Introduction

The concept of climate transition focuses principally on the credibility of an issuer’s climate change-related commitments and practices. In order to meet the global objectives enshrined within the Paris Agreement on Climate Change to keep the global temperature rise this century well below 2°C above pre-industrial levels and to pursue efforts to limit the temperature increase even further to 1.5°C, significant financing is needed. Capital markets have a critical role to play in enabling the climate transition by ensuring the efficient flow of financing from investors to issuers wishing to address climate change risk issues.

To help facilitate these flows, this document seeks to provide clear guidance and common expectations to capital markets participants on the practices, actions and disclosures to be made available when raising funds in debt markets for climate transition-related purposes, whether this be in the format of:

1. Use of Proceeds instruments, defined as those aligned to the Green and Social Bond Principles or Sustainability Bond Guidelines, or,
2. General Corporate Purpose instruments aligned to the Sustainability-Linked Bond Principles.

Given that transition pathways must be tailored to the sector and operating geographies of an issuer, and noting that issuers are generally at different starting points and on different pathways, this document does not seek to provide definitions or taxonomies of transition projects, noting that there are several efforts in this area underway globally. Rather, it clarifies the issuer-level disclosures which are recommended to credibly position the issuance of Use of Proceeds or Sustainability-Linked instruments to finance the transition, particularly of ‘hard-to-abate’ sectors.

The recommended disclosures are based on:

1. The work conducted by the Climate Transition Finance Working Group – under the auspices of the Green and Social Bond Principles Executive Committee. The working group consisted of representatives from more than 80 entities participating in the capital markets.

2. Analysis and existing climate change disclosure frameworks developed by relevant industry groups, regulatory bodies and the scientific community regarding climate change mitigation and adaptation. The recommendations in this Handbook leverage these frameworks, and articulate their relevance to Use of Proceeds or Sustainability-Linked Bonds.

There are four key elements to these recommendations:

1. Issuer’s climate transition strategy and governance;
2. Business model environmental materiality;
3. Climate transition strategy to be ‘science-based’ including targets and pathways; and,
4. Implementation transparency.

Disclosure on these elements should be referenced in connection with any Use of Proceeds or Sustainability-Linked Bond issuance. Relevant disclosures could be included in the company’s annual report, framework document, or investor presentation, as long as they are publicly accessible to investors. Concurrently, the recommended independent review, assurance and verifications listed below could be included as either a Second Party Opinion as part of the issuance documentation or provided in the context of an issuer’s ESG reporting (in particular the assurance and verification of environmental data).

Issuers wishing to label financing instruments with a climate ‘transition’ label, may consider referencing this guidance in connection with the issuance as the Climate Transition Finance Handbook 2020.

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1 Examples include, but are not limited to, (i) the EU Taxonomy, (ii) Japan’s public and private initiatives on transition finance, (iii) National Standard of Canada for Green and Transition Finance, (iv) Financing Credible Transitions: A Climate Bonds Initiative Project.
2 A series of workshops and market consultations were undertaken in the second half of 2019 and the first half of 2020.
3 Provision of a summary reflecting the main characteristics of a bond and illustrating its features in reference to the four key elements of the Climate Transition Finance Handbook may help inform market participants. To that end, a template will be made available on the GBP SSBP website hosted by ICMA which once completed can be made available online for the purposes of providing information to the market.
1 - Issuer’s climate transition strategy and governance

The financing purpose should be for enabling an issuer’s climate change strategy. A ‘transition’ label applied to a debt financing instrument should serve to communicate the implementation of an issuer’s corporate strategy to transform the business model in a way which effectively addresses climate-related risks and contributes to alignment with the goals of the Paris Agreement.

Rationale

The concept of climate transition focuses principally on the credibility of an issuer’s climate change-related commitments and practices. Climate transition finance is the extent to which an issuer’s financing program supports the implementation of its climate change strategy. This strategy should clearly communicate how the issuer intends to adapt its business model to make a positive contribution to the transition to a low carbon economy. In this framework, an issuer’s ability to identify eligible climate-related expenditures alone will not necessarily equate to a broader corporate strategic intention to address climate change risks and opportunities in the long-term. Corporate climate change strategies should respond to stakeholder expectations by purposefully and explicitly seeking to play a positive role in achieving the Paris Agreement. Establishment of a corporate strategy to address climate change-related risks is a pre-requisite to issuing a transition-labelled instrument. A range of climate change scenario providers exist in the market today to inform strategy design. The choice of relevant provider, or the decision to design an in-house scenario, are up to the issuer. However, regardless of the source, an issuer’s strategy should be guided by the objective of limiting global temperature increases ideally to 1.5°C and, at the very least, to well below 2°C.

