

Transition finance for transforming companies

Avoiding greenwashing when financing company decarbonisation

DISCUSSION PAPER

10 September 2021

Authors: Anna Creed and Michelle Horsfield

With thanks to all those who had input into this paper as the Transition Programme Advisory Panel and reviewers.

Key messages

- The IPCC Special Report on Global Warming of 1.5 Degrees, Summary for Policy Makers, stresses that limiting global warming to 1.5°C would require rapid and far-reaching transitions in land, energy, industry, buildings, transport, and cities. Global net human-caused emissions of carbon dioxide (CO₂) would need to fall by about 45% from 2010 levels by 2030, reaching net zero around 2050.¹
- This message is now filtering through:
 - 61% of countries, 9% of states & regions in the largest emitting countries and 13% of cities over 500k in population have now committed to net zero emissions.²
 - Of the world's 2,000 largest public companies, 21% now have net zero commitments, representing annual sales of nearly USD14tn.³
 - 129 signatories representing GBP43tn in Assets under Management (AUM) have signed up to the net zero asset managers initiative since its launch in December 2020. They represent almost half of the entire asset management sector globally in terms of total funds managed.⁴
- The sustainable financial markets are booming: Green, Social and Sustainability (GSS) bonds and Sustainability Linked Bonds (SLBs) collectively reached USD496.1bn in H1 2021 as issuance surged.⁵ This includes an increasing number of types of use-of-proceeds (UoP) bonds including 'Transition Bonds', of which 18 have been issued to date.⁶
- The growth in SLBs has been substantial: in H1 2021 they formed 6% of the total labelled debt issuance even though the first SLB was only issued in September 2019 (by ENEL). The high emitting sectors that are crucial to a successful economy-wide transition (including industrial sectors and fossil-fuel-dependent sectors) are far more prominent in the SLB market than the UoP market.
- Given their forward-looking key performance indicators (KPIs), all SLBs are arguably inherently about transition, whether a climate, broader green and/or social transition. For a decarbonisation transition specifically, they represent a fantastic opportunity for companies' net-zero targets to be linked up with access to sustainable finance.
- But many of these early examples of SLBs and transition bonds have raised concerns in the market. Primary concerns are around the relevance, reliability, and ambition of transition pathways. KPIs have been set by the company and are therefore difficult to benchmark against peers or wider goals such as the Paris Agreement targets. There has been concern that some of these issuances have been 'business-as-usual' by another name. So, while the market has seen impressive growth, it has often been difficult to assess the impact and ambition of each bond. The market will not grow to its full potential if this is not addressed.
- Climate Bonds Initiative (Climate Bonds) established its Climate Bonds Standard and Certification Scheme since 2014, and in that time has Certified over USD150bn of UoP bonds.
- Climate Bonds has always recognised the importance for all sectors of the economy to go green. We have set eligibility criteria for use-of-proceeds across the renewable energy, buildings, transport, water infrastructure, waste management, forestry and agriculture sectors. Work is ongoing to develop the same for a number of high emitting sectors including cement, chemicals and steel. This will form the basis of an expanded range of use-of-proceeds bonds certification into sectors often labelled as transition.
- It is also Climate Bonds' intention to certify instruments beyond use-of-proceeds bonds, including SLBs and similar (e.g., Sustainability Linked Loans - SLLs). The intention is to provide transparency over the

¹ <https://www.ipcc.ch/2018/10/08/summary-for-policy-makers-of-ipcc-special-report-on-global-warming-of-1-5c-approved-by-governments/>

² ¹ Black, R., Cullen, K., Fay, B., Hale, T., Lang, J., Mahmood, S., Smith, S.M. (2021). Taking Stock: A global assessment of net zero targets, Energy & Climate Intelligence Unit and Oxford Net Zero : [Taking stock: A global assessment of net zero targets!](#).

³ Ibid.

⁴ [Net Zero Asset Managers Initiative - Home](#)

⁵ 'Sustainable Debt Market: Summary H1 2021', Climate Bonds Initiative. [cbi_susdebtsum_h12021_02b.pdf \(climatebonds.net\)](#)

⁶ Ibid

science-based criteria for credible SLBs and similar instruments, and assurance for investors that those requirements have been met in respect of any certified issuance. Consideration is also being given to the certification of companies (i.e. not in association with any particular financial instrument).

- This paper presents Climate Bonds' proposal of the five hallmarks of a credibly transitioning company, i.e. a company whose transition is rapid and robust enough to align with the global goal to nearly halve emissions by 2030 and reach net zero by 2050, in line with the Paris Agreement. These would be the key elements that would be the focus of assessment for certification, and all five hallmarks would need to be satisfied.
- They address 1) the requisite ambition of company level targets and 2) demonstrate the company's willingness and ability to deliver on those forward-looking targets, Specifically, the Hallmarks are:
 1. Paris-aligned targets
 2. Robust plans
 3. Implementation action
 4. Internal monitoring
 5. External reporting.
- The intent is to bridge the gap between existing market guidance that is tailored specifically to SLBs and have good take-up but are lighter touch in detail (such as ICMA's Sustainability Linked Bond Principles), and the deeper company-level assessment frameworks available that are more comprehensive but perhaps too complex for wide market take up. This proposal is to address concerns from issuers and investors on the burden of information and reporting requirements, while maintaining robustness and credibility.
- The proposal complements existing environmental, social, and governance (ESG) frameworks and methodologies but goes beyond them and is specific to fixed income instruments. It emphasises key governance elements that are important indicators of a company's willingness and ability to deliver on its decarbonisation targets, but also adds the granularity needed to ensure that those targets are ambitious and in line with the agreed climate goals. It moves away from a world of relative measures such as best in class, sector benchmarking or improvements compared to a historic baseline', to the more absolute measures tied to transition pathways that are common to all participants in the sector. This approach has worked well in the green use-of-proceeds market and is reflected in the upsurge in green or sustainability taxonomies worldwide – i.e. standardised classification schemes incorporating common eligibility criteria such as the EU Taxonomy. It requires scope 1, 2 and 3 emissions to be addressed and short, medium and long term targets to be set.
- Under this proposal, the transition green label would be split into three categories:
 - Green – already at net zero
 - Green transition – on a common sectorial transition pathway that aligns with net-zero
 - Interim transition – working towards the common sectorial pathway

Crucially, the third category of interim transition has a time-limited window, perhaps to 2025. This window enables all companies to positively engage with material decarbonisation, but its time limited nature ensures that the substantial change needed is not endlessly pushed into the future.

- Further discussion and development is needed to complete and finalise these proposals. Not least, there are some technical complexities around setting company boundaries for the purpose of assessment. But we welcome discussion and collaboration to take this work forward: please contact Climate Bonds to discuss.

1. Introduction

This paper explicitly addresses the challenge of the climate mitigation transition, and specifically, a proposal for assessing the credibility of a company's decarbonisation. Of course, economy-wide decarbonisation of the scale and speed required by the goals of the Paris Agreement cannot be achieved without due considerations of a "just" transition. Citizen participation, job creation and measures to address the social and economic impacts from sunset sectors and activities are key elements of a just transition to a low carbon economy. In addition, it is essential that all environmental, social and economic aspects critical to the delivery of the Sustainable Development Goals are simultaneously addressed. Transition in relation to these factors needs further consideration and is not addressed in this paper but will be an essential complement to it.

This paper is a companion piece to the 'Financing Credible Transitions' paper produced by Climate Bonds Initiative in partnership with Credit Suisse in September 2020.⁷

No-one can be left behind in addressing climate change

The climate mitigation trajectory the world must undertake by 2030 to meet the goals of the Paris Agreement is steep and front-loaded, demanding immediate and far-reaching action across all sectors of the economy and in all regions to achieve a net-zero global economy and a more resilient and equal society. The EU has a stated ambition to reduce emissions by 55% by 2030 and reach climate neutrality across the whole continent no later than 2050. China has announced the target of peak emissions by 2030 and net-zero by 2060.

Critically, no industry or organisation can be left behind. While progress has been made in expanding renewable energy supplies and reducing our reliance on fossil fuels in the energy and transport sectors particularly, many other activities continue at levels of emissions that have the potential to stall or undermine the low carbon transition.

Addressing this means companies producing goods and services needed into the long term are rapidly and progressing decarbonising their activities (this includes in 'hard-to-abate' sectors such as cement, steel, aviation⁸). Alongside this, it means companies producing goods and services that cannot be aligned with a low carbon economy, and for which substitutes exist, 'transition away' from their current activities re-orientate their business around activities that can be so aligned (for example, a fossil fuel energy generation company re-orientating its business to generate energy from renewables). And it means the rapid ramp up of activities which enable either of the above to happen.

