1 The case for transition finance in the 'decade for delivery'

This chapter provides an overview of the OECD Guidance on Transition Finance: Ensuring Credibility of Corporate Climate Transition Plans. The Guidance is a response to the growing trend among market actors and policymakers to develop transition finance approaches to broaden the perceived niche of sustainable finance. The chapter sets out the purpose, scope, and audience of the Guidance and concludes by identifying areas for future work with respect to transition finance.

1.1. Context: Transition finance to meet global climate objectives

As net anthropogenic greenhouse gas (GHG) emissions continue to rise across all major sectors globally and emissions increases from rising global activity levels outpace emissions reductions, there is growing recognition that public and private finance in support of climate mitigation goals needs to be scaled up across all sectors and regions (IPCC, 2022[1]). Article 2.1c of the Paris Agreement calls for "making finance flows consistent with a pathway towards low greenhouse gas emissions" (UNFCCC, 2015[2]). This is a necessary step in order to achieve the Paris Agreement temperature goal (Article 2.1a) of "holding the increase in the global average temperature to well below 2°C above pre-industrial levels and pursuing efforts to limit the temperature increase to 1.5°C above pre-industrial levels" (UNFCCC, 2015[2]). Today, there is broad consensus that to limit the average global temperature increase to 1.5°C, global GHG emissions need to reach net zero by 2050, and be reduced by 45% by 2030 compared to 2010 levels[1] (see, for example, (IPCC, 2022[3]), (IEA, 2021[4]), (GFANZ, 2022[5]), (SBTi, 2019[6])). Moreover, global GHG emissions need to peak before 2025, with rapid and wide-reaching emissions reductions across all sectors needed during the subsequent decades until 2050 (IPCC, 2022[1]).

To keep the collective target of limiting the average global temperature increase to 1.5 °C within reach, decarbonisation measures that can bring drastic reductions in emission intensity through transformative changes of energy and production systems (D'Arcangelo et al., 2022[7]) will need to be financed across all sectors of the economy and most importantly in energy-intensive and hard-to-abate sectors[2] (IDDRI, 2020[8]). This means that finance for the climate transition must take a dynamic and forward-looking view of companies' decarbonisation journeys, covering all sectors and especially emissions-intensive ones, while avoiding static views limited to what is already sustainable today. To achieve rapid and deep reductions across sectors and geographies around the world, it is necessary to take an approach to financing the transition that is inclusive and can increase financial flows in particular in emerging markets and developing economies (EMDEs), where challenges relating to feasibility[3] of transitioning to low-emission options may be greatest and financing capacity is lower (IPCC, 2022[1]).

1.1.1. Balancing environmental integrity and inclusiveness

The emerging concept of transition finance responds to this need to be inclusive of sectors and geographies. While a consensus definition of transition finance has thus far been elusive, there are several available approaches, both market-based and regulatory, which aim to capture the concept of transition finance and have the common aim of bringing sectors and geographies into the sustainable finance conversation that have previously either been excluded from it or were not the focal point. Moreover, there are several ongoing transnational initiatives, which may in the future contribute to the emergence of a consensus definition. In this context, during the first half of 2021, the OECD reviewed and compared 12 transition finance-related taxonomies,[4] guidelines and principles developed by governments and financial actors, and a sample of 39 transition-related financial instruments, to outline the emerging concept of transition finance (Tandon, 2021[9]). The analysis highlighted commonalities, divergences, and considerations for future market development, but without proposing a definition.

Ongoing discussions and transition finance initiatives will continue to inform views on issues such as eligibility of specific economic activities carried out by corporates for transition finance. Consensus on such questions seems unlikely to be reached immediately, due to their technical complexity, their dependence on context-specific variables (e.g., country-, sector-, and corporate-specificities) and socio-political sensitivity. However, as initiatives continue to develop, markets increasingly conduct transition finance transactions, and net-zero pledges and commitments grow exponentially, investor expectations likely will begin to converge, and certain types of investments will fail to garner investor acceptance.

Moreover, while the nature of the transition may be country-specific, financial market participants operate across many jurisdictions, so core elements and criteria employed by them should have a common basis and be comparable.

