



The Good Transition Plan 2022 (COP27)



INTRODUCTION

Since the release of *The Good Transition Plan* in October 2021, there has been significant development of ideas and guidance for how a financial institution should prepare a transition plan. We've prepared this addendum to **The Good Transition Plan Strategy Toolkit** to summarize new developments in transition planning over the past year as well as offer fresh perspectives and insights to help inform your bank's approach to transition planning in the lead up to COP27 and beyond.

The Glasgow Financial Alliance for Net Zero (GFANZ) released their first version of guidance for **financial institution transition plans**. Their framework resembled many elements of *The Good Transition Plan*. In our new 'The Good Transition Plan Strategy Toolkit' we have adopted the GFANZ framework.

The UK's **Transition Plan Taskforce** is making recommendations for the UK Government who intend to implement a mandatory transition plan for listed companies and financial institutions. Their '**sector neutral framework**' was open to consultation earlier in 2022.

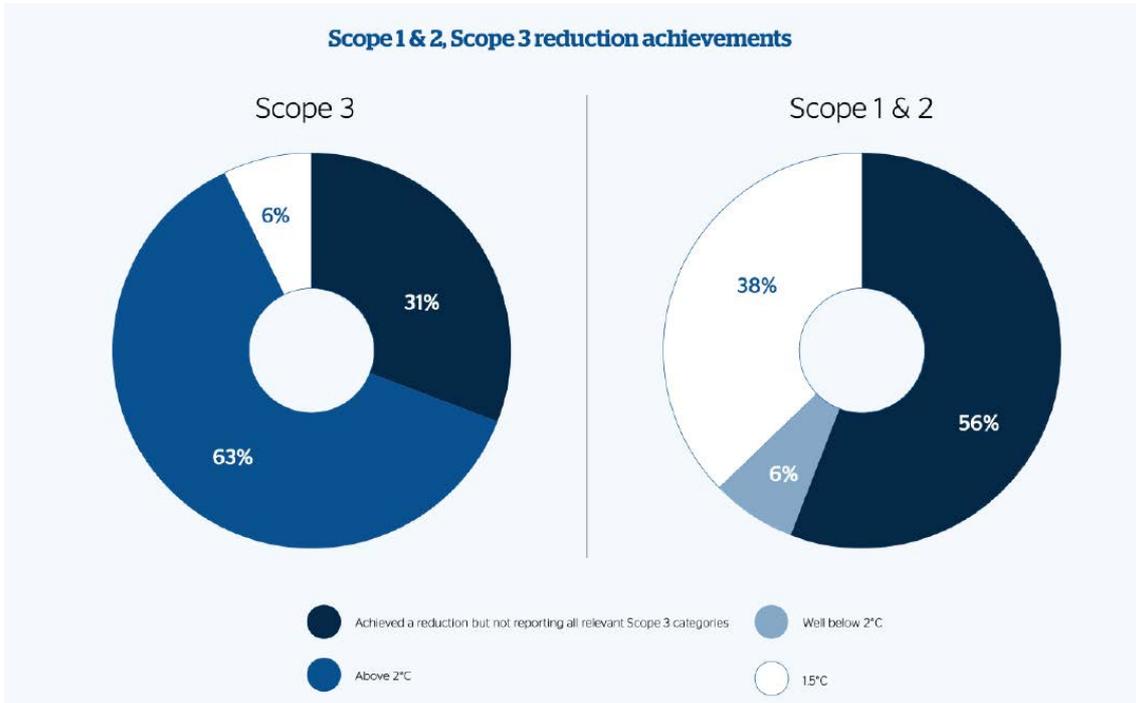
The Transition Pathway Initiative and The Institutional Investors Group on Climate Change (IIGCC) started to assess degrees of alignment for the banking sector. Whilst incomplete as an assessment, and selecting their own measures for what is most important, this exercise showed that the banks assessed have very significant misalignment in a number of areas:

Figure 1. Average percentage of sub-indicators that banks align with across the 27 banks assessed



Likewise, EcoAct's **deep-dive into financial institutions** showed that: "For an industry that relies heavily on the long-term view in terms of making investments and supplying finance, it is disappointing that none of the largest in the sector can demonstrate a long-term emissions reduction target despite the existence of long-term net-zero commitments."