There is a huge opportunity for finance in the transition to a low carbon economy

Estimates suggest that an annual USD6.9tn in infrastructure investment and between USD1.6tn and USD3.8tn for the energy transition, is required to meet the Paris Agreement targets.⁹ Driving private capital towards transition investments is key to scaling up finance: public money alone is not sufficient for the investment needed.¹⁰

And growing action to drive that change

According to a recent study out of Oxford University¹¹, 61% of countries, 9% of states and regions in the largest emitting countries and 13% of cities over 500k in population have now committed to net zero

⁷ That paper unpacks the types of decarbonisation transitions needed across the economy, presents 5 principles for a credible transition, evaluates transition related financial instruments to date and considers any implications for transition labelling www.climatebonds.net/files/reports/cbi_fincredtransitions_final.pdf

⁸ For example where the high emissions manufacturing process needs to be radically decarbonised over that time through measures such as switching fuel sources, implementing new technologies or installing new production processes.

⁹ Climate Investment Opportunities: Climate aligned bonds & issuers 2020 at https://www.climatebonds.net/files/reports/cbi_climate-aligned_bonds_issuers_2020.pdf

¹⁰ *ibid*

¹¹ https://ca1-eci.edcdn.com/reports/ECIU-Oxford_Taking_Stock.pdf

emissions. At the same time, of the world's 2,000 largest public companies, 21% now have net zero commitments, representing annual sales of nearly USD14tn'.¹² This is a start, but not enough.

Shareholder action can be credited with the initial momentum for encouraging companies to be more transparent and make stronger commitments to climate action through initiatives like *Climate Action 100+*. It is accompanied by the likes of the *Transition Pathway Initiative* that benchmarks company transition plans. The *Say on Climate* campaign advocates for shareholder say on climate transition action plans. For many companies, more of their debt is held in the fixed income market and the investors and advisors in this sector are putting increasing pressure on corporates to set out their decarbonisation goals and targets. Since its launch in December 2020, 128 signatories representing USD43tn in Assets under Management (AUM) have signed up to the Net Zero Asset Managers initiative. They represent almost half of the entire asset management sector globally in terms of total funds managed.¹³ In a similar style, the UN convened Net Zero Asset Owner Alliance represents USD6.6 trillion AUM from 40 institutional investors.

The sustainable finance market is booming, and increasingly attractive to transitioning companies

GSS bonds and SLB's) collectively reached USD496.1bn in H1 2021 as markets surged. See Figure 1.

Within this, Green (UoP) Bonds are the most mature instruments. Kicked off by the European Investment Bank (EIB) in 2007, in 2020 USD290bn of issuance hit the market with issuers including corporates, banks, municipalities, sovereigns and many others. At current rates of growth, it is expected that USD1trillion will be issued annually by 2023.¹⁴ The Green (UoP) Bond label has a long history of being used to raise finance for companies that are not yet 'near-zero' and need to decarbonise, for example, UoP relating to Buildings and Transport are both very well represented in the green bonds market.

Beyond the green label, a variety of 'other UoP bonds have emerged in recent years. See Box 1. These include the explicitly labelled 'Transition Bonds'. By the end of 2020, 13 Transition (UoP) Bonds had been issued, including from the European Bank of Reconstruction and Development (EBRD) and energy company SNAM, and an additional 5 were issued in the early months of 2020, including from Bank of China. See Appendix 1 for the full list. Interestingly, this label has attracted interest from companies who have made little foray into labelled green bonds.

Other formats beyond UoP bonds, such as the relatively recent Sustainability Linked Bonds (SLBs), have also emerged. As (usually) general purpose debt tied to company-level performance indicators, SLBs are proving attractive to issuers who don't have sufficient capital expenditures connected to sustainability projects, to smaller issuers that might lack the capacity to implement effective tracking or reporting practices required for use of proceeds instruments, or more generally to issuers who simply prefer to set performance indicators and reporting requirements at company level, rather than dedicated tracking and reporting of specific eligible projects and assets.

The growth in SLBs in the first half of 2021 has been substantial, with volumes of USD32.9bn, forming 6% of the total labelled debt issuance. And this includes issuance from companies who have previously issued UoP bonds.

High emitting sectors that are critical to a successful economy-wide transition, including industrial sectors and fossil fuel dependent sectors, are far more prominent in the SLB market than the green UoP market (even when viewing transition as a subset of green), where they are still largely absent. See Figures 2a and 2b. For example, the oil and gas sector is not widely active in the green bond market, with Repsol's foray receiving criticism, yet the reality is that the oil and gas sector will also need to transition. Italian oil and gas company ENI was one of the bigger SLB's issued in the first half of 2021 with its USD1.2bn SLB. This may be as operators in those sectors are at an earlier stage of their transition and so see greater potential to engage with investors via forward-looking SLBs.

¹² Black, R., Cullen, K., Fay, B., Hale, T., Lang, J., Mahmood, S., Smith, S.M. (2021). Taking Stock: A global assessment of net zero targets, Energy & Climate Intelligence Unit and Oxford Net Zero : [Taking stock: A global assessment of net zero targets](#)'.

¹³ [Net Zero Asset Managers Initiative](#)

¹⁴ Climate Bonds Sustainable Debt Market Summary H1 2021 at https://www.climatebonds.net/files/reports/cbi_susdebtsum_h12021_02b.pdf 1

Given their forward-looking KPIs, **all SLBs are inherently about transition**, whether a climate, broader green, and/or social transition. For a decarbonisation transition specifically, they represent a fantastic opportunity for companies' net-zero targets to be linked up with access to sustainable finance.

It is not the intention of this paper to investigate why some instruments are preferred to others, or to suggest some are of more importance than others. A plurality of different instruments that companies can choose between can only accelerate the transition – the ultimate objective – though we note that the variety of labels used across these instruments can be confusing and unwelcome for investors. Low interest rates continue to contribute to increased demand for all types of bonds particularly from high yield issuers and instruments with long duration. The demand for debt instruments with a focus on sustainability continues to increase. The number of dedicated funds and those with softer labels such as ESG, Sustainability, and SDG is growing all the time.¹⁵ In Europe, the ECB remains the largest buyer of bonds, including those labelled green and as of January 2021, SLB's have been eligible as both central bank collateral, and as assets for both the Asset Purchase Programme and the Pandemic Emergency Programme. Further, if individual instruments are issued in at least benchmark size (USD500m) they will be eligible for inclusion in broad market indices, hence, will be considered by mainstream investors too. This momentum must be seized through all and any measures possible.

More broadly, we expect policy initiatives globally to increase the emphasis on sustainable investment, including finance for transition. For example via the implementation of the European Union's Sustainable Finance Action Plan and the inclusion of 'transitional activities' in the EU Sustainability Taxonomy. In April 2021, the Financial Services Agency, Ministry of Economy, Trade, and Industry; and Ministry of the Environment of Japan, published draft guidelines on climate transition finance.¹ The guidelines are aimed at promoting financing for businesses that are either already decarbonised (e.g., renewable energy) or are transitioning towards that - in order to realise Japan's goal of a carbon-neutral society by 2050.

Box 1: Green, Social and Sustainability (GSS) Bonds

Use of Proceeds (UoP) bonds. Defined by the allocation of proceeds to specific environmentally or socially beneficial projects, assets activities, or expenditures. This category includes the following labels:

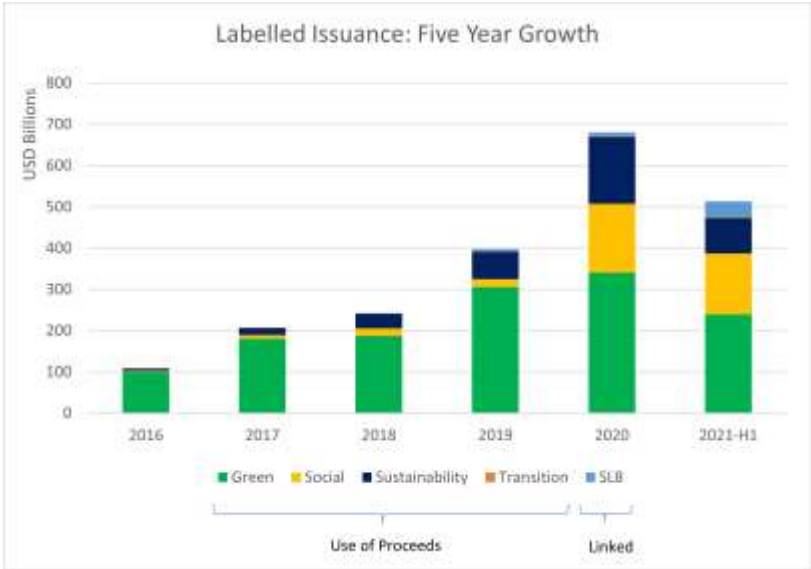
- *Green Bonds* - Proceeds allocated to climate and/ or environmentally beneficial projects.
- *Social Bonds* - Proceeds allocated to socially beneficial projects
- *Sustainability Bonds* - A hybrid of green and social bonds, proceeds are allocated to a mix of environmentally and socially beneficial projects.
- *Blue Bonds* - In the main a subset of green bonds, but with proceeds allocated to ocean based projects
- *Climate Resilience Bonds* - A subset of green bonds, with proceeds specifically allocated to climate related projects
- *Transition Bonds* - In the main a subset of green bonds, often with proceeds allocated to decarbonising assets or projects
- *Pandemic Bonds* - In the main, a subset of social bonds, with proceeds allocated to addressing pandemic related social issues, such as healthcare or employment. But may be allocated to projects with both social and environmental impacts.