Disclosure

Disclosures regarding corporate strategies may be aligned with recognised reporting frameworks such as the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD), or similar frameworks. These may be made according to the customary practices regarding corporate disclosures, e.g. via annual reporting, dedicated sustainability reporting, statutory filings and investor presentations.

Suggested information and indicators:

- A long-term target to align with the goals of the Paris Agreement (e.g. the objective of limiting global warming ideally to 1.5°C and, at the very least, to well below 2°C);
- Relevant interim targets on the trajectory towards the long-term goal;
- Disclosure on the issuer’s levers towards decarbonisation, and strategic planning towards a long-term target to align with the goals of the Paris Agreement;
- Clear oversight and governance of transition strategy; and,
- Evidence of a broader sustainability strategy to mitigate relevant environmental and social externalities and contribute to the UN Sustainable Development Goals.

Independent review, assurance and verification

Provision of an independent technical review of an issuer’s strategy may assist investors in developing a view regarding the credibility of the issuer’s strategy insofar as it addresses climate change risk issues. Such a review should include:

- Alignment of both the long-term and short-term targets with the overall scenario; and,
- The credibility of the issuers strategy to reach the targets.

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4 Examples include, but are not limited to the Network for Greening the Financial System (NGFS) Climate Scenarios https://www.ngfs.net/node/294092
5 For example, sector corporate benchmarking developed by the Institutional Investors Group on Climate Change (IIGCC) www.iigcc.org, and sector benchmarks and management quality frameworks developed by 1) the Transition Pathway Initiative www.transitionpathwayinitiative.org; or 2) Assessing Low Carbon Transition (ACT) initiative www.actinitiative.org.
2 - Business model environmental materiality

The planned climate transition trajectory should be relevant to the environmentally-material parts of the issuer’s business model, taking into account potential future scenarios which may impact on current determinations concerning materiality.

**Rationale**

Climate transition financing should be sought by the issuer for the funding needed in the strategic change over time to its ‘core’ business activities. These are the activities which are the main drivers of its current and future environmental impact. Climate transition finance is most relevant and required by those industries with high greenhouse gas emissions which face the most complex climate-related transition challenges. We note that the climate transition is not the only change faced by companies and that many are involved in various transformations across other business functions. The climate transition trajectory as far as it relates to financing should also be a material factor to the future success of the business model, as opposed to being an incidental aspect. The trajectory should also consider the salience of an issuer’s climate impacts on the environment and society, and seek to mitigate negative externalities.

**Disclosure**

Discussion of the materiality of the planned transition trajectory may be included in the disclosures referenced for Element 1 above. Existing market guidance regarding consideration of materiality may be applied in making such disclosure, for example the relevant guidance provided by accounting standards bodies.

**Independent review, assurance and verification**

Externally-provided comfort around materiality considerations may not be appropriate in all cases, however the accounting profession may provide guidance as required.
3 - Climate transition strategy to be science-based including targets and pathways

Issuer’s climate strategy should reference science-based targets and transition pathways. The planned transition trajectory should:

- be quantitatively measurable (based on a measurement methodology which is consistent over time);
- be aligned with, benchmarked or otherwise referenced to recognized, science-based trajectories where such trajectories exist;
- be publicly disclosed (ideally in mainstream financing filings), include interim milestones, and;
- be supported by independent assurance or verification.

Rationale

Sustainability performance improvement targets are typically set in accordance with a number of considerations. These include alignment with the Paris Agreement, market and stakeholder expectations, the company’s starting point, track record of achievement to date and the feasibility of improvement measures, including economic constraints/cost-benefit analyses, and the existence of proven techniques or technologies which deliver the anticipated improvements.

With regards to climate change, authoritative scientific analysis has determined the rate of decarbonisation (the ‘decarbonisation trajectory’\(^6\)) required in the global economy in order to align the various economic activities with those scenarios which imply a Paris Agreement-aligned level of warming. Science-based targets are targets that are in line with the scale of reductions required to keep the global temperature increase below 2°C above pre-industrial temperatures.\(^7\)

As part of a credible transition proposition, issuers should reference appropriate benchmark, sector-specific decarbonisation trajectories in communicating their strategy in this area. It is likely that an aim to align the business plans with a 1.5°C trajectory will be perceived as most credible\(^8\) to the increasing proportion of market participants.

