

# Transition finance for transforming companies

Tools to assess companies' transitions and their SLBs

AN UPDATE TO THE SEPTEMBER 2021 PAPER: 'Transition finance for transforming companies: Avoiding Greenwashing when financing company decarbonisation'

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Author: Anna Creed

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## Key messages

- The IPCC<sup>1</sup> stresses that limiting global warming to 1.5°C requires rapid and far-reaching transitions in land, energy, industry, buildings, transport, and cities. Global net human-caused emissions of carbon dioxide (CO<sub>2</sub>) need to fall by 45% from 2010 levels by 2030, reaching net zero around 2050.<sup>2</sup>
- This message is now filtering through:
  - As of 2022, 128 countries and 235 cities have committed to net zero emissions.<sup>3</sup> The pledges represent 91% of global GDP covering 83% of global GHG emissions.
  - Of the world's 2,000 largest public companies, 35% now have net zero commitments, representing annual sales of nearly USD21.6tn.<sup>4</sup>
  - 273 signatories representing USD61.3tn in Assets under Management (AUM) have signed up to the Net Zero Asset Managers initiative since its launch in December 2020. They represent over half of the entire asset management sector globally in terms of total funds managed.<sup>5</sup>
- The sustainable financial markets are booming. Green, Social and Sustainability (GSS) use-of-proceeds (UoP) bonds and Sustainability Linked Bonds (SLBs) collectively reached USD417.8bn in H1 2022.
- This includes an increasing number of labelled UoP 'Transition Bonds', of which 53 have been issued to date.
- The growth in SLBs has been substantial: in H1 2022 they formed 11% of the total labelled debt issuance (compared to 6% in H1 2021) even though the first SLB was only issued in December 2018.
- 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. But 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.
- Existing examples of SLBs and transition UoP bonds have raised concerns in the market around the relevance, reliability, and ambition of transition pathways. Targets set by the company are often difficult to compare to 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 or deliver meaningful emissions reductions if this is not addressed.
- This paper presents Climate Bonds' proposal of 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 Hallmarks can be used on a standalone basis by any stakeholder to set and / or assess the credibility of their own or others' transition. This includes those seeking to raise finance, those offering finance, supply chain actors looking for suitably committed transition partners and many others.
- They address 1) the requisite ambition of company level targets and 2) the company's willingness and ability to deliver on those forward-looking targets.

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<sup>1</sup> IPCC Special Report on Global Warming of 1.5 Degrees, Summary for Policy Makers 2021

<sup>2</sup> <https://www.ipcc.ch/2018/10/08/summary-for-policymakers-of-ipcc-special-report-on-global-warming-of-1-5c-approved-by-governments/>

<sup>3</sup> Hans, F., Kuramochi T., Black, R., Hale, T., Lang, J. (2022). Net Zero Stocktake 2022: Assessing the status and trends of net zero target setting across countries, sub-national governments and companies, New Climate Institute, Oxford Net Zero, Energy & Climate Intelligence Unit and Data-Driven EnviroLab. <https://ca1-nzt.edcdn.com/@storage/Net-Zero-Stocktake-Report-2022.pdf?v=1655074300>

<sup>4</sup> Ibid.

<sup>5</sup> <https://www.netzeroassetmanagers.org/>

- Specifically, the Hallmarks are:
  1. Paris-aligned targets (following Climate Bonds' five Transition Principles')
  2. Robust plans
  3. Implementation action
  4. Internal monitoring
  5. External reporting.
- Climate Bonds is developing two specific tools and offerings to support the market that use these Hallmarks as their foundation.
- The first is the expansion of the Climate Bonds Standard and Certification Scheme to certify, potentially with differentiated certification labels:
  - Non-financial corporates that are credibly transitioning to align with 1.5 degree pathways (including those already aligned and those who will align by 2030); and
  - Non-financial corporates that are already near zero (so already near alignment with 1.5 degree goals without the need for further deep transition); and
  - SLBs issued by any such corporate.
- Public consultation on these proposals is open from 6 September to 4 November 2022.
- This will complement the concurrent expansion of the Certification Scheme to UoP certifications across a wider range of sectors, including high-emitting sectors often labelled as transition such as cement, steel, chemicals and hydrogen production. Since its establishment in 2014, the Climate Bonds Standard and Certification Scheme has Certified over USD250bn of UoP bonds.
- The second is the expansion of Climate Bonds' market screening capabilities (and data provision) to include all SLBs issued in the market. Further details on this will be available later this year.
- Separately and jointly, the Hallmarks, market screening and Certification aim to bridge the gap between existing market guidance tailored specifically to SLBs which have good take-up but are lighter touch in detail<sup>6</sup>, and the deeper company-level assessment frameworks available that are more comprehensive but perhaps too complex for wide market take up.
- They 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

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<sup>6</sup> In particular, ICMA's Sustainability Linked Bond Principles released in June 2020 that have been followed by over 80% of sustainability-linked bonds, and this share is expected to increase over time.

# 1. Introduction

*This paper explicitly addresses the challenge of the climate mitigation transition, and specifically, 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.<sup>7</sup>*

## 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, the United Kingdom has enshrined into law a 68% reduction in emissions by 2030, net zero by 2050.

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, aviation<sup>8</sup>). 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 and 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. Figure 1 provides a schematic for these categories of transition.

Figure 1: Categories of transition



Source: ‘Financing Credible Transitions’ Climate Bonds Initiative in partnership with Credit Suisse, September 2020<sup>9</sup>

<sup>7</sup> 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](https://www.climatebonds.net/files/reports/cbi_fincredtransitions_final.pdf)

<sup>8</sup> 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.

