GFANZ
Glasgow Financial Alliance for Net Zero

Scaling Transition Finance and Real-economy Decarbonization

A GFANZ Secretariat Technical Review Note and Supplement to the 2022 Net-zero Transition Plans report

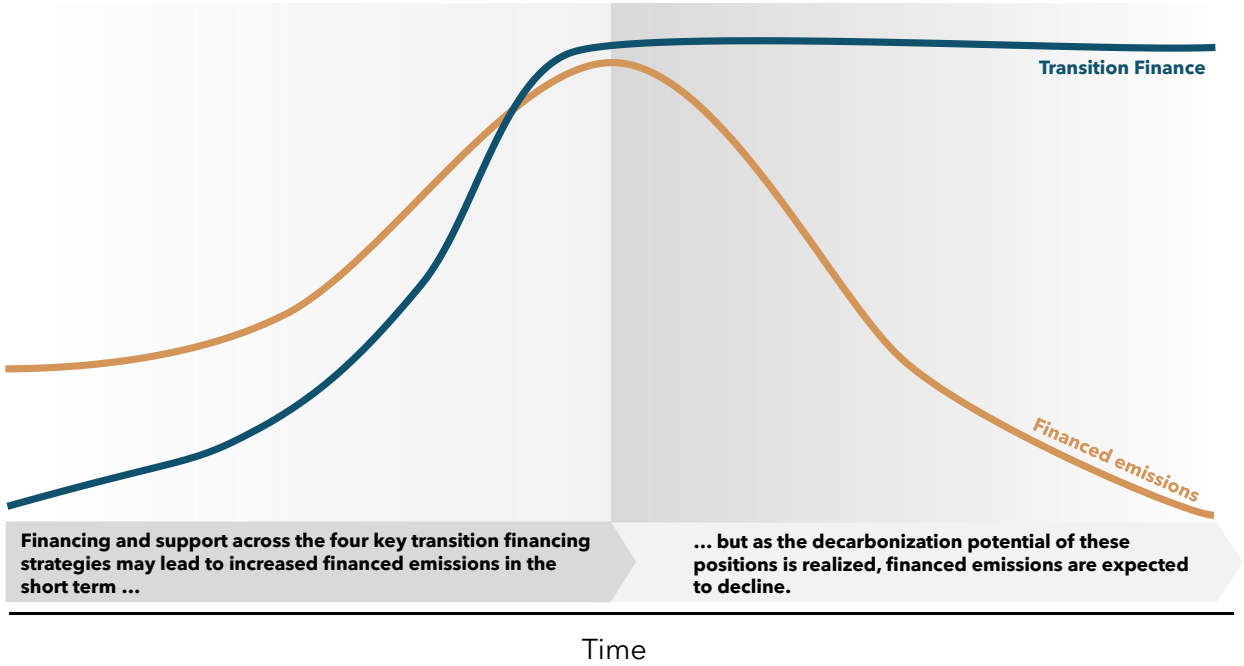
High-level summary

December 2023

Overview

The purpose of this GFANZ Secretariat Technical Review Note is to introduce Attributes for the GFANZ four key transition financing strategies and to explore forward-looking approaches to evaluate potential decarbonization contributions in support of scaling transition finance.

- To support a whole-economy transition to net zero, financing and related services across four key transition financing strategies need to scale.
- Financing gaps and opportunities exist across all sectors and addressing this will require action by governments, companies, and the financial system. Private finance plays a key role by providing the capital necessary for a transition at scale and pace to the real-economy companies that need it most.
- Current mechanisms that rely solely on historic and point-in-time metrics, targets, and considerations may not adequately drive capital allocation to critical areas, such as hard-to-abate sectors.
- Incorporating forward-looking metrics as a complementary consideration may more fully capture the "value add" of the decarbonization potential of high-emitting exposures.
- The GFANZ Secretariat anticipates adoption and further development of the concepts presented in this Note will continue into 2024 and beyond.