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\(^6\) Recognised trajectories include but are not limited to: ‘Climate Positive’; ‘Net Zero 2050’; Paris Agreement 2 Degrees Scenario; ‘1.5 Degrees Scenario’, IEA Sustainable Development scenario (as updated October 2020) and associated Transition Pathway Initiative benchmarks.

\(^7\) We note that the Science Based Targets Initiative (SBTi) is a branded verification body for science-based targets. While committing to the SBTi is one way in which issuers could meet the disclosure recommendations included here, Element 3 refers to any target that is based on a Paris Agreement-aligned methodology.

\(^8\) Note: the concept of a 1.5 degree trajectory is highlighted as being relevant based on reference to the Paris Agreement, however there is no intention to necessarily recommend or mandate this target in the context of this guidance document.
Disclosure

A number of pre-existing disclosure frameworks exist which issuers may find helpful in preparing to disclose their climate transition plans. It is acknowledged that other similar frameworks may be relevant, and that additional guidance may emerge over time.

Suggested information and indicators

- Short, medium, and long-term greenhouse gas reduction targets aligned with Paris Agreement;
- Baseline;
- Scenario utilised, and methodology applied (e.g. ACT, SBTi, etc.);
- Greenhouse gas objectives covering all scopes (Scope 1, 2 and 3); and,
- Targets formulated both in intensity and absolute terms.

Independent review, assurance and verification

A variety of services providers are currently offering independent review services which set out to review a particular issuer’s proposed quantified ‘decarbonisation trajectory’, and offer an opinion on the extent to which this is aligned with reference trajectories noted in Element 1 above. Such independent, expert reviews provide prospective investors with an assessment of whether the proposed trajectory is aligned with the science-based trajectories deemed necessary to limit climate change to safe levels.
4 - Implementation transparency

Market communication in connection with the offer of a financing instrument which has the aim of funding the issuer’s climate transition strategy should also provide transparency to the extent practicable, of the underlying investment program including capital and operational expenditure. This may include R&D-related expenditure where relevant, and details of where any such operating expenditure is deemed ‘non-Business as Usual’, as well as other relevant information indicating how this program supports implementation of the transition strategy, including details of any divestments, governance and process changes.

**Rationale**

Acknowledging the various pressures that issuers from hard-to-abate sectors are currently coming under, there is an obvious incentive to respond in the short term with announcements regarding strategy, targets and related commitments. However, addressing the issue of financing of business operations and infrastructure to ensure the operational picture can deliver the announced response over extended time horizons is more challenging and time-consuming. Ultimately however it is the internal allocation of capital by the company in order to implement the strategy which will be most important, alongside the governance that supports such re-allocation.

For this reason, it is recommended to provide transparency with regard to the planned capital and operational expenditure decisions which will deliver the proposed transition strategy. Issuers should report in qualitative and quantitative fashion the climate-related outcomes and impacts that these expenditures are intended to result in. It is also worth highlighting here that it is not solely ‘greening by’ or ‘greening of’ expenditures that contribute to a proposed transition strategy. Where a transition may have negative impacts for workers and communities, issuers should outline how they have incorporated consideration of a ‘just transition’ into their climate transition strategy, and may also detail any ‘social’ expenditures that are considered relevant within the context of transition finance.

**Disclosure**

Disclosure of capital expenditure (capex) and operational expenditure (opex) plans and other relevant financial metrics to the extent they relate to a transition strategy may be made via a company’s annual report, website, or sustainability report. Disclosure of anticipated capex and opex line items may take the form of a simple table providing detail on specific elements and their connection to the announced strategy, with estimated amounts involved.

**Suggested information and indicators**

- Disclosure on the percentage of assets/revenues/expenditures/divestments aligned to the various levers outlined in Element 1 above;
- Capex roll-out plan consistent with the overall strategy and climate science.

**Independent review, assurance and verification**

Specific assurance or verification of capex and opex plans (i.e. assessing whether expenditures have occurred as originally planned) is unlikely to be appropriate given the difficulty in accurately predicting these forward-looking types of expenditures. The company may wish to consider providing an analysis of the extent to which outcomes have aligned with original plans, i.e. whether spending took place as anticipated, and in the event it did not, providing explanations as to why.