<sup>9</sup> [Financing Credible Transitions \(White Paper\) | Climate Bonds Initiative](#)

## 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.<sup>10</sup> Driving private capital towards transition investments is key to scaling up finance: public money alone is not sufficient for the investment needed.<sup>11</sup>

## And growing action to drive that change

According to 2022 figures<sup>12</sup>, 128 countries (66% of countries representing 91% of global GDP and 83% of global emissions) and 235 cities have committed to net zero emissions. Of the world's 2,000 largest public companies, 35% now have net zero commitments, representing annual sales of nearly USD21.6tn'.<sup>13</sup>

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. As of 2022, 273 signatories representing USD61.3tn in Assets under Management (AUM) have signed up to the Net Zero Asset Managers initiative since its launch in December 2020. They represent over half of the entire asset management sector globally in terms of total funds managed<sup>14</sup>. The related UN convened Net Zero Asset Owner Alliance represents USD10.6 trillion AUM from 74 institutional investors (up from USD6.6tn in 2021)<sup>15</sup>.

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

Green, social and sustainability Use-of-Proceeds Bonds (UoP) and Sustainability Linked Bonds (SLBs) collectively reached USD417.8bn in H1 2022. See Figure 2.

Within this, Green UoP Bonds are the most mature instruments. Kicked off by the European Investment Bank (EIB) in 2007, in H1 2022 USD218.1bn 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.<sup>16</sup> The Green UoP 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 H1 2022, 53 Transition UoP Bonds had been issued, with issuance dominated by issuers from Japan and China, following the launch of Transition Finance programmes in both countries for hard-to-abate sectors. 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

<sup>10</sup> Climate Investment Opportunities: Climate aligned bonds & issuers 2020 at [https://www.climatebonds.net/files/reports/cbi\\_climate-aligned\\_bonds\\_issuers\\_2020.pdf](https://www.climatebonds.net/files/reports/cbi_climate-aligned_bonds_issuers_2020.pdf)

<sup>11</sup> *ibid*

<sup>12</sup> Hans, F., Kuramochi T., Black, R., Hale, T., Lang, J. (2022). Net Zero Stocktake 2022: Assessing the status and trends of net zero target setting across countries, sub-national governments and companies, New Climate Institute, Oxford Net Zero, Energy & Climate Intelligence Unit and Data-Driven EnviroLab. <https://ca1-nzt.edcdn.com/@storage/Net-Zero-Stocktake-Report-2022.pdf?v=1655074300>

<sup>13</sup> Hans, F., Kuramochi T., Black, R., Hale, T., Lang, J. (2022). Net Zero Stocktake 2022: Assessing the status and trends of net zero target setting across countries, sub-national governments and companies, New Climate Institute, Oxford Net Zero, Energy & Climate Intelligence Unit and Data-Driven EnviroLab. <https://ca1-nzt.edcdn.com/@storage/Net-Zero-Stocktake-Report-2022.pdf?v=1655074300>

<sup>14</sup> <https://www.netzeroassetmanagers.org/>

<sup>15</sup> <https://www.unepfi.org/net-zero-alliance/>

<sup>16</sup> Climate Bonds Sustainable Debt Market Summary H1 2021 at [https://www.climatebonds.net/files/reports/cbi\\_susdebtsum\\_h12021\\_02b.pdf](https://www.climatebonds.net/files/reports/cbi_susdebtsum_h12021_02b.pdf) 1

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 2022 has been substantial, forming 11% of the total labelled debt issuance (compared to 6% in H1 2021). 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 UoP market, where they are still largely absent. See Figures 3a and 3b. For example, the oil and gas sector is not widely active in the UoP 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, and Repsol themselves came to the SLB market in July 2021. 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.

Given their forward-looking targets, **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. 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.<sup>17</sup> 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.<sup>i</sup> 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. The United Kingdom has also committed to delivering transition guidance through the creation of the Transition Plan Taskforce convened in 2022<sup>18</sup>.

*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

<sup>17</sup> 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.<sup>17</sup> 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.<sup>17</sup> Examples of other recent product additions include green ETFs from Horizon ETF and L&G.<sup>17,17</sup> The proliferation of these investment solutions is in keeping with an upward trend in sustainable fund inflows, as noted by NASDAQ.

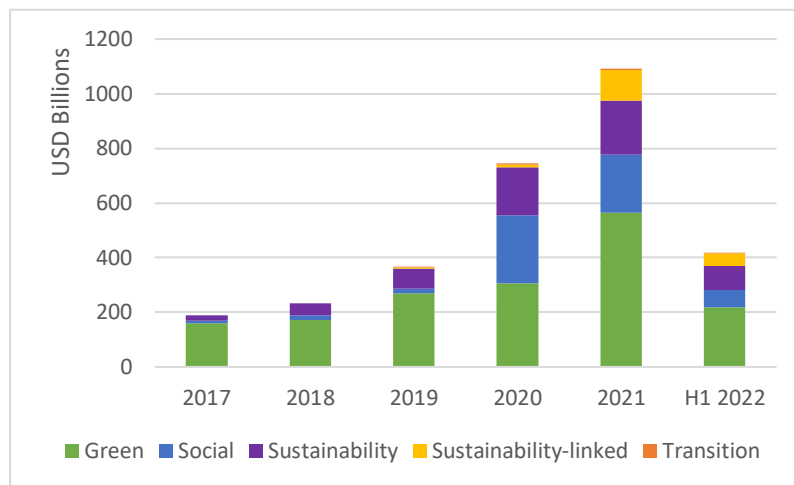
<sup>18</sup> <https://transitiontaskforce.net/>

- **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

**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.

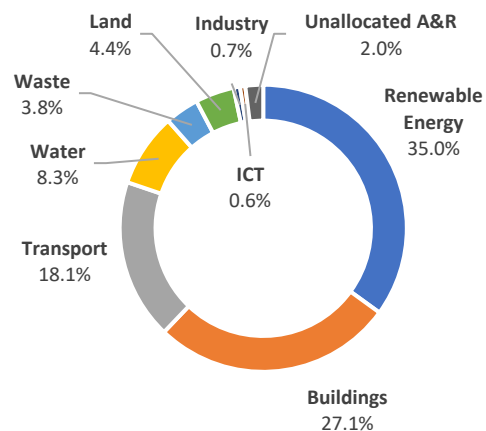
**Hybrid: Sustainability-linked green bonds (SLGBs).** A hybrid that ties the use of proceeds model of a green bond with the performance-based structure of an SLB. The first SLGB was issued by Japanese construction company, Takamatsu, in March 2021. There are expectations that this structure will gain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