Although 75% of companies have committed to offsetting, none are discussing removals or including these removals in their targets as a prerequisite of reaching net-zero. Just 31% are currently offsetting, either for only Scope 1 & 2 emissions, or part of Scope 3.



EcoAct, *The 2022 Corporate Climate Reporting Performance Report, 2022* (page 32).

NGOs have stepped up their scrutiny of bank transition plans and are providing comprehensive assessments of **bank targets and updates to transition plans**, and specific policies in relation to **Coal, Oil & Gas** clients. In a world with heightened awareness of **greenwashing** and greater levels of scrutiny and transparency, public awareness in the role of finance to support or delay transition is growing, and with it the pressure on banks to make more rapid and substantial changes to their climate impacts.

Alongside the challenge of going faster, there's a need for banks to incorporate broader aspects of sustainability within their transitions. For example how to create a **Nature Positive** transition, or to make a socially **Just Transition Plan** – and how to create a transition plan which addresses the **intersection of both** (credit to the excellent work of the team at LSE Grantham Institute).

In the real economy, countries will continue to develop their own transition pathways and policy frameworks – an issue where financial institutions have **called for greater clarity from governments** in their latest call for action. It includes a call to “ensure regulatory approaches, including micro- and macro-prudential regulation, continue to allow for the financial system to play a role in supporting orderly real-economy transition and do not unduly tighten the flow of transition finance to countries, sectors, and companies that are actively seeking to transition”. The flip side of this, which perhaps needs greater attention from regulators, is the necessary role in tightening the flow of finance to activities which work against transition – something that financial institutions could collectively be calling for to level up the playing field.

To help banks in setting a course to the best version of a transition plan they can create, the **Climate Safe Lending Network** gathered input from a wide range of stakeholders to co-create *The Good Transition Plan*, published in October 2021. At COP27, we will build on this strategy guide further and integrate the key frameworks proposed by international bodies by publishing a FREE practical toolkit here: **Good Transition for Banks**.

This toolkit is structured in line with the GFANZ framework for Financial Institution Transition Plans and is designed to be integrated into banks' strategy decision-making processes.



DECONSTRUCTING TRANSITION PLANS

Transition plans should...

- a. provide **disclosure** about
- b. strategy **decisions** that lead to
- c. climate **outcomes**.

DISCLOSURE

Disclosure is a function of **intention** (what you want to show) X **compliance** (what you have to show).

In other words, a bank could disclose lots of information to 'tick the box' and comply with a disclosure requirement. But it could do so in a way that either has the intention to show the most relevant aspect from a climate risk and impact perspective or has the intention to distract from that.

An example might be disclosure on financing policies for high-emitting sectors.

Example: We will no longer provide direct financing (either via project finance or reserve-based lending) to new oil and gas developments. [This disclosure doesn't mean that there would not be indirect financing at a corporate level, nor does it rule out finance for expansion within existing fields.] We will also not provide financing to new clients in the oil and gas sector unless clients have credible transition plans at the point of onboarding. [This disclosure doesn't mean that existing clients would necessarily be subject to credible transition plans for further finance.]

Good disclosure practices should promote transparency. For example, more granular disclosures help readers to identify the sectors or activities being financed than generic, high-level disclosures. Conversely, banks that try to disguise the extent of their financed emissions, for example by using only intensity metrics or percentages and changes from the previous year instead of absolute figures, are likely to reduce confidence in their transition plans.

DECISIONS

Decisions are a function of **decision-logic** (the purpose codified as a set of principles) X **context** (an interpretation of principles based on specific/local circumstances).

For example, what counts as a qualifying credible transition plan for a client? To what extent does the action lead to the most positive long-term outcome? There can be difficult dilemmas – such as continuing to run old, high-emitting technology until zero-carbon solutions are ready, compared to financing slightly-lower emitting technology that is contracted to run long after zero-carbon alternatives would be available (path dependency).

It's possible, therefore, that a more consistent decision-logic might be applied to a changing context with decisions changing when certain 'tipping points' are reached.



OUTCOMES

Outcomes are a function of **direct outputs** (carbon accounts directly attaching to a business) x **systemic influence** (the contribution towards positive/negative changes elsewhere in the economy).