1.1.2. Growing evidence points to a mismatch between high-level emission reduction targets and actionable transition plans

The growing number of net-zero commitments by various market and government actors reflects the need for robust transition finance approaches that are based on credible corporate transition plans: To date, 131 countries and territories, covering over 90% of global Gross Domestic Product (GDP) and 83% of global GHG emissions, have adopted net-zero targets and more than one-third (702) of the largest (2000) publicly-traded companies now have net-zero targets (Net Zero Tracker, 2022[10]). More than 450 financial firms from 45 countries and territories, representing over USD 130 trillion in assets, have pledged to mobilise finance to reach net-zero emissions by 2050, by virtue of being members of the Glasgow Financial Alliance for Net Zero (GFANZ) (GFANZ, 2021[11]). However, according to CDP, only about a third of the companies (4002/13100+) that disclosed through them in 2021 had climate transition plans in place (CDP Worldwide, 2022[12]). Similarly, only about 17% of CA100+'s focus companies had set medium-term targets in the second round of net-zero company benchmark assessments, even though such targets are necessary to gain a better understanding of a company's proposed transition trajectory (FT, 2022[13]). This trend is even more pronounced for micro, small and medium-sized enterprises (MSMEs) and companies operating in EMDEs. For example, a 2022 survey of SMEs in the United Kingdom found that more than three quarters of respondents did not have carbon targets in place and half did not know the meaning of the term 'net-zero' (Edie, 2022[14]). Similarly, the lack of information about corporates' emissions or transition plans is frequently cited by asset owners and asset managers in EMDEs as a deterrent to transition investment (WEF, 2022[15]).

1.1.3. Credible corporate climate transition plans to prevent greenwashing in transition finance

As the OECD's 2021 review identified, in the nascent space of transition finance there is an emerging risk of greenwashing and a need to ensure environmental integrity (Tandon, 2021[9]). Specific risks include, amongst others, the potential to create carbon-intensive lock-in when investing into technologies that present a marginal improvement but are overall still emission-intensive and long-lived, or when investing into efficiency or other types of improvements as part of existing polluting assets and delaying the transformation or replacement of those assets. By ensuring that high-level net-zero pledges translate into clear and actionable targets that can be verifiably implemented, and significantly increasing transparency, credible corporate transition plans can reduce or avoid risks related to greenwashing, lock-in and delayed action. Conversely, without credible corporate transition plans, transition finance runs the risk of becoming a way for market actors and governments to justify delayed or insufficient action, while promoting existing investments as advancing the climate transition, even if those potentially have little positive environmental impact or are even damaging in the long run.

1.2. Purpose and aims of the Guidance

To unlock the flow of financing to corporates that have credible plans to decarbonise their business models towards net zero, while mitigating risks of greenwashing and carbon lock-in, two important shifts are needed:

- Credible transition planning is mainstreamed across relevant entities, and in particular corporates (both public and private).

- The meaningful assessment of transition plans becomes part of financial market participants' core considerations, when deciding to provide finance to a corporate.

The Guidance aims to enable these shifts by supporting the mainstreaming of transition considerations in the planning and decision-making of corporates across all sectors of the economy.

To achieve this objective, the Guidance first identifies barriers and challenges to mainstreaming transition finance. They include, amongst others, a lack of clarity and coordination on guidelines, standards, and definitions, difficulties in measuring sustainability performance and relevant Key Performance Indicators (KPIs), as well as the risk of greenwashing (see, for example, results of the OECD industry survey on transition finance, (Shrimali, 2021[16]), (CBI, 2021[17]), (BNP Paribas, 2019[18])). This compounds the level of ambiguity and lack of comparability in a market that is inherently difficult to coordinate, due to the heterogeneity of the actors seeking financing and the different policy environments within which they operate.

The Guidance then presents ten elements of credible corporate climate transition plans, promoting increased transparency to support the growth of the transition finance market while ensuring environmental integrity. This Guidance helps to ensure that existing targets are credible and achievable, including by providing solutions for the proportionate treatment of companies that need more flexibility, such as MSMEs, as well as certain companies operating in EMDEs.

1.3. Framing of the Guidance

1.3.1. Working definition of transition finance and relationship with the broader sustainable finance ecosystem

In the context of this Guidance, transition finance is understood as finance deployed or raised by corporates to implement their net-zero transition, in line with the temperature goal of the Paris Agreement and based on credible corporate climate transition plans.

This definition of transition finance is based on the recognition that within the broader sustainable finance discussion, a distinction could usefully be made between transition finance tools and market practices that are focused on *the process of becoming sustainable* and approaches that, for the most part, *define what is already sustainable*, by way of a point-in-time assessment. In presenting elements of credible corporate climate transition plans, this Guidance aims to provide clarity to corporates, financial market participants, and policymakers on the former dimension. Complementary work to assess alignment of finance with the Paris Agreement temperature goals is being conducted under the Research Collaborative on Tracking Finance for Climate Action, which provides an analysis of existing climate-alignment methodologies and metrics used in finance (Noels and Jachnik, forthcoming[19]).