Figure 2 Growth in sustainable finance instruments 2017-2022 first half



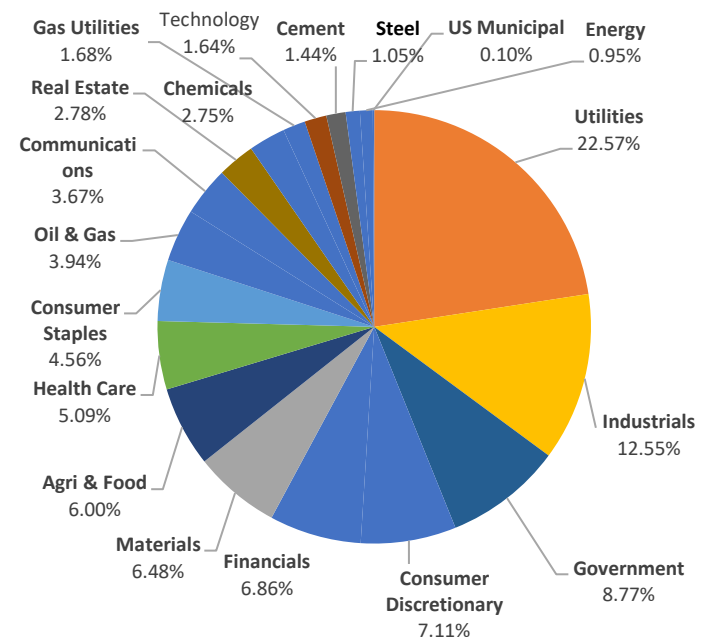
Source: Climate Bonds Initiative

Figure 3a: UoP Bonds by sector allocated proceeds



Source: Climate Bonds Initiative

Figure 3b: 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 UoP bonds and SLBs has been mixed. While investors welcome the inclusion of more types of entity into the sustainable debt space, there are significant concerns around the relevance, reliability, and ambition of transition pathways. Performance targets 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<sup>19</sup>. 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 1.5C. The framework would have benefited from greater detail on the transition plan for the next few years and how capital will be allocated.

## A framework for assessing the credibility of a company's transition – five Hallmarks

Chapter 2 presents a framework for assessing the credibility of a company's transition. This framework consists of **five hallmarks of a credibly transitioning company** (the 'Hallmarks'). The Hallmarks address:

1. The requisite ambition in terms of company-level performance targets set; and
2. The company's willingness and ability to deliver on those forward-looking targets.

The Hallmarks complement existing ESG frameworks and methodologies but go beyond them. They emphasise key governance elements that are important indicators of a company's willingness and ability to deliver on its decarbonisation targets, but also add the granularity needed to ensure that those targets are ambitious and in line with the agreed climate goals. They move 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.

These Hallmarks can be used on a standalone basis by any stakeholder to set and / or assess the credibility of their own or others' transition. This includes those seeking to raise finance, those offering finance, supply chain actors looking for suitably committed transition partners and many others.

## Tools from Climate Bonds' for assessing credible transitions – with the Hallmarks as their foundation

In addition, Climate Bonds is developing two specific tools and offerings to the market that use these Hallmarks as their foundation. These new offerings complement our existing focus areas as described in Box 2.

Firstly, given the increasing attraction of SLBs and corporate net zero targets, to issuers, investors and underwriters alike, in order to support market growth, Climate Bonds is **expanding its certification to encompass the certification of credibly transitioning entities (or parts of them) and any Sustainability Linked Bonds (SLBs) they issue**. These proposals for certification are rooted in and align with the Hallmarks but provide greater precision as is necessary for the incorporation into a Certification and Standard Scheme, one of the objectives of which is ensuring consistent assessment and evaluation across all certified entities and instruments. More broadly, SLBs and company certifications will follow the basic pillars established for UoP bonds, namely a standardised (common) rule set, binary assessment, simplicity, transparency, and science-based criteria.

Certification of SLBs will 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 metrics, targets and transition plan information used and shared by different issuers.

<sup>19</sup> <https://www.eni.com/en-IT/media/press-release/2021/06/eni-launches-first-sustainability-linked-bond-issue.html>



As assessment of SLBs requires assessment of company-wide sustainability Performance Targets, and the transition plan detailing how they will meet those targets, it is a small step to also then certifying companies transition agendas, irrespective of any associated financing instrument. 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.

The first priority is the certification of non-financial corporates<sup>20</sup> and any SLBs issued by them. Public consultation on the certification criteria for these corporate and their SLBs runs from 6 September to 4 November 2022. These criteria are detailed in the [Climate Bonds Standard and Certification Scheme version 4.0 available here](#). Chapter 3 of this paper provides an explanation and rationale of how the Hallmarks have been translated into specific criteria for Certification, taking key elements of the certification requirements in turn, and addresses additional elements needed to address the assessment of credible transitions within a standardised certification scheme.

The next priority for Climate Bonds will be the certification of financial institutions and any SLBs issued by them, and public bodies (including sovereigns) and any SLBs issued by them. Those proposals will be subject to consultation early in 2023.

In addition, Climate Bonds will shortly be launching a new Transition Sustainability Linked Bonds Database. This database will **expand our market screening capabilities (and data provision) to include all SLBs and transition labelled UoP bonds issued in the market**. It is important to note though, that inclusion in the Database does not mean the bonds are certified Climate Bonds with the additional rigour and independent verification inherent in the certification process. Further details on this Database will be available later this year.

Separately and jointly, the Hallmarks, market screening and Certification aim to bridge the gap between existing market guidance tailored specifically to SLBs which have good take-up but are lighter touch in detail<sup>21</sup>, and the deeper company-level assessment frameworks available that are more comprehensive but perhaps too complex for wide market take up. They 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.

*Box 2: Climate Bonds’ current market offerings and focus*

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 USD250bn 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. With a recent focus on ‘hard-to-abate’ sectors, eligibility criteria have been developed for cement, base chemical and steel production, are under public consultation for hydrogen production, and underway for mining, gas and coal decommissioning. These criteria will form the basis of an expanded range of UoP bonds certification into sectors often labelled as transition.