- Outcomes (direct) = Direct impact
- Outcomes (systemic) = Broader contribution to transition

Direct outcomes include the Scope 3 financed emissions for the financial institution. For high-impact sectors, this often requires including clients' scope 3 emissions. But what is the impact that the client has in decarbonising the wider economy? For example, consider a petrol filling station fully powered by solar panels on its own roof. Depending on the accounting principle applied, it might be that the financed emissions are recorded as zero. However, the contributions of a petrol filling station to the wider economy are arguably far more relevant in terms of the degree to which it contributes to catalysing or preventing a net zero transition via the products it sells and services it offers.

What matters most?

Ensuring there is a focus on the right elements requires two aspects:

Firstly, conducting a full impact assessment, following the process outlined by the [UN Principles for Responsible Banking](#) which recommends that banks should:

- **Determine their scope** for impact analysis.
- **Review the scale of exposure** to different sectors.
- **Understand the context** and what the most relevant challenges and priorities in the countries/regions where the bank operates are.
- **Run an analysis** to identify the most significant positive and negative impacts of the bank's products and services (not internal operational impacts).
- **Prioritise the 2 most significant impact areas**, by engaging with internal and external stakeholders.
- **Assess the intensity/salience** for each impact area. This means measuring their current performance and identifying Sustainable Development Goals, national or regional frameworks they want to align with. This work will be important to define their baseline and prepare them to move to the next stage: target setting.

Secondly, including the **full range of relevant external stakeholders** – those who contribute to or are impacted by the bank's portfolio activity. By ensuring an open and inclusive process there is greater likelihood of a fair and balanced assessment by stakeholders who can best assess which topics would have the biggest impact and where the bank has the most influence.



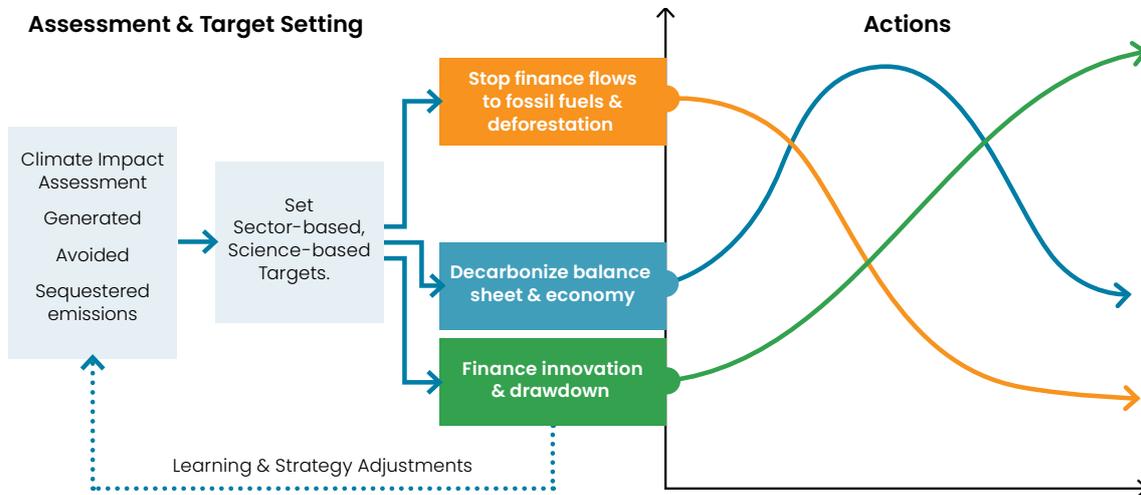
A (climate) transition plan is effectively a climate lens on the entire corporate strategy, meaning that the Corporate Strategy department needs to be involved integrally. It is important that the tensions and synergies are identified between elements of the transition plan and other strategic initiatives – with a follow-up analysis on how best to resolve or optimise the strategy. A similar process can then take place to form a ‘nature’ transition plan (with a nature/biodiversity lens), a social transition plan (social justice lens), etc.

Well in advance of creating a transition plan, it may be helpful for every financial institution to consider the full diversity of relevant stakeholders and form an external advisory group to serve as a sounding board for input and guidance on decision making in their climate strategy process.