Sustainability Linked Bonds (SLBs). Proceeds of SLBs are usually not allocated to specific projects, assets or activities but used for general purposes. The sustainability angle comes from the issuing entity making forward commitments to future delivery of sustainability outcomes, often in the form of company level key performance indicators (KPIs). In some cases, the cost of capital is linked to achievement of those KPIs.

Hybrid: Sustainability-linked green bonds (SLGBs). A hybrid that ties the use of proceeds model of a green bond with the performance-based structure of an SLB. The first SLGB was issued by Japanese construction company, Takamatsu, in March 2021. There are expectations that this structure will gain traction rapidly over the coming years.

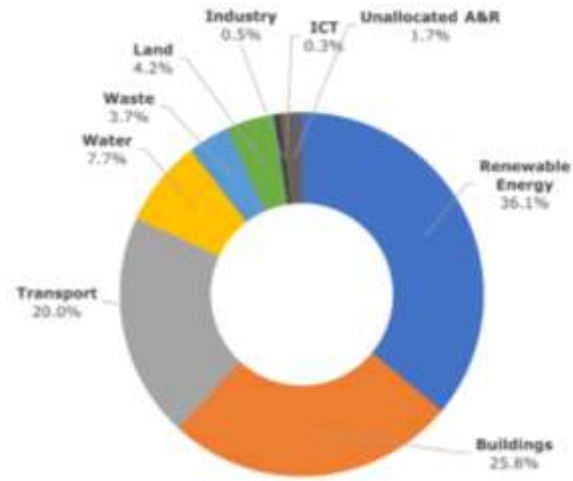
¹⁵ BlackRock's EM focused active BGF Emerging Markets Impact Bond Fund employs norms-based screening, along with a proprietary GSS taxonomy and ESG integration in issuer-level analysis.¹⁵ SSGA's new State Street Sustainable Climate Bond Funds range uses Climate Bonds' data as an input into the fund methodology to scale up green bonds, along with a proprietary screening to help mitigate and adapt for climate impact and exclude controversial issuers.¹⁵ Examples of other recent product additions include green ETFs from Horizon ETF and L&G.^{15,15} The proliferation of these investment solutions is in keeping with an upward trend in sustainable fund inflows, as noted by NASDAQ.

Figure 1 Growth in sustainable finance instruments 2016-2021 first half



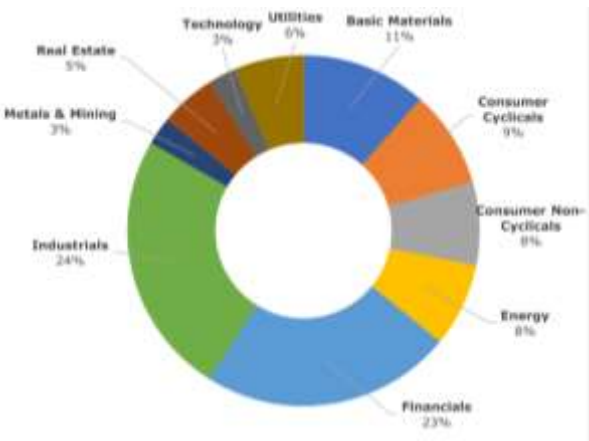
Source: Climate Bonds Initiative

Figure 2a: Use of Proceeds Bonds by sector allocated proceeds



Source: Climate Bonds Initiative

Figure 2b: SLBs by issuing sector



Success means full accountability and no greenwashing

As the sustainable finance market expands to include high emitters and high emitting activities at greater scale, one key challenge is the need to demonstrate the credibility of the entity’s future transition and avoid greenwashing.

So far, the market response to transition bonds and SLBs has been mixed. While investors welcome the inclusion of more types of entity into the sustainable debt space, the primary concerns are around the relevance, reliability, and ambition of transition pathways. KPIs set have been entity-specific and difficult to benchmark against peers or wider goals such as the Paris Agreement targets and there has been concern that some of these issuances have been ‘business-as-usual’ by another name. So although on paper the market has seen impressive growth, it has often been difficult to assess the impact and ambition of each bond. The market will not grow to its full potential if these concerns are not addressed.

For example, ENI issued an SLB in June 2021. ENI is notable in the sector for its commitment to include lifecycle emissions (scope 3). This framework made a step in the right direction for fossil-fuel-based entities to start their transition journey, by outlining commitments to reduce emissions from existing activities and stating entity ambition to invest in renewables. However, the genuine ambition of the instrument could have been strengthened if it was set in the context of a wider corporate strategy in line with 1.5oC. The framework would have benefited from greater detail on the transition plan for the next few years and how capital will be allocated.

Expanding the Climate Bonds Certification Scheme

Climate Bonds' focus to date has been UoP bonds. Climate Bonds screens all labelled UoP bonds for inclusion in the Climate Bonds Database to facilitate market tracking and intelligence. Separately, the Climate Bonds Climate-Aligned database includes unlabelled bonds issued by a pool of entities that derive at least 75% of their revenues from climate-aligned activities. Climate Bonds has also developed and runs the Climate Bonds Standard and Certification Scheme - a labelling scheme with Climate Bonds Certification awarded to bonds meeting the science-based climate mitigation and adaptation criteria for eligible UoP and fulfilling management and reporting requirements aligned with the pillars of the Green Bond Principles. Over USD150bn of UoP bonds have been Climate Bonds Certified to date.

Climate Bonds has always recognised the importance of all sectors of the economy going green. Collaborating with external experts, eligibility criteria for use-of-proceeds across the renewable energy, buildings, transport, water infrastructure, waste management, forestry and agriculture sectors have been defined. Work is now ongoing to develop similar eligibility criteria and climate transition pathways for other high emitting sectors including cement, chemicals, steel and oil and gas. This will form the basis of an expanded range of UoP bonds certification into sectors often labelled as transition.

It is also our intention to certify instruments beyond UoP bonds, including corporate SLBs and similar (e.g. Sustainability Linked Loans - SLLs) to provide guidance to issuers and assurance to investors around the credibility of those instruments which can at present prove difficult to evaluate due to lack of consistency in approaches and metrics used by different issuers. This will require assessment both of the company's transition KPIs, and their ability to deliver on their targets. Such certification would follow the requirements set for UoP bonds, namely a standardised (common) rule set, binary assessment, simplicity, transparency, and science-based criteria.

Commercial and development banks (with their large loan portfolios), municipalities, sovereigns and other public entities are perhaps the ultimate 'mixed portfolio companies'. In the coming months, Climate Bonds will consider further how this framework could be used or adapted to assess the transition of such entities. This will be key to assess SLBs and other transition related instruments from such issuers. For example, it has been reported that Brazil is laying the groundwork for a sovereign bond issue linked to its ESG credentials.

As assessment of SLBs requires assessment of company-wide transition KPIs and strategies, it is a small step to also then certifying companies transition agendas, irrespective of any associated financing instrument. Climate Bonds is also considering the certification of any company articulating and implementing transition. Such certification would offer a valuable element of 'environmental due diligence' for any stakeholder in that company interested in its transition, including shareholders, investors, supply chain partners, and customers.

A framework for eligibility for Certification

Chapter 2 presents Climate Bonds view on the five hallmarks of a credibly transitioning company. These are the key elements that would be the focus of assessment for certification. They address 1) the requisite ambition in terms of company-level targets set and 2) demonstrating the company's willingness and ability to deliver on those forward-looking targets.

This proposal aims to bridge the gap between existing market guidance tailored specifically to SLBs which have good take-up but are lighter touch in detail¹⁶, and the deeper company-level assessment frameworks available that are more comprehensive but perhaps too complex for wide market take up. See [Figure 3](#) for a schematic

¹⁶ In particular, ICMA's Sustainability Linked Bond Principles released in June 2020 that has been followed by over 80% of sustainability-linked bonds, and this share is expected to increase over time.

representation of this gap. The Hallmarks focus on what is essential to demonstrate a credible transition rather than trying to cover all components that may be relevant. This is to address concerns from issuers and investors relating to the burden of information and reporting requirements, while maintaining robustness and credibility.

It complements existing ESG frameworks and methodologies but goes beyond them. It emphasises key governance elements that are important indicators of a company’s willingness and ability to deliver on its decarbonisation targets, but also adds the granularity needed to ensure that those targets are ambitious and in line with the agreed climate goals. It moves away from a world of relative measures such as ‘best in class’, ‘sector benchmarking’ or ‘improvements compared to a historic baseline’, to the more absolute measures tied to transition pathways that are common to all actors in the sector. This approach has worked well in the green UoP market and is reflected in the upsurge in green or sustainability taxonomies worldwide.

