are tasked with executing on the net-zero commitment understand exactly what is expected of them;
- provide transparency to investors, consumers, and others who have a stake in the firm's success and require an understanding of how the firm will align to net zero; and
- contribute to the cross-comparability of transition planning across the sector, allowing for clear benchmarking of their plan.

As evidenced by recent global efforts, including those by the United States Securities and Exchange Commission (SEC);[12] the European Financial Reporting Advisory Group (EFRAG);[13] Japan's Financial Services Authority (JFSA);[14] the United Kingdom's Transition Plan Taskforce (UK TPT);[15] the International Sustainability Standards Board (ISSB);[16] and the G20 Sustainable Finance Working Group (SFWG),[17] the public sector, standards-setters, and international organizations recognize the importance of the development and disclosure of transition plans by the private sector, with some jurisdictions considering mandating their disclosure. Transparent, credible net-zero transition plans from financial institutions and real-economy companies are useful for several policy objectives, providing:

- securities regulators with standardized visibility into the activities firms are undertaking to meet their net-zero commitments, ensuring that they are high-integrity, not greenwashed, verifiable, and easy to understand, particularly to investors;
- supervisors with visibility into potential financial stability risks that could arise from changes — or lack thereof — in firms' climate-related business and financing activities, including a holistic picture of how the financial sector will shift strategies and exposures in the net-zero transition; and
- policymakers with a means of monitoring private sector compliance with economy-wide climate objectives, rules, and laws.

As the public sector, standards-setters, and international organizations consider the disclosure of transition plans, GFANZ encourages a common global approach to reduce fragmentation and ensure that they are most useful.

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12 The SEC proposed rules around climate-related disclosures, including "transition plans" which they define as "a registrant's strategy and implementation plan to reduce climate-related risks."

13 EFRAG has been designated by the European Commission to define disclosure standards for the Commission's proposed Corporate Sustainability Reporting Directive (CSRD). This includes a climate standard, which outlines proposed disclosure requirements for transition plans. EFRAG will share a draft with the European Commission in November 2022 to be considered for adoption.

14 Japan's Financial Services Authority issued guidance on transition finance in 2021, which touched on governance and disclosure of "climate transition strategies and plans." It is not legally binding guidance.

15 The UK Transition Plan Taskforce was launched to develop a gold standard for transition plans in the UK. The taskforce will develop a sector-neutral framework to enable companies across all sectors to develop meaningful plans to support the transition, and launched a public Call for Evidence. They will use feedback received during the consultation period to inform proposed requirements from the UK government.

16 ISSB's climate-related disclosure draft touches on transition plans in the context of a firm's disclosures of climate-related risks and opportunities on its strategy and decision-making.

17 One of the goals of the G20's SFWG will be to develop a transition finance framework and identify reporting practices for transition considerations, including transition plan disclosures.

For more information, please visit gfanzero.com