<sup>20</sup> I.e., Companies providing goods and services in the real economy.

<sup>21</sup> 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.

## 2. Hallmarks of a credible company transition

### Introduction

The five Hallmarks of a credible company climate mitigation transition are:

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 but still not be followed through. Evidence of change is important (Hallmark 3) and capex/opex investments and strategic changes to the business provide tangible milestones in the roll out of a companies' transition strategy. An internal feedback loop to track progress and recalibrate if necessary is essential given it is unlikely all will go to plan (Hallmark 4). And lastly, 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 for the Hallmarks:

- 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 nor of the Climate Bonds Standard and Certification Scheme at this time.

Figure 4: The Hallmarks of a credibly transitioning company



## HALLMARK 1: Paris-aligned targets

In its paper ‘Financing Credible Transitions’<sup>22</sup> Climate Bonds articulated its Five Transition Principles. These are the foundational building blocks for Hallmark 1. Figure 5 provides an overview of these Principles for context.

There are **two key elements to Hallmark 1: 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.

As discussed in Box 3, what it means to be Paris Agreement aligned will vary from sector to sector. What is consistent though is that each sectoral pathway *does not* simply reflect a sector average, or best-in-class, but absolute, forward-looking pathways that are 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.<sup>23</sup> There may be some opportunity for flexibility here, particularly in the early stages of transition. Higher emissions in some 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%. 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.

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

<sup>22</sup> [Financing Credible Transitions \(White Paper\) | Climate Bonds Initiative](#)

<sup>23</sup> 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.

common criteria on a sectoral or 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 activities<sup>24</sup>, and in some cases lays out targets for good performance today, but not transition pathways to define targets going forward<sup>25</sup>. 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.

*Box 3: What is meant to be Paris Agreement aligned will vary from sector to sector*

The collective goal for transition is net zero emissions across the global economy by 2050, and approximately halving of emissions by 2030. This is necessary if we are to stay within 1.5 degree global warming limits. The scope of this challenge means there is a shared responsibility on all to reduce emissions to the minimum as fast as possible. What is possible though varies by sector. With this disparity in mind, some sectors will need to do the heavy lifting in the short term while the barriers to scaling up mitigation in other sectors are reduced.

Some sectors will be able to reach net zero well before 2050. For example, for car manufacturing, where low carbon technologies (electric vehicles) are already 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 after 2040 or earlier in some EU countries. 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.

Other 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.

And some sectors 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 some sectors, there may always be some residual emissions that cannot be eliminated. In this case, and only this case, compensatory measures should be taken to counter those unavoidable emissions, such as purchased offsets. Offsets should not be used in place of or to delay decarbonisation of the underlying activity. Where offsets 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.

**The second element of Hallmark 1 is the set of company-specific metrics and targets 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's Performance Targets.**

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 Performance Targets 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 Performance Targets 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-

<sup>24</sup> 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 at this time. For sectors that do not have a sector-specific pathway, SBTi recommends the use of a 'cross sectoral transition pathway' but this is by definition a non-sector specific average and therefore may require under or overperformance on a sector-by-sector basis.

<sup>25</sup> 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 more advanced in this area with transition pathways for some sectors including buildings and transport, and shortly to be added cement, base chemicals and steel, but not for all.

loaded, and therefore, those 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 Performance Targets 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 programmes that will deliver the change needed over the long term to be able to reach the end goal of net zero emissions. Therefore, targets should be identified for key milestone dates, with interim targets as needed to enable tracking of performance on a regular basis.

Suggested milestone dates and associated Performance Targets 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 Performance Targets; and
- The medium term i.e., 2025 to 2030, for which period it is reasonable to expect well-defined plans and associated Performance Targets 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 Performance Targets are explained, and it is clear how any particular investment contributes to or is part of that.

**They should address all material emissions.** There have been examples where SLB issuers have come to market omitting 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 Performance Targets, 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 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, Performance Targets for a company engaged in the stranded activity of coal-fired electricity generation should address downstream scope 3 emissions via indicators associated with the ‘turning off of the tap’ for those scope 3 emissions, e.g. decommissioning of those generation facilities, and/ or a declining emissions intensity threshold over the whole energy generation output if the company’s transition strategy is to transition towards renewables.

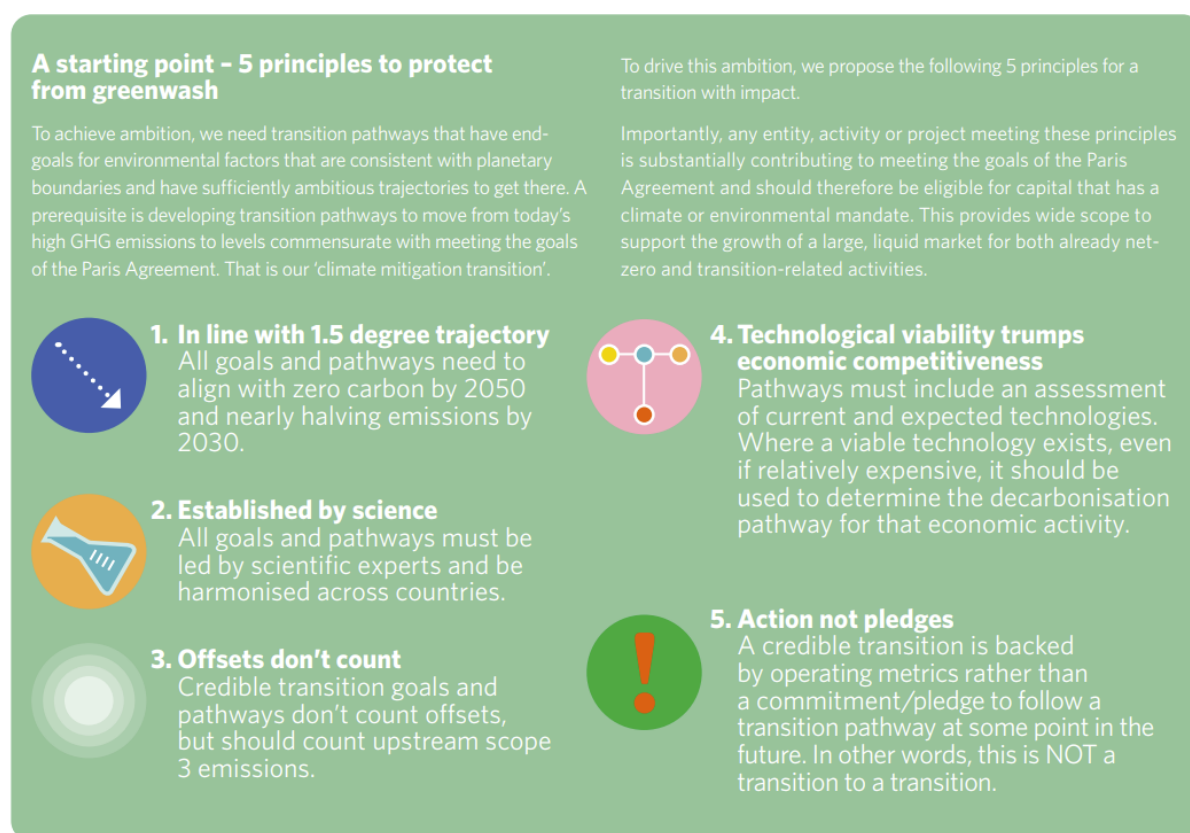
Whereas Performance Targets for a company engaged in an activity that needs to continue into the longer term should address downstream scope 3 emissions directly where they can exercise control over those emissions. For example, a car manufacturer knows the future operating emissions impact of any vehicle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