Consultation engagement

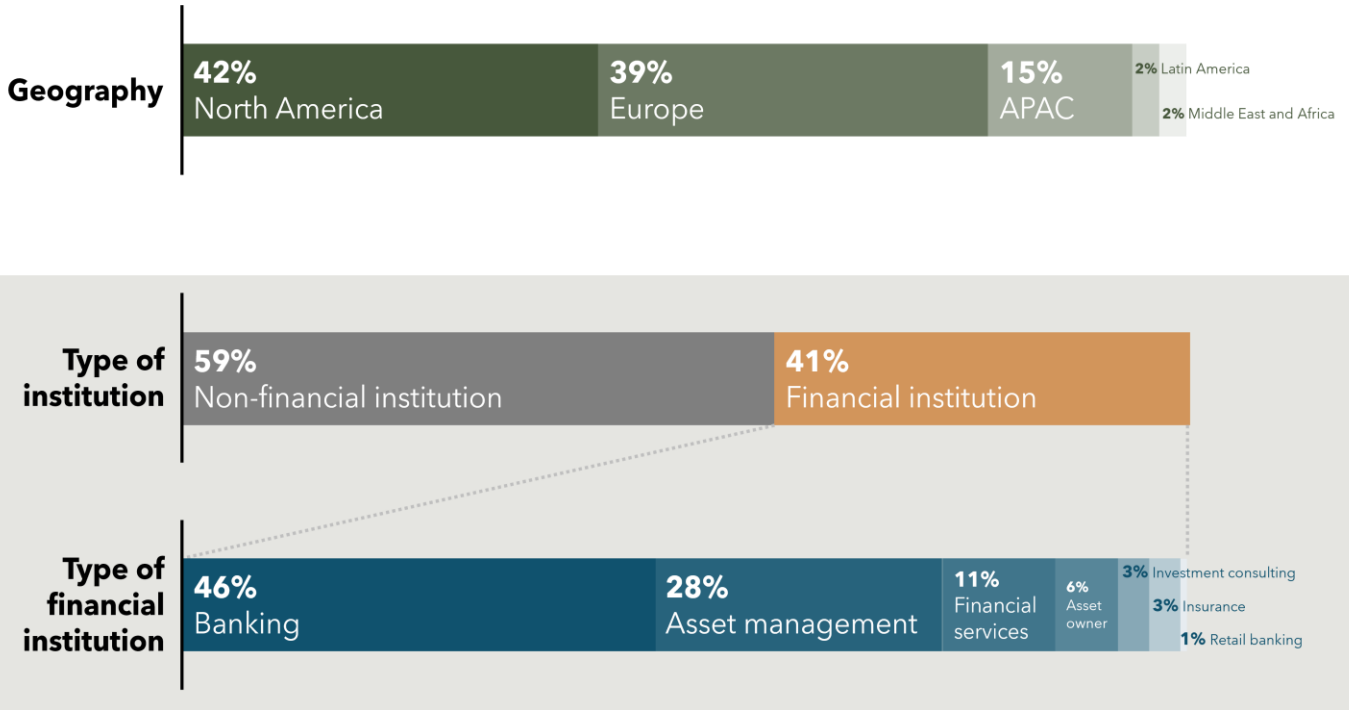
The GFANZ Secretariat is grateful for the participation of the financial industry, NGOs, and subject matter experts. The GFANZ Secretariat conducted four primary types of engagement to support this effort: public consultation, focus groups, outreach events, and webinars. Such engagement served two primary purposes: i) to raise the level of awareness and encourage stakeholders' engagement with GFANZ's work, and ii) to solicit and inform feedback on the proposed transition financing strategies and potential decarbonization contribution methodologies. In

Promoted to 15,000+ and engaged 1,700+ individuals across 120 organizations

2,000+ Downloads **&** **300+** Responses via consultation and bilateral engagements

15,000+ Reached with "Requests for input"

1,700+ Directly engaged via events, workshops, and working groups



Part I

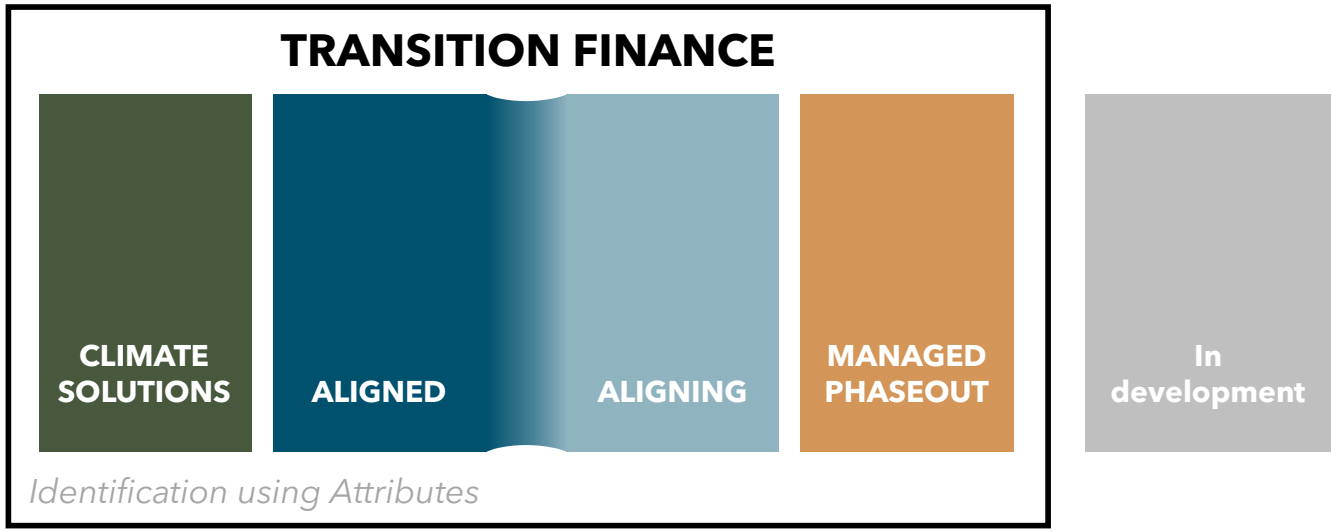
Transition Finance

Part I – Overview

Part I of the Technical Review Note revisits the GFANZ definition of Transition Finance and the four key financing strategies, outlining principles-based Attributes that could be used to screen opportunities, portfolio holdings, and clients, for their applicability. Such an assessment could be useful to inform net-zero transition planning within financial institutions, especially the Implementation and Engagement Strategies.

The Attributes build on the original GFANZ definition and draw on other relevant frameworks. The Attributes are principles-based, pan-sector, and globally applicable, accommodating for use of sector, region, or application specific frameworks or taxonomies where available and appropriate.

Part I starts with an overview of select existing frameworks with relevant maturity scales and/or transition finance categories.



Climate Solutions

Climate Solutions consists of three sub-types:

1) **Solutions** are assets and entities that directly remove or reduce real-economy GHG emissions.
2) **Enablers** are assets and entities that indirectly contribute to, but are necessary for, emissions reductions by facilitating the deployment and scaling of Solutions or supporting the decarbonization of other actors' operations.
3) **Nature-based solutions** represent actions to protect, sustainably manage, and restore natural and modified ecosystems in ways that address societal challenges effectively and adaptively, to provide both human well-being and biodiversity benefits.