In this framing, transition finance can be seen as one tool within the broader sustainable finance toolbox to be deployed to make finance and the real economy consistent with the temperature goal of the Paris Agreement. For example, transition finance, as defined in this Guidance, can be a useful building block for climate alignment approaches, which rely on asset- and portfolio-level methodologies to assess consistency with the Paris Agreement temperature goal (see for example, (Noels and Jachnik, forthcoming[19])). At the same time, credible corporate climate transition plans can make use of such metrics and methodologies. Importantly, both types of approaches have the same long-term temperature goal at their core and thus complement each other.

The Guidance can also usefully build on and be informed by relevant tools in the area of responsible business conduct, such as the *OECD Guidelines for Multinational Enterprises* [OECD/LEGAL/0144, annex] and related OECD Due Diligence Guidance for Responsible Business Conduct (RBC) (OECD, 2018[20]), related OECD work on key considerations for institutional investors under the *OECD Guidelines for*

Multinational Enterprises (OECD, 2017[21]), and OECD work for institutional investors on Managing Climate Risks and Impacts through Due Diligence for Responsible Business Conduct (OECD, forthcoming[22]). Moreover, the Guidance can also usefully interact with forthcoming OECD Policy Guidance on Market Practices to Finance and Strengthen ESG Investing (OECD, forthcoming[23]).

1.3.2. Mainstreaming versus labelling

The OECD's 2021 review suggests that there are diverging opinions on whether transition finance requires a dedicated label (Tandon, 2021[9]). An important starting point for the Guidance is a recognition of the need to mainstream transition considerations in the strategies of all corporate actors that need and seek to transition to net zero. Today, the growth of labelled sustainable and green financial products is contributing to increases in investments in economic activities that are already sustainable. Existing providers of green certifications, labels, and standards are now also beginning to offer similar services for transition-related financial products, such as sustainability-linked bonds (SLBs) and transition bonds (see, for example, (CBI, n.d.[24]), (CBI, 2021[17]), (ICMA, 2020[25])).

With the growing recognition that companies need to put in place credible transition plans, there are now also initiatives that provide certification for the credibility of a company's decarbonisation targets (see, for example, (SBTi, 2021[26]), (Carbon Trust, n.d.[27])). These initiatives are crucial to increase transparency and create incentives for investors and corporates, but they are only one tool in the toolbox for the global net-zero transition.

The downside of an approach that is limited to labelling and certification is that it can crowd out companies that are not able to afford certification, do not have access to or are not able to generate all the information needed to comply with the certification requirements, or operate within a policy environment that does not provide a framework that makes it feasible for them to align with such requirements. This may run counter to the objective of mainstreaming and is a criticism levelled at sustainable finance in general (see, for example, (Ameli, Kothari and Grubb, 2021[28]), (WWF, 2022[29])). Therefore, this Guidance promotes an approach that can include labelling and certification for those actors that choose to follow that route, but focuses on mainstreaming transition considerations, to the extent possible, in all relevant finance deployed or raised by corporates, including those that are not able or choose not to achieve or apply for certification.[5]

1.4. Scope of the Guidance

The Guidance does not aim to substitute for existing transition finance-related initiatives, principles, and frameworks, but rather to complement them by distilling common elements, highlighting emerging good practices, and pointing to areas where additional information by corporates can increase credibility.

The broad definition of transition finance presented above is not based on the identification of specific transition activities, nor does it propose metrics or eligibility considerations at fund- or portfolio- level. With a focus on credible corporate climate transition plans, which is emerging as a necessary element across different transition finance approaches, the Guidance provides an umbrella approach that can interact with taxonomies, roadmaps, relevant guidelines, transition and green labels, certifications, and eligibility criteria at the entity-, fund-, or portfolio-level, as well as other sustainable finance tools and frameworks.

While the transition finance concept could extend to finance substantial contributions to other environmental objectives and goals of the Paris Agreement, such as climate adaptation and resilience, or biodiversity, these other objectives are not the main focal point of the Guidance at this stage. Notably, while the Guidance focuses on corporate transition planning to align with the Paris temperature goal by decarbonising, there is also ongoing work by other initiatives (e.g., the Task Force on Climate-related Financial Disclosures and the International Sustainability Standards Board) to help corporates understand,

assess, and mitigate their exposure to climate-related risk (both transition risk and physical risk). While this work and the Guidance are related, they each require different toolkits and specific considerations.