Figure 3: Climate Bonds Certification of company transitions fills a gap in the market



Requesting your input

For the reasons highlighted above, this paper has a very broad intended audience:

- It provides guidance to any organisation looking to articulate and implement a credible climate mitigation transition strategy, including but not limited to those raising finance explicitly for that.
- It aids investors by promoting accountability of companies in their sustainability strategy and availability of information necessary to evaluate their investments, in SLBs, SLLs, equity etc.
- It assists underwriters by moving the market towards expected approaches to structuring and disclosures that will facilitate credible transactions.

It is also a proposal, presented for discussion that seeks input and contributions. We have been fortunate to be able to build upon existing frameworks for assessing corporate transitions and transition strategies and there is much coherence between that guidance and this proposal. We do not wish to ‘re-invent the wheel’ or confuse the market. However, we are not in full agreement in all aspects, and we look forward to discussing these areas of divergence in order that collectively we give clear and consistent advice and support to the market.

2. Hallmarks of a credible company transition

Introduction

Five Hallmarks of a credible company climate mitigation transition are identified:

1. Paris-aligned targets
2. Robust plans
3. Implementation action
4. Internal monitoring
5. External reporting.

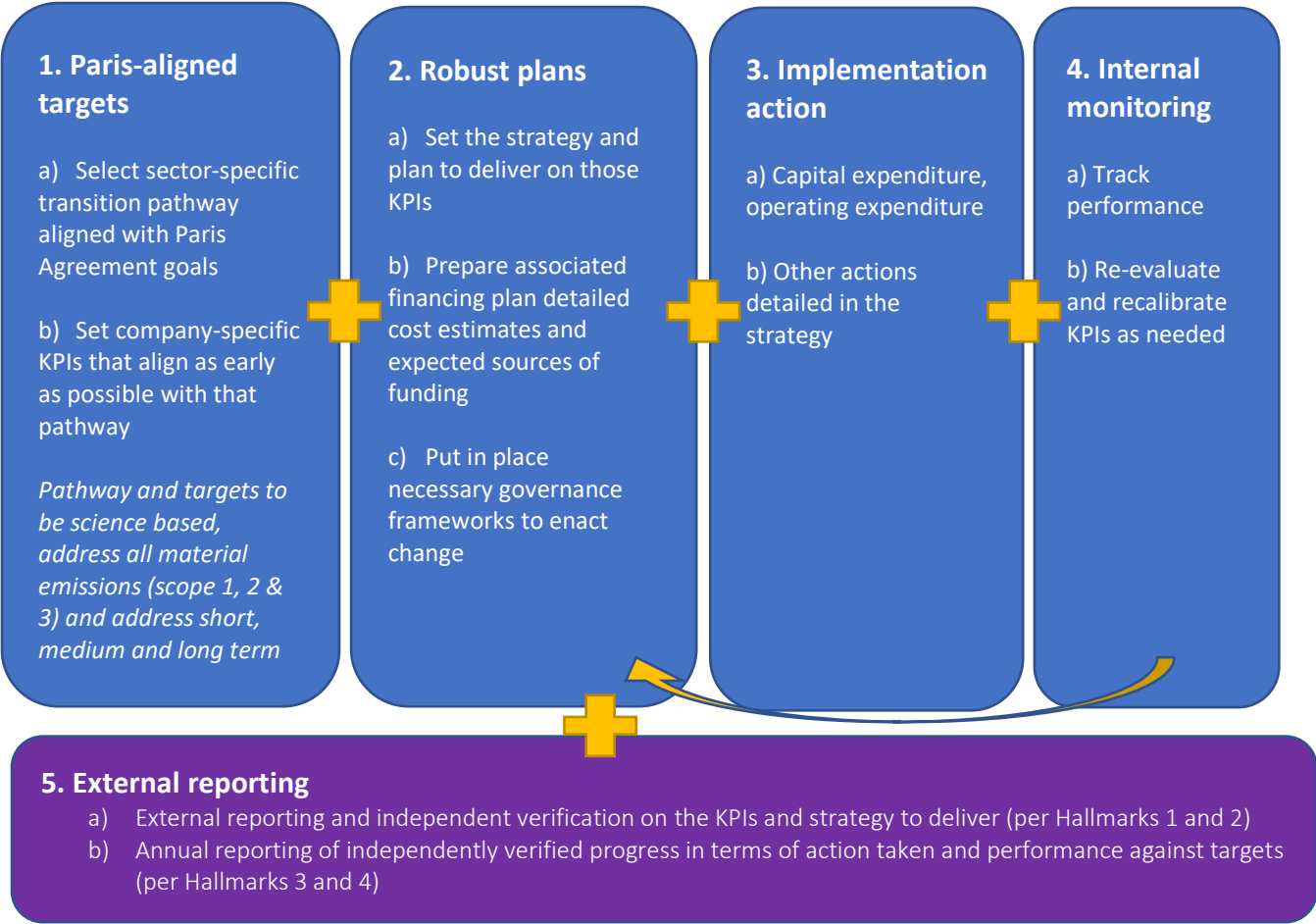
To some extent, this represents a hierarchy of performance. There is value in public commitment to ambitious targets (Hallmark 1), but these are only convincing when the enabling environment has been created to deliver on them (Hallmark 2). But this alone is not sufficient. Public commitments can be made in good faith (or not) but still not be followed through. Evidence of change is important (Hallmark 3) and capex/opex investments and strategic changes to the business provide information on the direction of travel of a companies' transition strategy. Thus far, these are only the steppingstones in advance of delivery against the selected targets (Hallmark 4). External reporting is always important to build trust in the market (Hallmark 5).

The requirements for each of these Hallmarks are summarised in [Figure 4](#). Before delving into the detail of each, it is important to recognise the principles that set the intent:

- To be attractive to investors (and other stakeholders), company transitions need to be credible. Specifically this means they need to be:
 - Science based, i.e., aligned with the climate science.
 - Testable, and so consideration is given to 1) what should be assessed, 2) over what time period, 3) how it should be credibly demonstrated.
- To be usable by large numbers of companies and investors (and other stakeholders), the requirements need to be:
 - Relatively simple, focussing on critical information, particularly that which acts as a meta indicator of multiple aspects of good performance.
 - Not reinvent the wheel, for this reason, we draw heavily on existing guidance and frameworks, though streamlining where we think appropriate to minimise demands on companies.
 - Consistent over time and companies – to enable comparability across companies and to encourage company participation by setting clear and stable requirements.

We note that these Hallmarks can be applied to assess the adequacy of transition in respect of the attainment of other environmental and social goals, although the science and timeframe is less clear in many of those cases. Although this wider scope is of critical importance, it is not the focus of this paper.

Figure 4: The Hallmarks of a credibly transitioning company



HALLMARK 1: Paris-aligned targets

There are two key elements to target setting:

The first is the selection of a common sectoral decarbonisation pathway, a pathway that shows how that sector will align with the collective goal of keeping global warming below 2 degrees and ideally 1.5 degrees, per the Paris Agreement. We call this the sectoral green transition pathway.

This pathway *does not* simply reflect a sector average, or best-in-class, but an absolute, forward-looking pathway that is technologically feasible and ensures the sector aligns with **overall** net zero emissions economy goals.

In its Special Report on Global Warming of 1.5°C (SR15) the Intergovernmental Panel on Climate Change (IPCC) presented pathways with no or limited overshoot of 1.5°C. In these pathways, global emissions need to drop by 45% from 2010 levels by 2030 and down to net zero globally by 2050.

This pathway must be common to all companies in that sector / practicing that economic activity.¹⁷ There may be some opportunity for flexibility here, particularly in the early stages of transition. Higher emissions in some

¹⁷ it is important that companies use a common source for their decarbonisation goals, and do not attempt to define their own company-specific sector decarbonisation pathway. This leads to a lack of comparability between companies and increases the risks of collective emissions reductions failing to meet the scale and speed needed to meet our common targets. It is also time and cost-inefficient. International efforts to harmonise taxonomies are a recognition of this important principle of common criteria for good performance. There may, of course, be considerations at play affecting the relative ease or difficulty of establishing common GHG thresholds in different contexts or locations, while balancing other development needs (e.g. degree of economic development or maintaining resource security). For this reason, there may be some flexibility in applying the climate science in different regions and contexts – but again, this should be determined as a collective level, e.g. through science-based regional taxonomies which are harmonised internationally, not through bespoke approaches. As a note of caution, targets that align with NDCs cannot automatically be taken to represent credible transitions to 1.5°C goals, at least at this time, as in aggregate, NDCs do not equal even a 2°C world.

parts of the economy or sector may be compensated for by reductions elsewhere. However, this flexibility reduces as the overall proportion of carbon neutral or near-zero carbon activities increases towards 100%.

Many sources of credible transition pathways are now available for companies to utilise, from individual institutions defining transition pathways on a sectoral basis (e.g. Transition Pathway Initiative, ACT Initiative, SBTi) to voluntary or regulated taxonomies (e.g. Climate Bonds and EU Taxonomies respectively) establishing common criteria on an economic activity basis. These include targets for high-emitting sectors that will be of particular relevance for transition. There are certainly gaps in this guidance which does not have full coverage across economic activities¹⁸, and in some cases lays out targets for good performance today, but not transition pathways to define targets going forward¹⁹. There are some inconsistencies in the guidance between different sources due to differences in underlying assumptions, which can cause confusion. Further work is needed to address these issues and provide greater assistance to corporates and investors.