The section dives deeper on each Attribute, with discussion on key considerations on Solutions and Enablers, including:

- GHG emissions reduction – actual and/or expected impact
- Criticality/uniqueness

Summary of Attributes

APPLICATION: ASSETS, ENTITIES	
ATTRIBUTE	
A. Real-economy emissions reduction	Contribution to emissions reduction by: i. Demonstrating direct or indirect net contribution to real-economy emissions reductions in a significant[1] manner; **AND** ii. Not leading to the extension (beyond net-zero pathways) of the lifetime emissions of assets identified for phaseout.
B. Expecta-tions of net-zero alignment	Where the Climate Solutions itself is associated with emissions, reasonable efforts are planned or being made to address emissions reductions in the near and medium-term, and can be expected to align to a science-based pathway over time in a net-zero economy. When assessing for Attribute B, financial institutions are strongly encouraged to consider the Attributes under the Aligned and Aligning section.

1 "Significant" should be considered within the appropriate context, such as the asset class or sector.

Aligned and Aligning

The **Aligned** strategy includes those entities that are well on track or have successfully transformed or repositioned their operations to be net-zero aligned.

At the core of the **Aligning** strategy are entities that currently fall short of full alignment with net-zero objectives yet demonstrate progress and are converging toward net-zero.

The section dives deeper into each Attribute, with emphasis on the importance of net-zero transition plans

- Both Aligned and Aligning entities should have a net-zero transition plan but may be at different stages of development and implementation.
- NZTPs provide a basis for assessing Performance over time and support the assumptions used in the EER calculation.

Specific conditions for "transitional" activities are also outlined.

Summary of Attributes

Application: Entities		
Attribute	**Aligned**	**Aligning**
A. Established net-zero commitment/ambition	Commitment/ambition to reach net zero, specifying science-based pathways/benchmarks.[1]	
B. Established net-zero targets (set to pathway)	Emissions-based KPIs: Scope 1 and 2; Scope 3 if material; At a minimum, short- to medium-term interim targets established between time of commitment and net zero.[2]	
C. Net-zero transition plan	Established and being implemented; Consider including current and planned low-carbon capex and opex (where available).	Developing; Consider including planned low-carbon capex and opex (where available).
D. Additional KPIs (Where applicable)	Where applicable, consider tracking low-carbon revenues, planned low-carbon capex and opex, other financial metrics as proxy for alignment (where available); benchmarking/accreditation scores by third-party platforms; just transition considerations and KPIs,[3] etc. The EER metrics introduced in Part II offers a complementary KPI to monitor in the context of alignment.	
E. Performance	Actual performance against established targets/KPIs and alignment to pathways – at least two continuous years.	Demonstrating increasingly meaningful progress toward established targets/KPIs and convergence toward pathways (e.g., expected convergence to interim targets).

1 Based on science-based net zero pathways, including those that may be region or sector-specific. For sectoral pathways, see GFANZ Guidance on Use of Sectoral Pathways for Financial Institutions for further guidance.
2 The GFANZ Secretariat recognizes that many entities may be in the early stages of implementing their net-zero commitment, and that there is an interim phase where entities may be committed and taking significant steps in establishing targets. Financial institutions are encouraged to capture these exposures separately under "In development" and incorporate actions to support such entities' progression on the alignment scale as part of the financial institution's net-zero transition plan. Please refer to In development for details.
3 For example, investments in human capital development in skills/training; financial considerations regarding affordability of products and services, etc.

Managed Phaseout

Managed Phaseout

- The MPO section anchors on the APAC Coal MPO paper – the ten recommendations of the APAC paper have been mapped to each Attribute to ensure connectivity between the two papers.
- The body of the section includes general considerations under the Attributes but makes clear that this Note does not supersede the APAC guidance, and that users should refer to APAC paper for details and case studies.

Summary of Attributes

Application: Assets/projects[1]		
Attribute		**Relevant APAC MPO Recommendations**
A. Established net-zero commitment/ambition	Commitment to retire the asset early (i.e., before the expected or intended economic life). The commitment may be based on (not exhaustive): the planned remaining operating life; emissions avoided by shortening the operating life; relevant sector pathway, etc.	**Recommendations 1, 2, 4, and 5** cover details related to the enabling environment for a credible phaseout and to the need for financing
B. Established net-zero targets (set to pathway)	Emissions- or Transition-based:[2] Targets set against the pathway or benchmark established as part of the phaseout commitment to track phaseout progress (e.g., early retirement year; interim targets along the phaseout GHG emissions profile; etc.)	**Recommendation 6** provides details on targets
C. Net-zero transition plan (or phaseout plan)	Phaseout plan specific to the asset and/or captured as part of financial institution or owner/operator's phaseout strategy.[3] The phaseout plan may include estimates of capex and opex requirements. Planned capex and opex may also be used as an indicator/KPI that tracks capital allocation as part of progress toward phaseout; consider specific capex needs such as carbon efficiency, decommissioning, general capex to support early retirement, etc.	**Recommendation 3** covers overall details in an entity's phaseout plan. **Recommendation 7** includes consideration of provision of same or similar services after phaseout. **Recommendation 8** includes wide-ranging types of plans required to manage the socio-economic impacts of a phaseout. **Recommendation 9** specifically covers the viability analysis of the phaseout plan.
D. Additional KPIs (Where applicable)	May include operational KPIs; decommissioning provisions; retraining of staff; plans in place for alternative (e.g., clean energy) supply; third-party validation/audit; phaseout financing structure; just transition considerations and KPIs, etc. The EER metrics introduced in Part II offer a complementary KPI to monitor in the context of alignment.	KPIs may be associated with **Recommendations 3, 6, 7, 8, and 9**
E. Performance	Actual performance against established targets/KPIs for phaseout asset along the specific pathway or benchmark.[4]	**Recommendation 10** provide considerations on transparency and accountability