The Guidance is predominantly focused on transition planning as it relates to non-financial corporates aligning their operations and activities with the temperature goal of the Paris Agreement. However, elements regarding credible transition plans could also be useful for public entities, including State-Owned Enterprises. Furthermore, the Guidance does not aim at tackling in detail financial market participants' transition plans, the specificities of transition risk management, nor the explicit role of shareholder engagement in transition finance, although the importance of these elements is recognised. The latter two points are only covered to the extent that they play an important role in ensuring credible corporate climate transition plans. Similarly, the Guidance touches upon financial market participants' transition plans since credible corporate transition plans are understood as being essential to inform them, but does not treat them in detail.

1.4.1. Accounting for ongoing and future developments

Beyond the question of labelling, there remains a multitude of unresolved challenges in the area of transition finance, especially with regards to eligibility of different sectors and activities, suitability of different pathways, obstacles arising from data availability from corporates, and challenges in companies' enabling conditions.[6] For example, in addition to ensuring that transition finance is available for corporates across geographies, it will be necessary to strengthen enabling conditions and remove existing barriers to feasibility. Until such a time when enabling conditions are improved and challenges with respect to data availability and other issues have been overcome, approaches to transition finance need to carefully balance the need to be inclusive with ensuring environmental integrity and avoiding emissions lock-in. To provide this balance and a more tailored and proportionate approach, the Guidance offers modifications for elements that can be particularly challenging for MSMEs, or certain types of companies operating in jurisdictions where enabling conditions might be lacking, such as in EDMEs.

The Guidance is a living document that can be updated in the future to consider new developments in the transition finance space and related discussions on how to enable the transition in all countries. In addition to setting out elements of credible corporate transition plans, the Guidance also calls for monitoring developments with respect to expectations of credible transition plans, and continuously seeking to meet the highest standards for transparency and credibility. In this context, the Guidance points to areas for further work, such as on policy incentives, tailored blended finance instruments and development of national sectoral pathways, amongst others.

In the future, extensions of the Guidance could consider:

- Other environmental and sustainable transition objectives, such as climate change adaptation and resilience, biodiversity, water, circular economy, or pollution.
- More detailed work on the possible use of the Principle of Do-No-Significant-Harm.[7]
- Additional work on ensuring a just transition.
- More detailed considerations related to criteria and tools used as part of corporate transition plans, such as the role of the *OECD Guidelines for Multinational* Enterprises [OECD/LEGAL/0144, annex] and related Due Diligence Guidance for RBC (OECD, 2018[20]) in developing and implementing corporate transition plans.

1.5. Who is the Guidance for?

The Guidance outlines key challenges in the development of the nascent transition finance space and presents the elements of credible corporate transition plans to help address risks related to greenwashing and carbon-intensive lock-in. Through this approach, the Guidance can:

- Help financial market participants (asset managers, institutional and retail investors, and banks) identify credible investment opportunities among corporates who are raising finance to implement their transition plans.
- Support corporates in developing those transition plans, including to attract the financing necessary to implement them.
- Provide useful references to policymakers or regulators that have developed or are considering developing policy frameworks for corporate climate transition plans.

1.6. Reader's Guide

The remaining chapters of the Guidance address the following topics:

- Chapter 2 provides an overview of ongoing initiatives in transition finance. Building on the OECD's 2021 review, it describes recent developments in transition finance, including relevant guidelines, taxonomies, and principles-based approaches. It examines selected financial instruments relevant to transition finance. Finally, it takes a detailed look at corporate transition plans as part of broader transition finance initiatives and gives an overview and comparison of existing non-governmental, industry-led, public, and transnational initiatives in the area.
- Chapter 3 focuses on the main challenges observed in transition finance and faced by market actors (financial market participants and non-financial corporates). It is based on a review of the literature, insights from the industry survey, and bilateral consultations. The analysis also presents three targeted case studies of non-financial corporates that have issued transition finance instruments. By looking at the main challenges faced by market actors, this chapter helps calibrate the elements presented in Chapter 4.
- Chapter 4 presents ten elements of credible corporate climate transition plans, building on existing approaches and complementing them by suggesting additional areas where further transparency is warranted to increase credibility. It takes a proportionate approach to ensure inclusiveness by offering modifications for MSMEs and microenterprises, as well as corporates that operate in challenging policy contexts and enabling environments, such as certain corporates in EMDEs.