THE TRANSITION PLAN'S THREE HORIZONS



The transition plan needs to include actionable, near-term actions (often prohibitive policies or covenants that could be implemented). It then needs to look at the medium-term value propositions and engagement strategies to transition their current portfolio (and typical client profiles). And financial institutions need to set out how they will implement effective innovation strategies to support the development of climate solutions for the longer-term future.

The Climate Safe Lending Network originally laid out this framework in [Taking the Carbon Out of Credit](#), published in July 2020. It is useful to reflect upon the priorities and interactions between first, second and third horizon activities especially since longer-term sustainability change projects have a higher probability of failure. ([Recent research suggests](#): “4% of sustainability change efforts meet their goals in full, with almost 50% not getting even halfway there.”)



TRANSITION PLANS: DESIGNED TO BE USED, DISSECTED, AND UPDATED

Whereas one might claim that most things which are managed get measured; in the field of climate disclosures, it is increasingly the case that much of what gets measured is not yet sufficiently managed. As Duncan Austin observes in [The Towering Problem of Externality-Denying Capitalism](#): “We often measure things to disclose them in supplementary tables to not really have to manage them. Unfortunately, ‘measuring and disclosing to avoid really managing’ seems to have caught on.”

The intention to really manage the most important aspects of transition starts with presenting data in a way that most readily invites understanding, scrutiny and constructive input. Giving users of transition plans the ability to **drill down** to the most relevant information (recognising the diversity of users and questions) can be helpful for sensemaking. How well a transition plan can be navigated is likely to determine how useful it will be, how often it will be updated to stay timely and incorporate learning from implementation, and how easily meaningful comparisons could be made to accelerate the whole sector. Simply adding long documents with disclosures which distract focus from where the attention most needs to be, could be highly counter-productive.

CONTINGENCIES VS. DEPENDENCIES

Knowing what is required from a context means that banks could say what it is they would need (e.g., from policy via advocacy) to put in place policy and action, which is commensurate to the change required (e.g., specific actions/commitments from banks). For example, if carbon price was X, we would finance \$Y billion of sustainable solution Z in the next 1, 3, or 10 years.



GREEN-WISHING VS. CONDITIONAL OPTIMISM

Rather than setting a pathway based upon magical thinking or contributions from unknown others into unfamiliar technologies, transition plans should work on the principle of 'conditional optimism'. We have seen rapid acceleration of technological transformation in the past through, what Nobel-prize winning economist, Paul Romer, called, 'endogenous growth'. However, the conditions for that are that the protagonists have to fully align with their own expectations. Romer compares 'complacent optimism' (what could be called 'green-wishing' today) to conditional optimism (which might look like investing heavily in drawdown technologies):

Complacent optimism is the feeling of a child waiting for presents. Conditional optimism is the feeling of a child who is thinking about building a treehouse. "If I get some wood and nails and persuade some other kids to help do the work, we can end up with something really cool?"





CONCLUSION

The first version of a bank's transition plan is the final stage of preparation – the connective tissue linking measurements to targets. But before the ink is dry on the transition plan, it necessarily becomes part of a dynamic strategy process. When the thinking and analysis behind the plan meets the reality of the world outside, 'emergent strategy' (as described by strategists like Henry Mintzberg) can take over from 'intentional strategy'. Those unintentional actions are often grounded in the mental models, culture, and persistent patterns of behaviours and beliefs that are present within an organisation. Having a firm understanding of those forces is, therefore, essential in driving meaningful change which is why the Climate Safe Learning Lab and Fellowship Programme for bankers pays particular attention to these aspects. And for the transition plan, it should evolve quickly into a living and breathing document, continuously updated with observations and insights from the bank's interactions with clients and stakeholders, and perceptions of emerging developments within society and the economy.

Our Good Transition Plan Strategy Toolkit is, therefore, designed to help banks complete their preparations in a practical way. But also to help bankers to frame the challenge of transition itself as an evolving journey of identifying tensions and synergies and responding effectively. As a co-evolving initiative, the Climate Safe Lending Network seeks to learn along with all of its participants and we look forward to integrating your emerging wisdom for the benefits of all as we move towards activating an effective and fully sustainable 'good' transition.