The second is the set of company-specific key performance indicators (KPIs) selected by the company to describe how and when the company will catch up with/ follow/ outperform that sectoral green transition pathway. Let's call these the company KPIs.

Ideally, every company would already be on or exceeding their sectoral green transition pathway. But many companies have been slower to start the transition and will be playing catch up. What is important is that their company-specific KPIs and associated performance levels for those KPIs clearly articulate whether or not they are currently on that sector specific transition pathway, and if not, when they will align with and continue to follow that pathway.

These KPIs will reflect the commitment, willingness and ability of the company to decarbonise. To collectively achieve the global emissions reductions target, it is critical that decarbonisation is rapid and front-loaded, and therefore, those KPIs and performance targets should align with the relevant sectoral green transition pathway as soon as possible and continue to follow that pathway (or better, out-perform it) from then on.

Both the common sectoral green transition pathway and the company-specific KPIs should describe a decarbonisation trajectory over the short, medium and long term. As noted above, decarbonisation needs to be rapid and front loaded, but we also need to ensure that we are designing and implementing long term programmes that will deliver the change needed over the long term. Therefore, it is proposed that company KPIs are identified for key milestone dates, and ideally the same milestone dates to enable greater comparability between companies, at least in the same sector. Suggested milestone dates and associated KPIs might recognise the following three stages:

- The short term i.e., now to 2025, for which period it is reasonable to expect a high degree in certainty and detail in planning and associated KPIs; and
- The medium term i.e., 2025 to 2030, for which period it is reasonable to expect well-defined plans and associated KPIs that recognise the critical collective milestone of halving emissions by 2030, though recognising those might be subject to change; and
- The long term, i.e., 2030 to 2050, for which period it is reasonable to expect broad plans that can map the pathway to align with the collective milestones set out in the Paris Agreement, though recognising a greater level of uncertainty and flexibility as information this far into future is subject to greater change. An issue at present is that many companies have a plan until 2030, but then are blank until 2050 for which they pledge net-zero without an indication of the pathway to get there.

This is important however short the term of any transition related financial instrument. If claims are being made that any particular instrument is linked to or directly financing a part of the overall company transition, that can only be a credible claim if the longer-term transition strategy and KPIs are explained, and it is clear how any particular investment contributes to or is part of that.

¹⁸ For example, most Taxonomies are 'green' taxonomies, they address economic activities that will be needed in the future and often set GHG performance levels for them that will ratchet down over time. However, they do not address economic activities that need to be phased out, so called 'stranded activities' so do not address the necessary speed and scale of 'transition away', critical information for target setting for companies practicing those activities. And of course, even for non-stranded activities, the green taxonomies do not have complete coverage at this time. The full range of manufacturing activities for example is rarely covered, nor mining.

¹⁹ For example, the EU Taxonomy regulation requires that all large companies disclose what proportion of their revenues comply with the criteria in the EU Taxonomy and therefore are sustainable. It includes high emitting activities that need to transition e.g. cement and steel, and aviation (forthcoming). But the criteria for those activities are static – they represent thresholds for good performance for today but no pathways for tomorrow. The regulation notes that the criteria for all 'transitional activities' in the Taxonomy will be reviewed every three years, but there is no indication of the likely forward pathways. The Climate Bonds Taxonomy is a little more forthcoming, with transition pathways for some sectors including buildings and transport, but not for most.

They should address all material emissions. We have seen examples where issuers have come to market omitting KPIs which address material sources of their emissions. This raises concerns for investors as incomplete accounting for emissions makes it difficult to determine whether the company is making a comprehensive transition or just ‘cherry-picking’ low-hanging fruit, which would raise questions over greenwashing. Transition cannot be credible without addressing all material emissions.

This includes scope 1, 2 and 3 emissions. On scope 3 emissions specifically, upstream scope 3 emissions embedded in purchased goods or services should be addressed in the selected KPIs, as the company has a choice over who it purchases from and therefore associated embedded emissions in those inputs. For downstream scope 3 emissions, whether and how these are addressed in the KPIs depends in large part on whether the activity of the company is ‘stranded’, and the company needs to transition away from it or not.

For example, KPIs for a company engaged in the stranded activity of coal-fired electricity generation should address downstream scope 3 emissions via KPIs associated with the ‘turning off of the tap’ for those scope 3 emissions, e.g. decommissioning of those generation facilities.

Whereas KPIs for a company engaged in an activity that needs to continue into the longer term should address downstream scope 3 emissions directly *where they can exercise control over those emissions*. For example, a car manufacturer knows the future operating emissions impact of any vehicle it produces and should be moving from fossil fuel to electric powered vehicle manufacture to minimise downstream scope 3 emissions.

KPIs may be expressed in either a greenhouse gas (GHG) metric or another proxy indicator. GHG is a simple and well understood metric that enables straightforward comparability across companies in a sector, and a rapid assessment of whether the company’s transition is aligned with the targets for the sector, and therefore sufficiently rapid and robust. However, there may be other ‘proxy’ indicators which are also of merit. A food processor might set a KPI relating to the percentage of commodity purchases from farms or supply chains certified as being under climate-smart farming methods for example. A company switching from coal to renewables energy generation might set a KPI relating to the percentage of coal fired generation that will be decommissioned by a specified date.

Where non-GHG KPIs are used, the impact in terms of GHG emissions and how and for how long it delivers alignment with decarbonisation pathway for that sector should be clearly described.

A company might select a KPI relating to reductions compared to business-as-usual. Indeed, such metrics are often attractive to investors who seek some form of ‘additionality’ or measurable impact arising from their investment, [and they are recognised/ supported in ICMA’s Sustainability Linked Bond Principles]. However, as noted above, credible transition means aligning with forward looking sectoral green transition pathways, common to all those in the sector, that take into account future carbon budgets at a global collective level. Setting company-specific KPIs that are expressed solely as a reduction compared to the company’s own BAU are insufficient. The measure of success must not be how large or small a company’s change is relative to its own performance - but whether the result will be compatible with the collective emissions reductions targets needed.²⁰ Therefore again, where KPIs are framed in terms of reductions compared to BAU, these targets should be recalibrated to express how they align with the forward-looking transition pathways for that sector.

Note 1: Squaring the circle on sectoral transition pathways and company net zero targets. The proposal above is that all companies should seek to align with common, sectoral decarbonisation pathways. But many of those pathways do not target net zero emissions by 2050.

Different industries will have greater or lesser potential to reduce emissions/ increase sequestration over time, meaning that the end goals and speed of transition will vary substantially by sector. But the shared requirement for all is to reduce emissions to the minimum as fast as is possible. Given the speed of change required to align with the Paris Agreement, the majority of sectors will face a steep short term decarbonisation trajectory.

From a purely scientific perspective, every activity needs to decarbonise well before 2050. Some sectors will be able to reach net zero well before 2050. For example, for car manufacturing, low carbon technologies (electric vehicles) are readily available and well established in the market, and in some jurisdictions competing high carbon technologies will be increasingly prohibited e.g., there are to be no sales of new petrol and diesel cars

²⁰ One implication of this is that a company can be deemed to be credibly in transition while it is only making a small step change in the short term, if it has already, previously taken a large step change to decarbonise. In this case, it would effectively be continuing to deliver a ‘low carbon’ product or service, and so long as its future targets are aligned with overall decarbonisation targets for that sector. Conversely, a company that is making a large step change may still not be deemed to be making a credible transition if it is so far behind the curve that despite that large step change it still lags behind the transition pathway for the sector in which it operates.

after 2040 or earlier in some EU countries. However, some sectors face significant barriers to decarbonisation that are material to defining their pathways. Such barriers may be economic and/or technological or may be political or face a high degree of dependency on external factors. For example, the scale up of the use of green cement is, in part, blocked by its lack of safety record as major construction companies require a 20-year safety record.

Conversely, other activities may not be able to reach net zero emissions at all but should still be recognised in an economy wide transition. Impoundment hydropower reservoirs, for example, can emit methane, a potent GHG, but despite this can often be relatively low GHG emissions alternatives to fossil fuels, with the additional critical benefit that they also provide balancing and storage services to support intermittent renewables.

For fossil fuel companies moving towards renewables, the substitute renewable technology is already well established, the issue is how fast existing fossil fuel energy generation facilities should be and can be decommissioned.

With this disparity in mind, some sectors will need to do the heavy lifting in the short term while the barriers to scaling up of other sectors is reduced. For companies in sectors with greater decarbonisation potential, emissions reductions should be front loaded as much as possible. For companies in sectors that will always have some residual emissions that cannot be eliminated, ideally compensatory measures should be taken to counter those unavoidable emissions. For all companies, offsets should not be used to delay decarbonisation of the underlying activity, but if they are used, they should be clearly and separately identifiable as additional actions on top of efforts to directly reduce emissions and follow the sectoral green transition pathway. This would help to provide full transparency and so not distract from tackling emissions that can be reduced.