1 To support a range of approaches, the Attributes include potential entity-level application (e.g., a holding company of multiple assets for phaseout), but the identification and segmentation exercise in such instances may still necessitate assessment against the indicators on an asset-by-asset basis.
2 Emissions-based metrics and targets focus on how the activity changes real-economy GHG emissions over time; transition-based metrics and targets categorize the focus of the financial activity according to the relationship to net zero (e.g., Paris-aligned, production volume, etc.). For further discussion of these types of metrics targets, refer to the GFANZ Financial Institution Net-zero Transition Plans – Supplemental Information.
3 Please refer to the GFANZ resources listed at the end of this section for further guidance on considerations for credible Managed Phaseout transactions and aspects to be included in a phaseout plan/NZTP.
4 Note that this may be challenging if the asset is operated largely as normal until planned retirement.

In development

- This section discusses the value from assessing exposures that may not meet current transition finance Attributes as an input to financial institution NZTPs
- Suggested sub-groups to highlight important areas that may not meet Attributes
- Includes potential actions that may be considered by financial institutions to help progress sub-groups into one of the financing strategies over time
- Notes that there may be exposures with no viable options for progression and encourages financial institutions to capture and track these for added transparency

Excerpt of potential sub-groups (not the full table)

	POTENTIAL SUB-GROUPS
Alignment maturity scale	Committed to Aligning
	Not Aligned
Process and data limitations	Exposures pending assessment
	Exposures with limited data and resources
Other	"Transitional" activities without retirement date
	"Transitional" activities that supports an Aligning entity without a NZTP

Use case considerations and other highlights

Use case considerations

An expanded section on application considerations, including segmentation, different application dimensions, degree of association, etc.

Other highlights

Included mention of regionality and sector-specific considerations in the overview to Part I, also further addressed under Areas for further work.

Using one or more key financing strategies

- Considerations in light of the non-mutually exclusive nature of the four key transition finance strategies to support instances where FIs may wish to apply Attributes for segmentation purposes

Application dimensions

- Clarifies that the Attributes may be applied to individual exposures and portfolio level; point in time and window of time, etc.

Degree of association and influence

- Clarifies that further transparency is encouraged to take into account differing degree of association with the end decarbonization impact based on the financing structure results. For example – primary market exposure provides more direct and higher degree of association, vs secondary market exposure

Other highlights

Regionality and sector-specific considerations

- Highlights the need for regional and sector-specific granularity that may not be available
- References GFANZ Sectoral Pathway guidance
- Further addressed in Areas for Further Work

Part II

Potential decarbonization contribution methodologies

Part II – Overview

Part II introduces the concept of Expected Emission Reductions (EER) as a complementary measure to existing KPIs that may offer perspective on the forward-looking decarbonization potential of holdings and opportunities. This offers a potential approach to assess and quantify the decarbonization contribution potential of exposures, with transparency and awareness of limitations paramount to credible application.

It builds on the EER concept introduced in the consultation paper and outlines potential methods for deriving it for the different key financing strategies:

- For Climate Solutions, the method described is Avoided Emissions (AE)
- For Aligned and Aligning, as well as for Managed Phaseout, the Note proposes Emissions Reduction Potential (ERP)

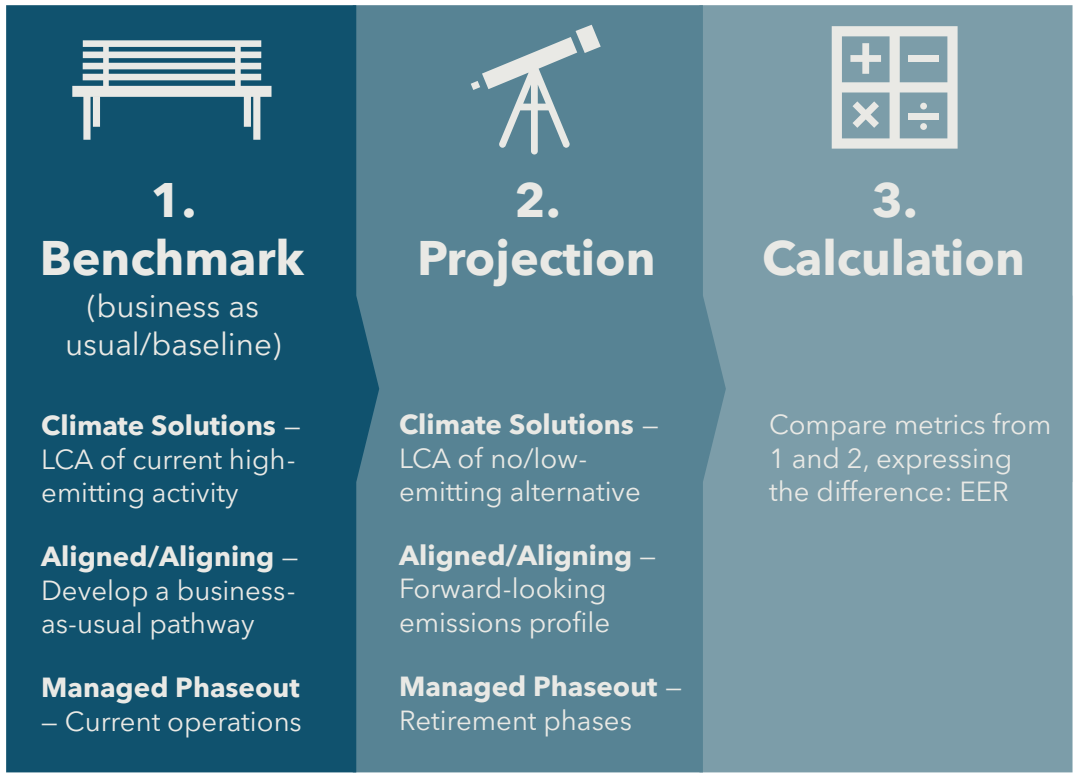
CLIMATE SOLUTIONS	ALIGNED AND ALIGNING	MANAGED PHASEOUT
Avoided Emissions (AE)	**Emissions Reduction Potential (ERP)**	**Emissions Reduction Potential (ERP)**
Contributions to global decarbonization efforts outside of an entity's value chain through climate solutions and carbon removal projects	An entity's emissions reductions via its operations Upstream and downstream value chain indirect emissions reductions	Contributions to decarbonization efforts through the early phaseout of high-emitting assets