**Performance Targets may be expressed in either a greenhouse gas (GHG) metric and/ 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 select metrics and KPIs 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 select 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 Performance Target expressed in terms of GHG 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. 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 Performance Targets that are expressed solely as a reduction compared to the company's own BAU do not facilitate comparability and therefore are insufficient and should also be recalibrated to express how they align with the forward looking transition pathways for that sector. 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.<sup>26</sup>

Figure 5: Five principles to ensure an ambitious Transition (the five ‘Transition Principles’)



Source: 'Financing Credible Transitions' Climate Bonds Initiative in partnership with Credit Suisse, September 2020<sup>27</sup>

## HALLMARK 2: Robust plans

### 1. Establish the transition strategy and action plan that enables the delivery of those company-specific Performance Targets

Forward delivery against the company-specific Performance Targets 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 Performance Targets.

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

<sup>26</sup> 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.

<sup>27</sup> [Financing Credible Transitions \(White Paper\) | Climate Bonds Initiative](#)

Performance Targets 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 Performance Targets) 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 Performance Targets.** These changes might be to:
  - Decarbonise ongoing activities (e.g., through technology or efficiency improvements, or alternative inputs)
  - Diversify activities and product mixes
  - End 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 Performance Targets. 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
  - Supply chain engagement
  - 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 Performance Targets 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 Performance Targets. 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 Performance Targets, 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 Performance Targets due to changing personnel, priorities or resource availability.

However, in ‘transitions away’ where the transition involves more fundamental re-orientation of a company’s activities to new products and services, there is greater risk of non-delivery against the Performance Targets. 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.

Overall it is proposed 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 to set, monitor and recalibrate Performance Targets and transition plans.

#### **4. Board sign-off**

The Board signs off a formal document in which the company commits to the selected Performance 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 performance targets**

Selected Performance 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 performance targets**

The company should have processes in place to track progress against the selected Performance Targets, and to track delivery of the underlying actions to deliver those Targets. This should include selection of appropriate tracking and estimation tools, including but not limited to GHG performance tools, and any equivalents for Performance Targets which are not expressed in terms of GHG emissions. This process can be described as a feedback loopback 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 Performance Targets and the rationale for those Targets, in line with Hallmark 1.
- How those Performance Targets will be calculated (e.g. what emissions will be included) and the tools and mechanisms by which progress against those Targets will be tracked.
- The narrative transition strategy, detailing the changes the company will make to deliver the Performance Targets.

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 Performance Targets 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

- Progress against the selected Performance Targets, 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. Executive remuneration**

Review of transition finance guidance carried out by GFANZ shows that many frameworks identify the need to link remuneration to delivery of the selected Performance Targets, but that there are questions as to how to structure it effectively and to what extent compensation should be dependent on the successful implementation of the Transition Plan. For example, both EFRAG and ISSB ask in the context of disclosures whether and how the remuneration process for the management is linked with climate related considerations. ACT factors executive remuneration into its assessment algorithm.

In this framework it is not essential for executive remuneration to be linked to the selected Performance Targets, being just one of many possible ways to drive governance, favoured in some regions but not others. Further, evidence suggests a lack of correlation between executive salary levels and share price performance in current US corporates.

## **3. 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.

## 4. Certification of non-financial corporates and their SLBs

This chapter presents an overview of the proposed certification criteria for non-financial corporates<sup>28</sup> and their SLBs. Those proposed criteria are available in the [Climate Bonds Standard & Certification Scheme version 4.0 here](#) and this chapter should be read in conjunction with that more detailed document. The Hallmarks are the foundation of these certification criteria, but the criteria go further to provide the additional level of detail and granularity required for a robust, transparent and coherent assurance scheme that will give sufficiently clear guidance to issuers, investors and verifiers alike, and ensure consistent assessment and evaluation across all certified entities and instruments.

### Part A: 'Accounting Rules'

#### Aspect 1: Company boundaries

Setting the boundary of the company is a non-trivial issue as different boundary approaches can lead to significant differences in emissions in scope and the strategies to address them.

The Applicant can set the boundary of the company they wish to have assessed and certified ('the Assessed Entity'). This may encompass parent + subsidiaries, just a subsidiary, or even just a sub-division of a company. The single requirement is that the Applicant has operational and/ or financial control of Assessed Entity as the assessment includes ongoing evaluation of the Applicant's ability to deliver their stated Performance Targets, and the Applicant will not be able to deliver without that control.