Note 2: An optimum number of KPIs?

It is important to avoid the proliferation of KPIs, in order to keep assessment and comparability as straightforward as possible. Of course, a single metric of lifecycle GHG emissions for each activity of the business would be the most comprehensive, but where this is not possible, and particularly where non-GHG indicators and metrics are used, efforts should be made to adopt 'meta-KPIs' which address as wide a scope of emissions as possible whether directly or indirectly. What is critical is that collectively the KPIs address the core business areas and all material sources of emissions for that business.

In respect of SLBs, setting three KPIs is common – where one or two are 'core' and the others more 'peripheral'.

HALLMARK 2: Robust plans

1. Establish the transition strategy and action plan that enables the delivery of those company-specific KPI's

Forward delivery against the company-specific KPIs selected under Hallmark 1 will only be credible if supported by a transition strategy and associated action plan that detail how the company will get from the current situation to where it needs to be to deliver on the selected KPIs.

It should describe in a step-by-step qualitative way the strategic objectives, orientations and policies, with particular emphasis on how the short-, medium- and long-term milestones reflected in the selected KPIs will be reached. The plan should aim to break the timeline down into 3-5 year intervals, recognising that less detail will be possible towards 2050. More specifically, the plan should detail:

- **The current position.** Each company will be at a different place in the journey towards a low carbon economy and the plan (and associated KPIs) should reflect where the company is today. A clear understanding of the current sources of emissions and the opportunities and risks of the low carbon transition should be detailed. This sets the scene for the nature of the changes that are needed.
- **In broad terms, the nature of the changes that will be made to deliver against the selected KPIs.** These changes might include:
 - decarbonise ongoing activities (e.g., through technology or efficiency improvements, or alternative inputs)
 - diversify activities and product mixes
 - exit activities that cannot be brought in line with net zero economy emissions goals, ideally via organic tail out or decommissioning
 - actions to address emissions of supply chain both up and downstream of the business.

N.B. Where options are unclear or none appear to be available, research and development plans should be articulated.

- **The specific actions to be taken to deliver the changes:** This action plan will define the changes that will be made to achieve the selected company-specific KPIs. It could be made up of a number of sub-plans. For example:
 - Technical plan for addressing the performance of sold products
 - Human Resources plan for ensuring the right provision of skills e.g., changes to staff training
 - Purchasing plan for supplier engagement e.g., renegotiation of supplier relationships
 - Marketing and Sales plan for client engagement
 - Business development plan for new business lines
 - Comms and PR plan for policy engagement

An assessment of delivery risks and a description of the measures being taken to mitigate those should be provided.

2. Determine the associated financing plan

All changes have financing implications in respect of the volume, timing and risk-return profile of finance needed to implement those changes. A financing plan is a tangible indicator of credibility in intent and ability to carry out the actions highlighted in the transition strategy and provides assurance to existing financial backers that the company will remain profitable during the transition.

The financing plan should address the needs and commitments for any capital expenditure (CapEx), operating expenditure (OpEx), merger and acquisition activities and research and development expenditures (R&D) necessary for the delivery of the transition strategy, in order that capital stock, working capital and overall business streams are aligned with the company specific KPIs selected under Hallmark 1. For some companies, capital allocation plans that support a repositioning of the capital stock will be critical. For others, operating expenditure may be more significant, including costs of retraining and redeploying staff or decommissioning stranded assets, or staff costs to operationalise low-carbon production practices.

The financing plan should be supported by a clear methodology that the company uses to determine the alignment of capital and other expenditures with its company-specific KPIs. The methodology should detail how the company evaluates the alignment of capital expenditure decisions, projects and plans with its selected KPIs. It should also disclose the percent of aligned capital expenditures and detail the year in which capital expenditures in carbon intensive assets will peak.

3. Put in place necessary governance mechanisms

For organisations that are decarbonising ongoing activities, this is not dissimilar to regular business-as-usual. For example, the activities might ‘just’ be about new electric furnaces to provide alternative clean energy supply, or upgrading engines to take a new fuel source – but there is no change to product or customer relationships, no need to build up new markets, no need to decommission whole activities etc.

In these situations, the selection of appropriate KPIs, supported by a transition strategy and finance plan to fund the actions detailed under that strategy, and a demonstration that those actions are being carried out on the schedule described in that strategy should be sufficient to consider the transition to be credible. That is, it is arguably less critical to revise existing governance structures, processes and incentives to enable the delivery of the transition strategy. The only exception to this might be where economic or technological challenges mean that those changes take place over a longer period, bringing greater risk of non-delivery against the selected KPIs due to changing personnel, priorities or resource availability.

However, for simplicity it is proposed that no assessment of governance factors (such as Board oversight of climate change, Board climate related capabilities / competencies, or executive remuneration linked to the selected KPIs) is required for companies undergoing these types of transitions.

However, in ‘transitions away’ where the transition involves more fundamental transformations of a company, there is greater risk of non-delivery against the selected KPIs. In these circumstances, more assurance is needed that the governance systems are in place to enable and drive through those changes over a long period of time. Therefore, it is proposed for companies undertaking these types of transitions, there is a requirement for Board oversight of climate change and Board climate related capabilities / competencies to ensure that the necessary leadership is in place. However, it is not essential for executive remuneration to be linked to the selected KPIs.

4. Board sign-off

The Board signs off a formal document in which the company commits to the selected targets, strategies and finance plans.

HALLMARK 3: Implementation action

For multiple reasons, there could be a lag between the establishment of the Transition Plan and selection of company-specific KPIs, and delivery against those KPIs. It can take time to raise the finance, deploy it, and then have associated capex or opex accumulate and 'bed in' sufficiently to deliver on the selected KPIs, for example time to build new low-carbon infrastructure, to train and/ or redeploy staff. For this reason, interim indicators of performance can be important to evidence progress in the delivery of the transition strategy.

These interim indicators include early action in the form of the roll-out of the capital expenditure plan, changes to operating expenditure, decommissioning / phasing out activities, changes to supplier relationships, and training undertaken by Board or Senior Executives.

HALLMARK 4: Internal monitoring

1. Ongoing re-evaluation and recalibration of headline targets

Selected targets should be regularly reviewed and recalibrated to reflect changing operating conditions and market developments such as new technologies coming online sooner than expected. Processes should be in place for such recalibration to tighten stringency where possible and overall to ensure continuous improvement.

2. Tracking performance against selected KPIs

The company should have processes in place to track performance against the selected KPIs, and to track delivery of the underlying actions to deliver those KPIs. This should include selection of appropriate tracking and estimation tools, including but not limited to GHG performance tools, and any equivalents for KPIs which are not expressed in terms of GHG emissions. This process can be described as a feedback loop back to Hallmarks 2 and 3.

HALLMARK 5: External reporting

External reporting and independent verification are well established in the green use-of-proceeds bond market. These are carrying through to SLBs and other entity level assessments. The requirements on this are captured in the ICMA SLB Principles.

1. External reporting

Companies to publicly disclose the following information up-front:

- Selected target KPIs and the rationale for those KPIs, in line with the principles established under Part 1: Selection of KPIs, e.g., relevance and materiality, scientific basis.
- How those KPIs will be calculated (e.g. what emissions will be included) and the tools and mechanisms by which performance against those KPIs will be tracked.
- The narrative transition strategy, detailing the changes the company will make to deliver the target KPIs

If disclosure is in connection to the raising of fixed-term finance, e.g., issuing an SLB, then particular emphasis should be placed on the KPIs and strategy over that term. However, it should not be limited to that. Credible transition requires demonstrating the long-term intent and forward momentum to achieve fully climate-aligned targets, particularly for companies with long-life assets or long-term transitions to make.

And on an ongoing basis, publicly disclose up-to-date information on

- Performance against the selected KPIs, reporting at least annually
- Explanation of the contribution of the main factors driving that performance, referencing the actions noted in the Transition plan. This includes providing information on:
 - i. Alignment of capex with the transition strategy and revised business operations. Noting that capex is a key performance indicator for financial market participants to consider, particularly where the company is undertaking capex over a period of time as a precursor to changing GHG footprint of the company.
 - ii. Other actions scheduled to be undertaken as noted in the transition strategy e.g. diversification of product lines, decommissioning of assets, revised supplier relationships etc
- If performance is falling behind that planned in the Transition Strategy, information on the mitigating action being taken and the implications for a revised Transition Plan and delivery against the selected KPIs.

Where there are concerns over commercial confidentiality, the approach of the green bond market which can be mirrored here is for public disclosure remaining at a higher level, with full, detailed disclosure to the verifying or certifying party.