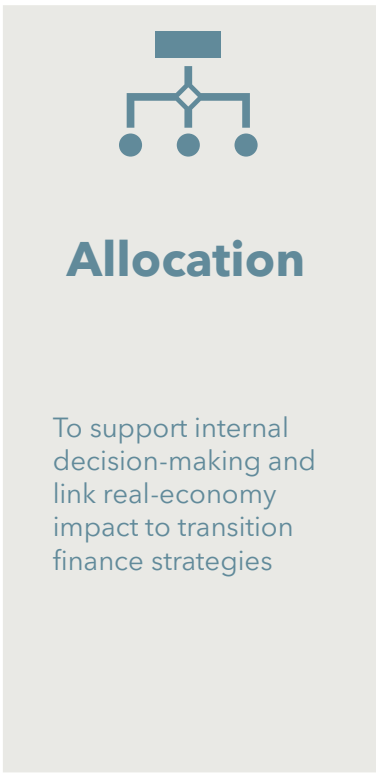
Measuring climate impact with decarbonization contribution

Quantification of EER follows the same steps for both methods:

1. Benchmark
2. Projection
3. Calculation

Considerations for potential allocation step are also included.





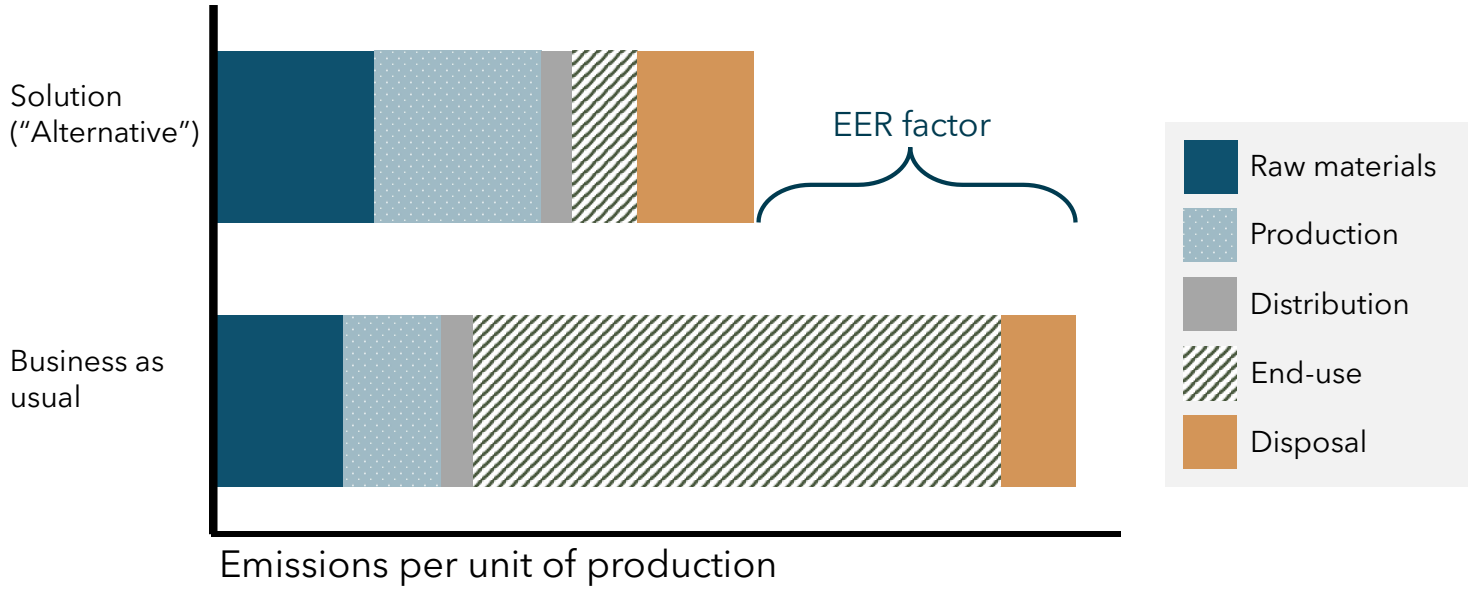
Potential emissions reductions for Climate Solutions

The Avoided Emissions method is introduced as one option to estimate potential emissions reductions associated with Climate Solutions.