1.7. Methodology

The development of the Guidance has benefitted from wide stakeholder input, both through the regular consultation of an Informal Reflection Group on Transition Finance[8] of jurisdictions who have either already developed transition finance approaches or are in the process of developing them; and through conducting an OECD industry survey on transition finance, targeting, amongst others, financial market participants, non-financial corporates, civil society, and academia. The results of the survey provide a basis for better understanding the challenges faced by market actors and other stakeholders in transition finance (as discussed in Chapter 3). The Guidance proposes possible solutions to help mitigate these challenges as part of the different elements that will be included in credible corporate transition plans (Chapter 4). An overview of the survey's scope and methodology is presented in Annex C.

The Guidance has also benefitted from insights of the OECD's Roundtable on Transition Finance, which was held as part of the OECD COP26 Virtual Pavilion and convened over 60 senior representatives from ministries of finance and the environment, banks, financial regulators and other key stakeholders to exchange views on transition finance (OECD, 2021[30]). Building on the OECD's 2021 stocktake analysis (Tandon, 2021[9]), the Guidance also draws on additional literature review, as well as bilateral interviews and consultations with non-financial corporates, financial market participants, and civil society institutions and associations that are active in the space.

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Notes

[1] Global net-zero carbon dioxide (CO_2) emissions will need to be reached in the early 2050s in modelled pathways that limit warming to 1.5°C (>50%) with no or limited overshoot, and around the early 2070s in modelled pathways that limit warming to 2°C (>67%). Similar reductions apply to non-CO_2 emissions (IPCC, 2022[1]).

[2] The term "hard-to-abate" generally refers to sectors that face particular challenges in their low-carbon transition, notably either due to an absence of low-carbon alternatives (as is the case in aviation, for example) or due to currently high costs of fully transitioning to low-carbon technologies and energy sources, as is the case in energy-intensive industries with high-temperature processes, such as iron and steel, cement and lime, chemicals, aluminium and other non-metallic minerals.

[3] In this Guidance, the definition of 'feasibility' follows that of the IPCC when referring "to the potential for a mitigation […] option to be implemented". In line with that definition, there are several context-dependent factors that can influence feasibility, thus enabling or constraining the implementation of different options. Factors can change over time, and they can be of "geophysical, environmental-ecological, technological, economic, socio-cultural and institutional" nature. Combining different options or strengthening enabling conditions can have an impact on feasibility (IPCC, 2022[1]).

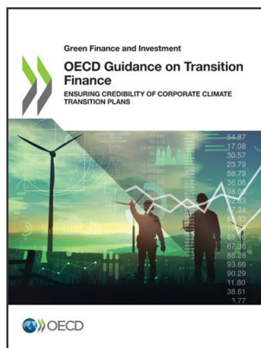
[4] Taxonomies that are relevant to transition finance are generally green finance taxonomies with transition elements (Tandon, 2021[9]), such as the EU Taxonomy, which, for the environmental objective of climate change mitigation, contains three categories of eligibility: economic activities that are already low –or zero-emission today, enabling activities, and transition activities.

[5] Certification is not to be mistaken with external verification of plans and targets, which may be essential to ensuring that commitments and targets formulated by companies are credible and science-based and for which a proportionate approach might be suitable.

[6] In this Guidance, the definition of 'enabling conditions' leans on that of the IPCC, when referring "to conditions that enhance the feasibility of […] mitigation options." In this context, they can include technological innovation, data availability, relevant policy instruments (including of fiscal nature), institutional capacity, and the applicable regulatory framework (IPCC, 2022[1]).

[7] The Principle of Do-No-Significant-Harm is discussed in more detail in subsequent chapters of this Guidance but broadly refers to the process of not supporting or carrying out any economic activities that do significant harm to an environmental objective (such as climate change mitigation, adaptation, protection of biodiversity and ecosystems, protection of water and marine resources, pollution prevention and control, circular economy).

[8] Members of the Informal Reflection Group comprised representatives of the following institutions: the Sustainable Finance Institute Asia, the Bank of Canada; the Directorate-General for Financial Stability, Financial Services and Capital Markets Union of the European Commission; the Financial Services Authority of Indonesia; the Ministry of Economy, Trade and Industry of Japan; the Ministry of Environment of Japan; the Financial Services Agency of Japan; the Permanent Delegation of Korea to the OECD; the Monetary Authority of Singapore; the National Treasury of South Africa; the State Secretariat for International Financial Matters of Switzerland; Her Majesty's Treasury; the United States Department of the Treasury; as well as the Co-Chairs of the Sustainable Finance Working Group (United States and China).



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