2. Independent verification

The publicly disclosed information should be supported by a verification assurance report from an independent, external verifier with relevant expertise, such as an auditor or environmental consultant

What these proposals do not incorporate

Appendix 2 summarises the key requirements of a number of existing frameworks for evaluating company transitions. As noted above, the intention of this proposal is to focus on what Climate Bonds considers to be the critical ‘meta-indicators’ of a credible company transition, in the interests of achieving a balance between sufficiency of information and efficiency of the process for adoption by the maximum number of users. With that in mind, for full transparency and discussion, below common elements in other assessment schemes that *have not* been incorporated into the hallmarks described above are highlighted.

1. Lobbying on policy / membership of trade associations

This issue is recognised in some frameworks including ACT and CA100+ indicator 7 as an important indicator of the strength of commitment to transition strategy, however it often has a relatively low weighting in the mix of factors assessed. It could be assumed that organisations who have a robust transition plan and associated KPIs that have been publicly disclosed would not jeopardise their credibility by engaging in driving policies that are in contravention to their stated low carbon vision (whether this is done publicly, through industry associations or lobbying behind closed doors). More pragmatically, as this issue is notoriously difficult to assess, there is no specific requirement on policy engagement in this framework.

2. Board leadership and executive remuneration

As noted above, governance factors relating to Board leadership is necessary for companies undertaking ‘transition away’, but not for those undertaking ‘transition within’. Executive remuneration is not considered an essential factor for either.

While governance measures can be important enablers of an organisation’s willingness and ability to deliver on their transition plans, organisations should increasingly be held accountable for direct transition or decarbonisation action and impacts e.g. capital expenditure shifts, as per Hallmark 3, and the monitoring of performance against the KPIs, as per Hallmarks 4 & 5.

3. Supply chain engagement

Whilst it is recognised that many companies will engage with their supply chains as part of their transition plan, this framework sets no targets in respect of those engagements.

However, as noted above, the sector-specific pathways and the company-specific KPIs that should be tracking them may well include consideration of the emissions upstream and downstream. This may or may not require direct supply chain engagement, depending on the maturity of the market and the ability to source or supply complaint products or services without a targeted supply chain engagement strategy.

4. GHG data validation

GHG emissions data can be externally verified by a third party and many jurisdictions already have this as a requirement. This is not explicitly recognised in this framework as Certification under the Climate Bonds Standard already requires approved external verifiers to provide assurance over the credibility of performance.

5. The performance linked coupon in SLBs etc

There are mixed views on what, if anything, can be inferred about the credibility of the company's transition from the performance linked coupon offered by the issuer. In particular, there is no clear evidence on the necessary materiality of the incentive to change corporate behaviour, particularly to date where many KPIs appear not to have been set at sufficiently high ambition levels, instead simply bedding in easy-to-reach targets that do not move the needle on business-as-usual. The reputational risk of failure to achieve the selected KPIs is likely to be a more important consideration.

For this reason, the materiality of the incentive does not presently form part of the assessment of the company's transition credibility.

3. Evaluating overall performance

What level of performance is good enough to represent a ‘credible transition’?

1. All Hallmarks must be satisfied

As outlined in the ‘Financing Credible Transitions’ paper, pledges to align with 1.5°C global warming limit, or even policies, procedures and governance practices which influence and guide operating performance in the right direction, are not sufficient to evidence a credible transition because they can only provide an indication of intent and commitment. The focus needs to be on impact that is actually being delivered today, alongside the credibility of plans to continue to meet those plans going forward.

For this reason, companies need to perform well for all of the Hallmarks, including each element within each Hallmark. We do not propose a weighting or scoring mechanism that balances out these factors as we do not believe high performance in one compensates for lower performance in another. The Hallmarks have been deliberately streamlined to focus on the elements that are essential. Not weighting different elements of the proposal also has the advantage of relative simplicity and transparency.

2. Shades of transition – need for differentiation?

Companies delivering against company-specific KPIs that are moving towards, but are not yet aligned with, the sectoral green transition pathways described in Hallmark 1 part 1 are not yet doing enough. Though their efforts to ‘catch up’ are important and deserve recognition, they should be distinguished from companies that have moved earlier or faster and have already sufficiently decarbonised to align with common sector-specific decarbonisation pathways.

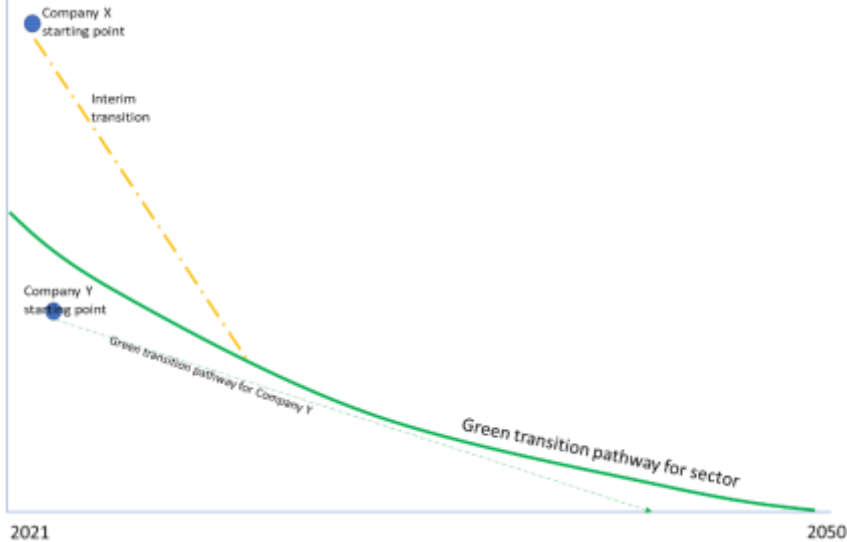
Therefore, we propose two different transition categories (and potentially different transition labels)²¹:

Green transition: Where actual GHG emissions and other achieved company-specific KPIs align with or outperform the appropriate sectoral green transition pathway.

Interim transition: Where actual GHG emissions and other achieved company-specific KPIs are catching up to the appropriate sectoral green transition pathway. Here the company may have set the wheels in motion via strategies and capital expenditure, but the impact has not yet filtered through at sufficient scale.

However, even then, it may be that only a time-limited ‘grace period’ is allowed for any company to be recognised as ‘interim transition’. For example, up to but not beyond 2025. Before the end of that period, all companies should have progressed from ‘interim transition’ to ‘green transition’. This window enables all companies to positively engage with material decarbonisation, but its time limited nature ensures that the substantial change needed is not endlessly pushed into the future. See [Figure 5](#) for a graphical representation.

Figure 5: Interim versus green transition illustrated



²¹ Over the long term many companies will potentially backslide, as transition does not happen in a vacuum but will be affected by a variety of economy, technological and market factors. So, movement between these categories is possible.

3. Some degree of subjectivity seems unavoidable

Practically speaking, it is a much simpler and more robust process to set and assess the performance of companies in terms of their delivery or not of expected operating metrics such as GHG metrics and/ or other company-specific KPIs (i.e. Hallmarks 1, 4 and 5). It is more challenging to assess the credibility and future effectiveness of plans to meet those targets going forward (Hallmarks 2 & 3), as this is a much more subjective assessment of how targeted, feasible, complete and resilient those plans are.

Guidance is required to define what constitutes good enough in respect of these elements. We continue to explore how existing frameworks and assessment methodologies can be utilised through a collaborative partnership.

Applying these requirements to a complex company

1. Making a binary assessment

As noted above, it is proposed that a company needs to meet all elements of all Hallmarks to be deemed to be credibly transitioning to a low carbon aligned future.

Where a company practices a number of economic activities (whether multiple instances of the same economic activities such as multiple cement manufacturing facilities with their own capex plans and revenue streams, or instances of a variety of economic activities such as . a company producing passenger vehicles and commercial buses) it is necessary to i) separately assess their targets, plans, strategies, capex and other actions for each activity, and then ii) recombine them to determine overall company performance.

The first 'separation' stage can be complex in practice but is conceptually straightforward. It requires targets, transition strategies and finance plans to be separately identifiable for each business stream, within a coherent, unified company strategy and plan that is nuanced enough to consider the interactions and inter-linkages between all business streams of the company. If separately identifiable in this way, then company revenues and capex can be allocated for separate assessment – as is the required methodology for company sustainability disclosures in line with the EU Taxonomy.

The second 'recombining' stage poses more challenges. What if part of the company is following the appropriate transition pathway, but another is not? What do you say about the performance of the company overall?

One approach is simply to report performance for each business stream. This provides full transparency, but also a complex response to answer the overall question 'is the company adequately transitioning'?

A commonly adopted approach is to weight multiple business streams according to relative value (e.g., by revenue share or GHG share) to give an overall score which is then subject to a straightforward pass threshold. This approach is used by Climate Bonds for its assessments of 'climate aligned bonds': where >75% of revenue is attributed to workstreams that meet our climate aligned criteria, the company (and its bond) is determined to be 'strongly aligned'. Where >95% is so attributed, the company (and its bond) is determined to be 'fully aligned'.