It is noted that while the Assessed Entity is the focus of the assessment and certification, a set of 'minimum safeguard checks' on the wider entity not forming part of the Assessed Entity are also applied. These 'safeguards' are addressed in more detail below.

Such safeguards are not addressed in the Hallmarks but have been added into the Certification requirements as a direct result of allowing the Applicant for certification to define their own boundaries for the Assessed Entity. The intention is to provide assurance to investors and other stakeholders that the performance and plans of the Assessed Entity are not 'greenwashing' other activities of the entity.

#### Aspect 2: Overall performance level required for certification

Certification is aimed at recognising all those already compatible with a net zero economy aligned with 1.5 degree warming limits or those making a rapid and ambitious transition to that, whatever their starting point.<sup>29</sup>

But within this universe, certification will encompass different 'tiers' of performance.

Specifically, certification is available to Assessed Entities where at least 90% of their revenue or emissions<sup>30</sup> is from activities whose performance either:

1. Already follows the Climate Bonds sector-specific 1.5 degree compatible criteria (i.e., criteria that denote they are already near net-zero); OR
2. Already follows the Climate Bonds sector-specific 1.5 degree alignment pathway(s) and criteria and their future Performance Targets and associated Transition Plan have credibly demonstrated that they will stay on those pathways over the short-, medium-, and long-term; OR
3. Does not yet meet Climate Bonds sector-specific the 1.5 degree alignment pathway(s) and criteria but their future Performance Targets and associated Transition Plan have credibly demonstrated that they will align with those pathways and criteria by 2030 and thereafter.

The alignment cutoff date of 2030 was selected to encourage companies 'catching up' via ambitious transition targets and plans but at the same time limit that window in light of the need to collectively front load emissions reductions as much as possible to enable the necessary halving of global emissions by 2030 and reach net zero by 2050. This window enables all companies to positively engage with material decarbonisation, but its time

<sup>28</sup> i.e., Companies providing goods and services in the real economy.

<sup>29</sup> Noting that some sectors may be able to do better than net zero, others may struggle to cover the 'last mile' of emissions reductions, at least without offsets. Some will be able to decarbonize more rapidly, others less so. Hence, whether and when net zero will be reached will vary by sector, as defined by the transition pathways set out in the sector specific criteria under the Climate Bonds Standard.

<sup>30</sup> At the discretion of the Applicant

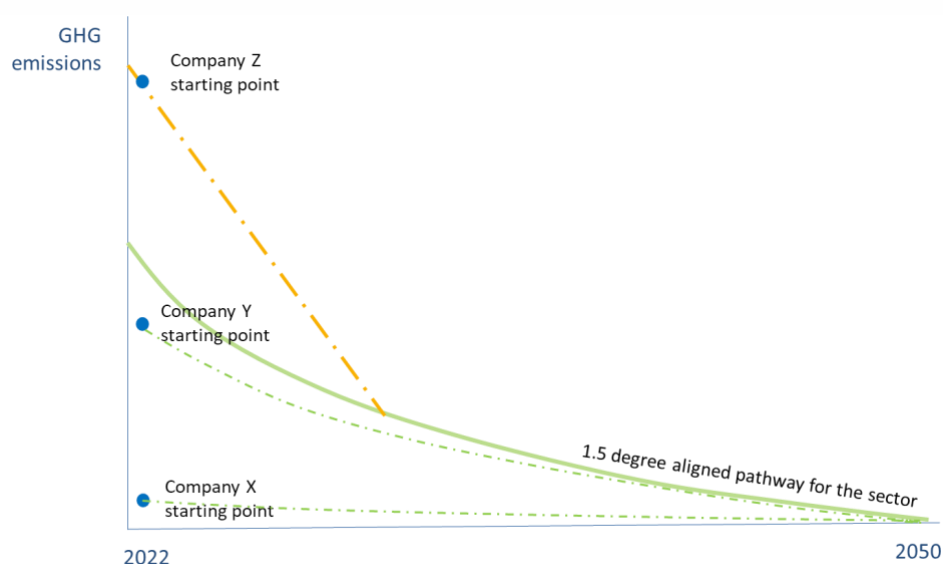
limited nature ensures that the substantial change needed is not endlessly pushed into the future. See Figure 6 for a graphical representation.

These different performance levels may be recognized with differentiated certification labels. Efforts to ‘catch up’ are important and companies undertaking this deserve recognition but should be distinguished from those that have moved earlier or faster and have already sufficiently decarbonised to align with 1.5 degree alignment pathways.

The 90% threshold was selected to represent ‘the majority’ of the Assessed Entity’s activities, with some flexibility to allow for the inclusion within the Assessed Entity’s boundaries of ‘smaller’ activities for which the relevant data or transition planning does not yet exist, or for which no sector specific pathway or criteria yet exists.

It is consistent with the approach 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’. And also consistent with the approach of many Second Opinion Providers to define pure plays as entities that derive at least 90% of revenue from green activities. 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.

Figure 6: Tiers of performance illustrated



### Aspect 3: Term of certification

Certification of companies will have a fixed term of 5 years. After that date, a new application for certification would be required, with updated Performance Targets and associated Transition Plans. 5 years is long enough to enable some evaluation of delivery of transition, but short enough to check that the entity regularly re-evaluates and resets its Performance Targets and Transition Plan in line with the latest guidance on ambitious, credible transition pathways.

Certification of SLBs will last for the tenor of the SLB. However, the Applicant is still required to re-evaluate its Performance Targets and Transition Plan every 5 years, while noting that any reset Targets must be at least as ambitious as those in place at the time of certification.