The approach proposes the use of Life Cycle Analysis (LCA) to derive EER since the focus of Climate Solutions is on end-use emissions reduction.

In absence of sufficient data for LCA, simplifications (such as reducing the emissions boundary to end-use emissions) may be necessary as an interim measure.

Calculation of the EER of Climate Solutions using LCA



Potential emissions reductions from Aligned and Aligning

The Emission Reduction Potential method is introduced as one option to estimate potential emissions reductions from Aligned and Aligning entities.

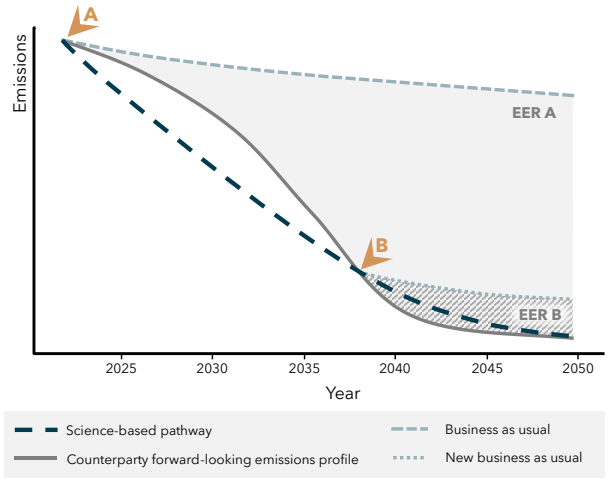
The proposed approach involves the development of a business-as-usual pathway as well as a forward-looking emissions profile for the entity in question and taking the difference between the two. The presence of a credible net-zero transition plan is of particular importance in the Projection step.

Considerations regarding the influence of timing of the financing decision and nature of the financed entity on the magnitude of EER are discussed in this section.

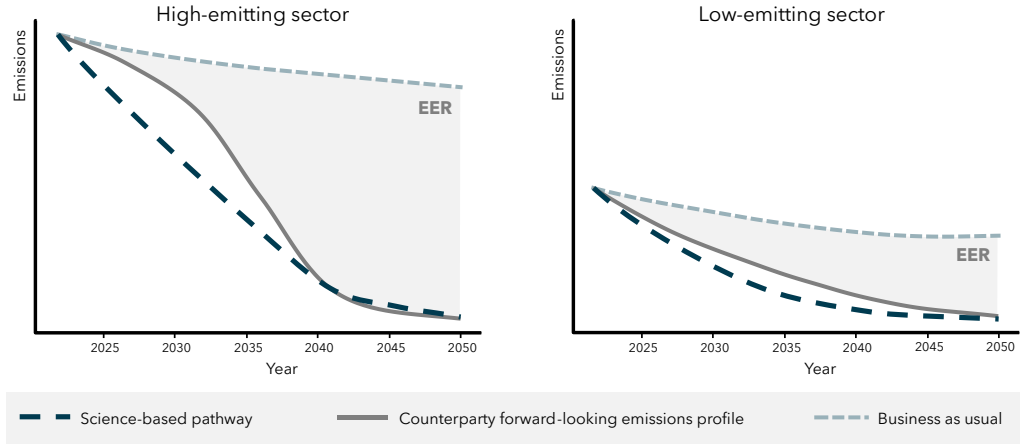
EER can be a complementary measure to support scaling of transition finance activities, especially in high-emitting sectors, particularly when rooted in the key Attributes outlined in Part I and taking into account the quality of net-zero transition plans.

The approaches outlined help to prioritize short to medium-term actions.