Some green bond issuers (normally banks) have also taken this approach, with 90% being a commonly accepted pass threshold. Examples of this include Iceland's Islandsbanki and Norway's Sparebank that provide general corporate purpose loans to issuers deriving 90% of revenues from green business.

2. Setting the boundary of the company

A further complexity in practice is where to set the boundary of a company. This is a non-trivial issue as different boundary approaches can lead to significant differences in emissions in scope and the strategies to address them.

Looking at the boundaries of a purely legal entity seems too narrow given how fragmented company structures can be. But including all companies linked under the same ownership may well be too broad. A logical boundary for the purpose of setting credible KPIs and transition strategies and plans would be a boundary of operational control. This can be defined in either financial or operational terms. This seems most logical for transition planning as the alternative of equity share only reflects economic interests. However, different users might prefer different boundaries such as equity share for investors and there may need to be flexibility in boundaries to allow for company disclosure depending on what is most representative.

Whilst many initiatives refer to the GHG Protocol that was devised from financial reporting standards and offers either control or equity, others like the ACT initiative prefer the 'levers of change' approach that encourages a wider accountability for emissions that reaches beyond the company boundary. Further consideration is needed regarding what that might mean in practice and comments are welcomed.

A last thought – company assessments for UoP bonds

Climate Bonds' view has always been that UoP stand independently of the issuer. If UoP relate to a wind farm, that wind farm exists and is providing low carbon energy, regardless of other activities of the issuer.

However, we recognise that investors voice strong support for any issuance to be accompanied by a company level carbon reduction strategy – particularly for transition related UoP bonds, to provide some assurance that the UoP issuance is part of a wider, credible transition strategy of the issuer.

At present, most investors who materially care about the transition strategy of a company will have their own models in place to assess whether that company complies with investment preferences and this assessment is made independently of the UoP of an instrument. Such models are proprietary and require resources including but not limited to standardised data, and intellectual capital. Investors are repeatedly asking for better standardisation and consistency of data, greater disclosure, and wider availability to facilitate these assessments.

The proposals outlined in this paper could form the basis of complementary assurance at issuer level. But we suggest they could be further streamlined for use-of-proceeds bonds. A key element would be for the issuer to outline the Paris-aligned target setting and plans to deliver that, and how the allocated use of proceeds contributes to that wider transition strategy (Hallmarks 1 and 2).

Appendix 1: Transition (UoP) Issuance to date

Issuer name	Label	Country	Amount USD	Issue date
Cadent Gas Limited	Transition	UK	743 m	19-03-21
Castle Peak Power Finance	Transition	HK, China	300 m	03-03-21
Snam	Transition	Italy	606 m	15-02-21
Snam	Transition	Italy	303 m	15-02-21
Bank of China Ltd (Hong Kong)	Transition	HK, China	278 m	14-01-21
Snam	Transition	Italy	667 m	07-12-20
EBRD	Green transition	Supranational	130 m	24-11-20
EBRD	Green transition	Supranational	20 m	20-11-20
EBRD	Green transition	Supranational	56 m	19-10-20
Castle Peak Power Finance	Transition	HK, China	350 m	22-06-20
Snam	Transition	Italy	565 m	17-06-20
Cadent Gas Limited	Transition	UK	567 m	11-03-20
EBRD	Green transition	Supranational	83.8 m	13-12-19
Credit Agricole CIB	Transition	France	110.1 m	27-11-19
EBRD	Green transition	Supranational	55.0 m	13-11-19
EBRD	Green transition	Supranational	555.7 m	17-10-19
Marfrig	Transition	USA	500.0 m	06-08-19
Castle Peak Power Finance	Transition	HK, China	500.0 m	25-07-17

Appendix 2: Alignment with existing guidance

We have been fortunate to be able to build upon existing approaches and material on transition and this framework has drawn heavily on the material from the Transition Pathways Initiative and the Climate Action 100+ benchmark, CDP’s initiatives (Assessing low-Carbon Transition Initiative and Science Based Targets initiative), UN’s Race to Zero, ICMA’s SLB Principles and the recommendations of TCFD. Each of these was designed for the purpose of:

- improving information to investors, or
- to offer guidance to corporates, or
- to drive ambitious corporate action.

We have also benefitted from the following approaches where we are aligned in aims, but they are not detailed enough to include here:

[Race to Zero](#) 1.5^o business playbook - A framework to guide decisions in a company preparing for the transition

[TCFD](#) - Recommendations for disclosing climate related information to inform investors understanding of climate risk

[ClientEarth Principles for Paris alignment](#) were drafted to bridge the gap between ambition and action. The principles state that a strategy has to be reasonable, transparent and accountable.

The table below summarises these other frameworks. The shading in the table denotes the degree of alignment between the content of these other frameworks and the proposals under the Hallmarks described above. Specifically:

- Dark green depicts requirements in other frameworks that are highly aligned to those in these Hallmarks
- Light green reflects requirements in other frameworks that are similar to those in these Hallmarks.

	Climate Bonds	ACT	SBTI	TPI	CA100+	ICMA	CDSB
	Hallmarks of a credible transition by a company	A framework for assessing a company’s willingness and ability to transition to ensure making an active contribution and is transforming.	A framework to guide a company in translating science into a target to ensure it’s ambitious.	A framework by asset managers to evaluate a company’s transition based on publicly available information	A benchmark. An expression of investors’ expectations of what companies should be doing set around 10 indicators	Guidelines that recommend structuring features, disclosure and reporting.	Sets standardised format to report environmental information
1. Select appropriate and ambitious targets							
Select common sector-specific transition pathway	1.1. Select KPI’s	2A Carbon Performance metrics 3B transition roadmap	C1 scope C2 Significance thresholds C3 Greenhouse gases C8 Level of Ambition C9 Absolute vs. intensity C16 Scope 3 screening	MQ4 GHG reduction targets	2. Long, medium, and short-term emissions targets	1. Selection of KPIs	Req 4 Sources of environmental impacts

Select aligned company-specific KPIs	1.2. Select aligned company-specific KPIs	2B Carbon performance assessment 4A Carbon performance targets	C7 Progress to date C10 Method validity Rec 6 Choosing an approach C14 Approaches C21 Requirements from sector specific guidance	Carbon performance assessment compares with sector specific benchmarks Also MQ7 Targets for reducing GHG emissions and MQ14 LT targets	2. Long, medium, and short-term emissions targets	2. Calibration of Sustainability Performance Targets (SPTs)	Req 5 Performance and comparative analysis
2. Establish the enabling environment							
Establish strategy to deliver the KPI's	2.1 Establish strategy to deliver the KPI's	1B Maturity of existing decarbonisation strategy 2C Strategic analysis 3A long term vision		MQ3 Commitment to action on climate change MQ16 Climate change risks and opportunity into strategy	1. Net zero GHG emissions by 2050 5.1 Strategy to meet GHG reduction targets		
Determine financing plan	2.2 Determine financing plan			MQ 19 Internal price of carbon			
Put in place necessary governance frameworks	2.3 Put in place necessary governance frameworks	4C board commitment 3C Board engagement		MQ6 Board oversight MQ15 Remuneration for Execs	8.1 Board oversight of climate change 8.2 Remuneration arrangements 8.3 Board climate related capabilities/competencies		Req 1 Governance Req 2 Mgmt policies, strategy and targets.
3. Action to set the wheels in motion							
Capital expenditure	3.1 Capital expenditure	Initial phase performance module 2 material investments cover this			The company is working to decarbonise its capital stock		
Other actions	3.2 Other actions	4B Strategic plan 4C Board commitment 5A Definition 5B Implementation				3. Bond Characteristics (e.g. variation of the coupon)	
Stakeholder engagement policy		Initial phase performance module 9 policy engagement covers this		MQ10 support efforts to mitigate climate change MQ11 Trade association MQ19 consistency policy to trade associations	7.1 Lobbying position aligned with Paris Agreement 7.2 Trade association lobbying consistency and 7.3 Process to ensure this		
Supply chain		Initial phase performance module 7 supplier engagement covers this	C20.1 Supplier or customer engagement targets				
4. Monitoring of performance against targets							

CAPEX/OPEX expenditure	4.1 CAPEX/OPEX expenditure	2A Carbon performance metrics 2B carbon perf assessment 4A Carbon performance targets		MQ14 targets for reducing GHG emissions	6.1 Future Capex alignment		
Other actions	4.2 Other actions				6.2 Methodology for aligning capital expenditures		
5. Ongoing reporting and monitoring to evidence compliance with all of the above							
Public disclosure of KPI's and strategy to deliver	5.1 Public disclosure of KPI's and strategy to deliver		Rec11 Where to disclose C24 Target validity	No – just whether they're aligned to the pathway or not	10.1 Support for TCFD recommendations		Req 8 Reporting policies
Annual reporting on progress	5.2 Annual reporting on progress	5C monitoring	C22 Frequency		10.1 Support for TCFD recommendations	4. Reporting	Req 9 Reporting period
Recalculation of targets			C23 Mandatory target recalculation				Req 10 Restatements
Data validation				MQ9 Verification of data		5. Verification	