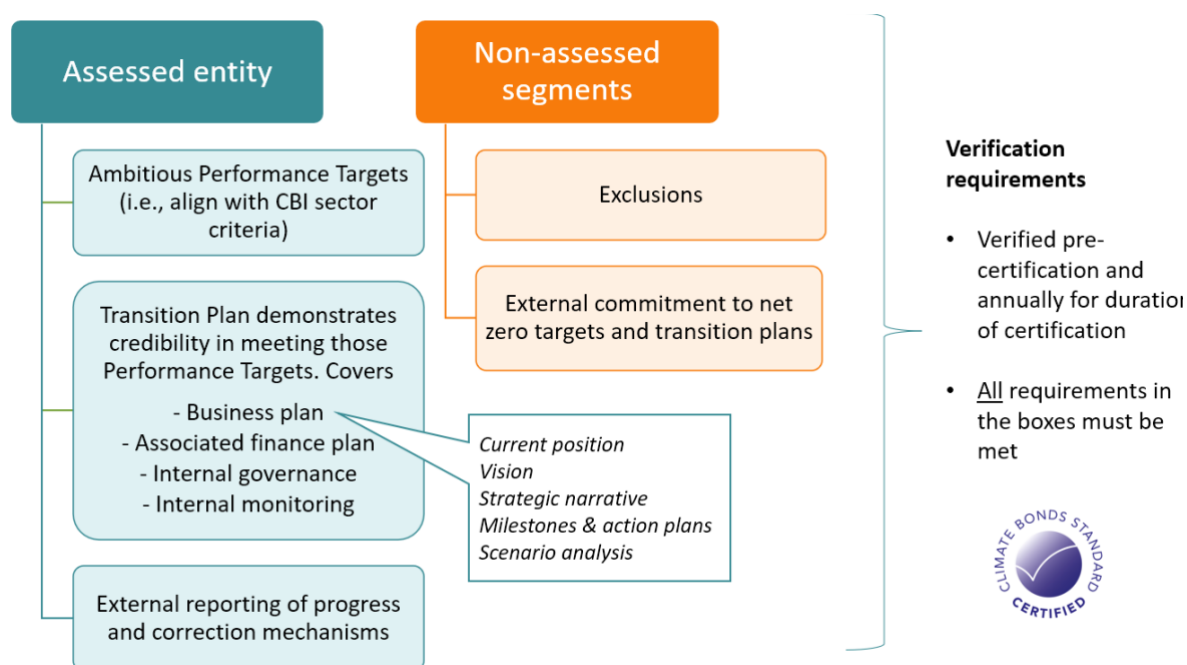
Despite these fixed term certifications, for both company and SLB certification, Performance Targets and Transition Plans must cover the full period until net zero targets are reached (regardless of whether this is before or after 2050), i.e., cover the short-, medium- and long-term, as certification assesses credibility for transition that is aligned with 1.5 degree warming limits.

## Part B: Core components of certification

Figure 7 summarises the key elements of the certification criteria. The development of these requirements has drawn from the Hallmarks described above, in conjunction with a review of the latest recommendations from a number of similar initiatives.<sup>31</sup>

These elements form a ‘checklist’ of essential requirements for certification. That is, all elements listed must be fulfilled. This ‘checklist approach’ is in contrast with some other guidance which provides a weighting for each element. The checklist approach has been selected a) as we do not believe high performance in one area compensates for lower performance in another, b) to avoid the challenge of setting perhaps arbitrary weightings for each component plus an overall threshold level to determine a sufficient level of overall performance for certification, and c) for overall simplicity and transparency as we aim to balance robustness with simplicity to maximise market take up.

Figure 7: Core components of certification



### Core component 1: Performance Targets for the Assessed Entity are ambitious (based on Hallmark 1)

The KPIs and Performance Targets set by and for the Assessed entity align with the sector-specific transition pathways and criteria<sup>32</sup> developed by Climate Bonds convened Technical Working Groups with advice from Climate Bonds convened Industry Working Groups.

These pathways and criteria are developed in line with the Five Transition Principles described under Hallmark 1 above. That is, they are science-based, compatible with 1.5 degree global warming limits and the halving of global emissions by 2030 and net zero emissions by 2050 and aim to address all material emissions (across scopes 1, 2 and 3) and provide transition pathways and criteria for the short-, medium- and long-term.

<sup>31</sup> These include: TCFD: [2021-Metrics\\_Targets\\_Guidance-1.pdf](#) (bbhub.io).

GFANZ: [GFANZ\\_Recommendations-and-Guidance-on-Net-zero-Transition-Plans-for-the-Financial-Sector\\_June2022.pdf](#) (bbhub.io)

SBTi Net Zero Standard: [Net-Zero-Standard.pdf](#) (sciencebasedtargets.org)

ACT Framework: [act-framework-eng-2019-04-09.pdf](#)

European Commission's Proposal for a Green Bond Standard: [resource.html](#) (europa.eu)

ISSB proposals on sustainability disclosures for the capital markets: [Exposure Draft on IFRS S1 General Requirements for Disclosure of Sustainability-related Financial Information](#) and [Exposure Draft IFRS S2 Climate-related Disclosures](#)

Draft European Sustainability Reporting Principles: [Public consultation on the first set of Draft ESRS - EFRAG](#)

ICMA SLB Principles: [SLB-QA-CLEAN-and-FINAL-for-publication-2022-06-24-280622.pdf](#) (icmagroup.org) and [Sustainability-Linked-Bond-Principles-June-2020-171120.pdf](#) (icmagroup.org)

UK Transition Plan Taskforce (TPT) [Transition Plan Taskforce | Setting a robust standard](#) (transitiontaskforce.net)

<sup>32</sup> Sector-specific pathways and criteria are developed on a rolling basis. At any time, certification is only possible in respect of activities in sectors for which Climate Bonds has developed criteria.

As part of the criteria development process, the Technical Working Group considers the GHG budget allocation for the sector per 1.5 degree climate scenarios, and current and foreseen technological capabilities for the sector. Consideration is given to any regional differences that may necessitate regional variation in the pathways or associated criteria, but rarely are criteria differentiated by region as the parameters for criteria setting are, broadly speaking, technological feasibility, not economic or political viability. Furthermore, the provision for different tiers of performance described above creates space for the certification of those operating in jurisdictions with greater barriers to decarbonization, without needing to explicitly set differentiated criteria region-by-region for each sector which would be a complex, challenging and perhaps ultimately a semi-arbitrary process.

In order not to create unnecessary duplication or conflict, transition pathways developed by other initiatives with a compatible climate science basis often form part of Climate Bonds' sectoral pathways and criteria. However, in some cases, these pathways have been tweaked and / or additional criteria are set on top of alignment with these pathways, on the advice of the Technical Working Group. For this reason, Climate Bonds certification requires alignment with Climate Bonds criteria, rather than simply alignment with sectoral pathways developed by others.