Timing of the financing decision



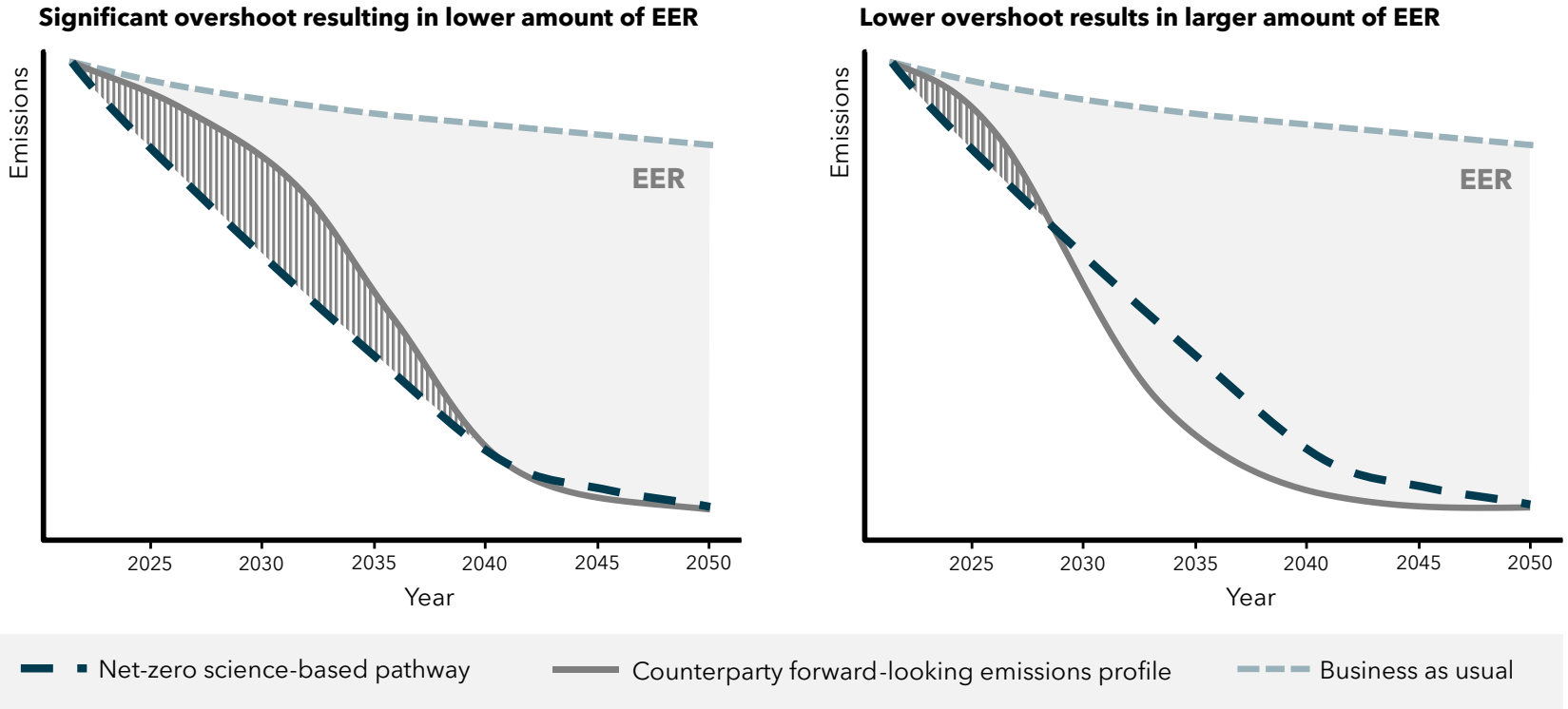
EER for high vs low-emitting sectors



Potential emissions reductions from Aligned and Aligning
The net-zero perspective

Understanding how close an entity is to the net-zero benchmark provides insight on the materiality of the EER.

- In this context, benchmark divergence measures can be useful tools as they measure a carbon budget over/undershoot based on cumulative emissions.
- Overshooting the benchmark significantly results in lower EER and vice versa.

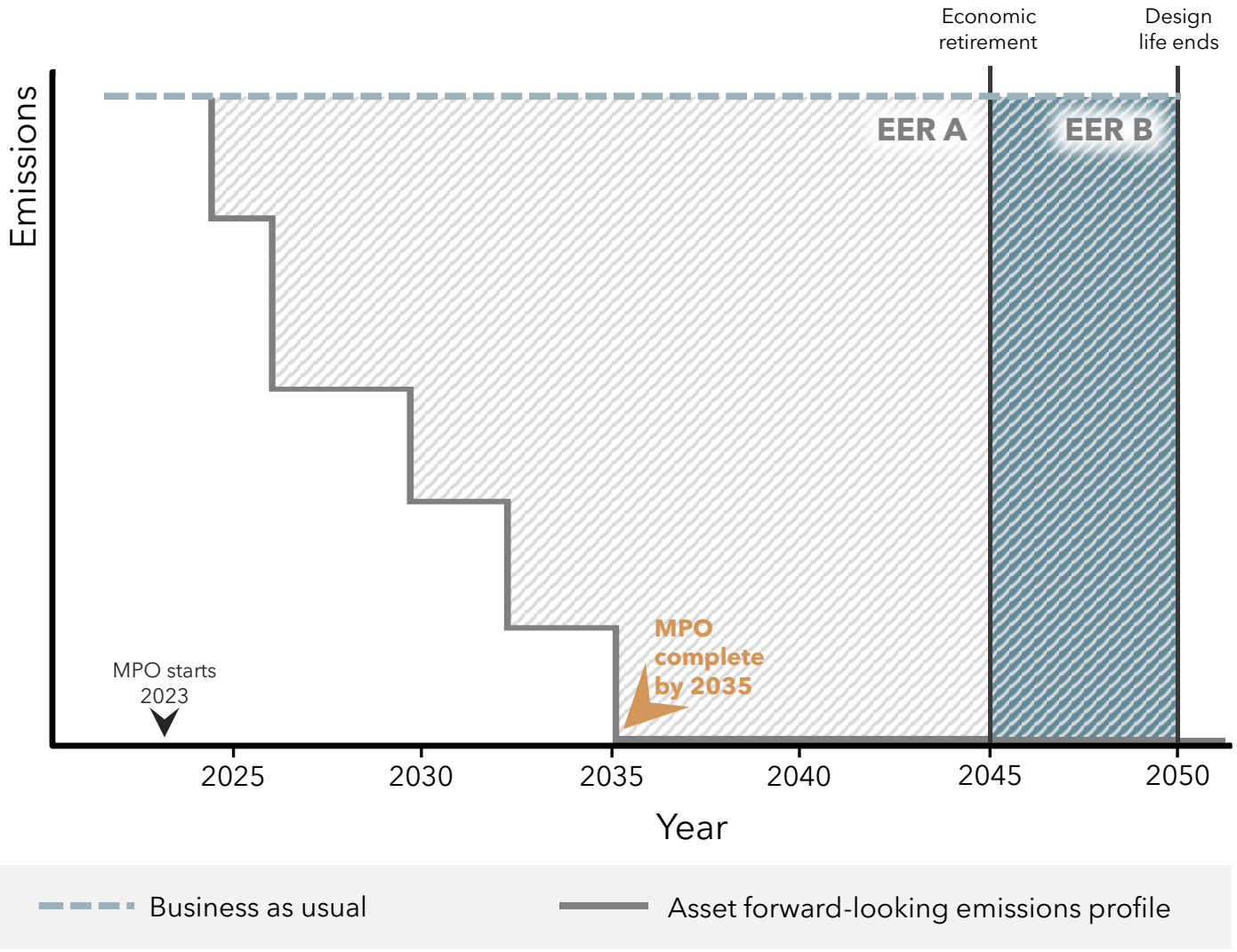


Potential emissions reductions from Managed Phaseout

For Managed Phaseout strategies, the emissions reductions are derived from a high-emitting asset's operations.