Given Climate Bonds' climate focus, these criteria predominantly address climate mitigation and climate adaptation and resilience.<sup>33</sup> If / where the non-financial corporate or its SLB encompasses Performance Targets focussed on other environmental and/ or social goals beyond the scope of the sector-specific certification criteria, certification does not encompass consideration of these and is effectively silent on the credibility of those Performance Targets.

## Core component 2: Transition Plan demonstrates credibility to meet those Performance Targets (based on Hallmarks 2, 3 and 4)

Where the Assessed Entity practices activities for which the sectoral pathways and criteria tighten or ratchet down over time (and therefore the Assessed Entity's Performance Targets tighten over time), it is necessary to assess the ability to meet those Performance Targets. That is, assessing the plans and mechanisms put in place and early actions taken to move from current emissions levels to the targeted emissions levels.

Specifically, the criteria focus on the following aspects that are looked for in the Transition Plan:

- **The business plan:** To demonstrate the Assessed Entity is aligning its overarching strategy and re-orientating its overarching business plan with this transition, and that it has identified achievable and sufficient milestones and actions over the short-, medium, and longer-term to deliver the set Performance Targets. This business plan will likely include a number of sub-plans and strategies, but the criteria pay particular attention to an **associated external engagement strategy** as tackling scope 3 emissions means tackling emissions that are not be in the Assessed Entity's direct control but are in their sphere of influence. Detail is needed here to demonstrate the Assessed Entity intends to engage with and influence its suppliers and customers to tackle its scope 3 emissions. It is noted, however, that this engagement plan need not address government or policy engagement (or lobbying) for the reasons given in Chapter 3.
- **An associated finance plan:** Transition will likely have significant financial implications – impacting costs, revenue and/ or on asset values and balance sheets. A coherent, comprehensive finance plan with accompanying sensitivity analysis 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.
- **Internal governance:** The requirements here focus on the Board's mandate to agree and oversee the setting and delivery of the Performance Targets and Transition Plan. They do not extend to Board or management remuneration, for the reasons given in Chapter 3.
- **Internal monitoring:** Transition will not be smooth. It likely will not go entirely to plan. Performance might outpace or under deliver on the set Performance Targets due to events both within and outside the Assessed Entity's control. What is important is that this is anticipated, monitored and corrective planning and action is taken as needed. This element of the criteria seeks to ensure that sufficient oversight of progress, and course correction is undertaken where

<sup>33</sup> And occasionally other environmental aspects where those have been identified as critical considerations either by the Technical Working Group or the Climate Bonds Standards Board

needed. It also ensures the Transition Plan is a living strategy, subject to regular re-evaluation and updating.

### **Core component 3: Safeguards on the Non-Assessed Segments**

These ‘safeguard’ criteria consist of a) a set of exclusions on the wider entity relating to the expansion of fossil fuel activities, and b) public commitments to net zero targets and transition plans for the wider entity.

In respect of the former, expanding fossil fuel operations would be a clear undermining of green or transition credentials, given the need to contract, not expand the availability and use of fossil fuels. The climate science is clear that new coal or gas is not compatible with reaching the 1.5 degree targets.

In respect of the latter, public commitment to such Targets and Transition Plans provides a degree of transparency and accountability on the part of the wider entity, and this is deemed sufficient as a minimum requirement on the Non-Assessed Segments. In contrast to the deeper requirements in respect of the Assessed Entity, certification will not require the verifier to assess the targets and plans for the wider entity encompassing the Non-Assessed Segments.

### **Core component 4: External verification and reporting**

External reporting and independent verification are well established in the green use-of-proceeds bond market. Enabling external oversight and assessment is accepted as critical to credibility.

Public disclosure and annual assessment and verification is in line with other guidance, labels and industry practice.

#### **A last thought – The performance linked coupon in SLBs**

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 Performance Targets 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 Performance Targets is likely to be a more important consideration.

For this reason, the materiality of the incentive does not presently form part of certification criteria.

## Appendix 1: 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° 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	<a href="#">ACT</a>	<a href="#">SBTI</a>	<a href="#">TPI</a>	<a href="#">CA100+</a>	<a href="#">ICMA</a>	<a href="#">CDSB</a>
	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
<b>1. Select appropriate and ambitious targets</b>							
<b>Select common sector-specific transition pathway</b>	1.1. Select common Performance Targets	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



	<b>Climate Bonds</b>	<a href="#">ACT</a>	<a href="#">SBTI</a>	<a href="#">TPI</a>	<a href="#">CA100+</a>	<a href="#">ICMA</a>	<a href="#">CDSB</a>
	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
<b>Select aligned company-specific KPIs</b>	1.2. Select aligned company-specific Performance Targets	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
<b>2. Establish the enabling environment</b>							
<b>Establish strategy to deliver the KPIs</b>	2.1 Establish strategy to deliver the Performance Targets	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		
<b>Determine financing plan</b>	2.2 Determine financing plan			MQ 19 Internal price of carbon			
<b>Put in place necessary governance frameworks</b>	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.
<b>3. Action to set the wheels in motion</b>							
<b>Capital expenditure</b>	3.1 Capital expenditure	Initial phase performance module 2 material investments cover this			The company is working to decarbonise its capital stock		
<b>Other actions</b>	3.2 Other actions	4B Strategic plan 4C Board commitment 5A Definition 5B Implementation				3. Bond Characteristics (e.g. variation of the coupon)	

	Climate Bonds	<a href="#">ACT</a>	<a href="#">SBTI</a>	<a href="#">TPI</a>	<a href="#">CA100+</a>	<a href="#">ICMA</a>	<a href="#">CDSB</a>
	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
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				
<b>4. Monitoring of performance against targets</b>							
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		
<b>5. Ongoing reporting and monitoring to evidence compliance with all of the above</b>							
Public disclosure of KPI's and strategy to deliver	5.1 Public disclosure of Performance Targets 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	

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