The Note therefore proposes use of the ERP quantification method that is also proposed for Aligned and Aligning strategies.

Illustration of ERP of a Managed Phaseout asset



Anchoring decarbonization approaches in five principles to ensure credibility

EER represents a complementary approach for mobilizing capital to transition finance activities and helps understand the emissions impact per $ financing.

The overarching five principles can serve as additional safeguards when implementing potential approaches to measuring EER.

Be transparent and verifiable: Documenting, referencing, and publicly providing methods, data, assumptions, and information that are used increases transparency, supports others in their efforts, and allows for third-party verification or assurance where such methodologies exist.

Link to net-zero transition: Establishing the link and consistency between the portfolio, portfolio holding, and/or client identified as Transition Finance, and the contribution to an orderly net-zero transition across the whole economy contributes to the credibility of the process and relevance to decision-making.

Be consistent over time: Consistent application of the concepts in this Note, including documenting changes to data, methods, and assumption, allows for comparisons over time.

Balance conservativeness, science-based, and practicalities: Where possible and practicable, use of the best available, fact-based information developed through a scientific process helps identify probable variables and pathways for conservative analysis.

Support action in a timely manner: Prioritizing short- to medium-term emission reduction actions recognizes the need for achieving milestones by 2030 in order to preserve the best possible chance of averting environmental tipping points.

Use case considerations

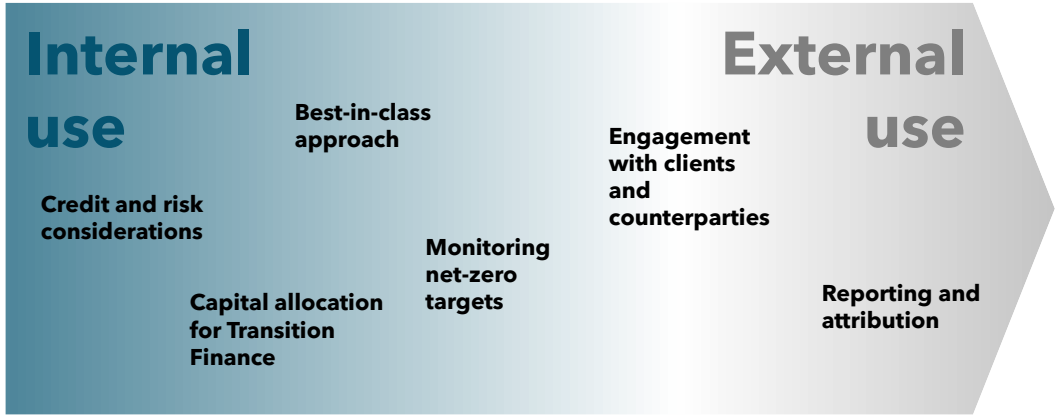
The nascent EER approach will require refinements over time and is expected to be primarily used for internal decision-making in the short term.

The preliminary EER roadmap suggests testing and adopting EER approaches for internal decision-making, as complementary to other net-zero transition planning metrics such as capital mobilized.

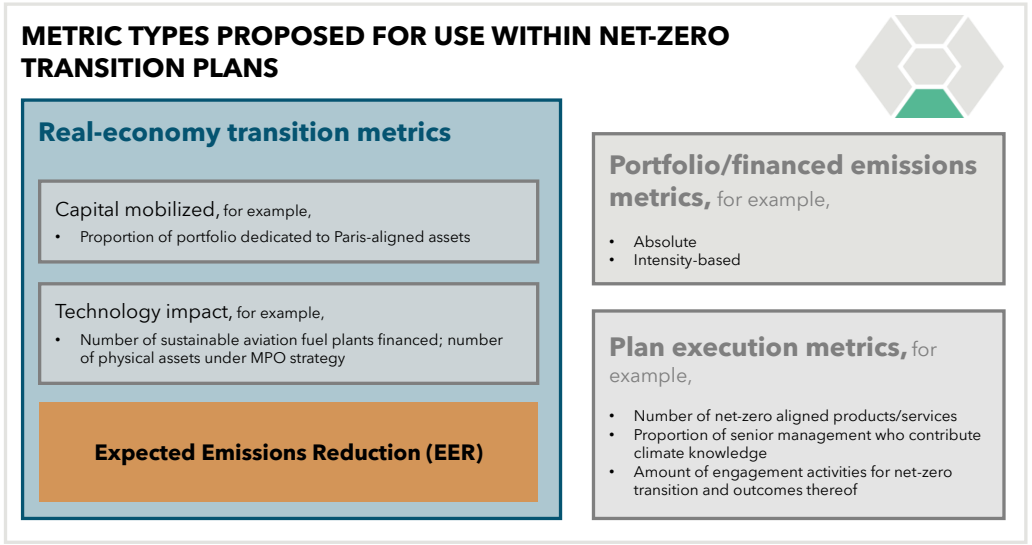
Allocation of EERs to specific financial institutions, aggregation of EERs derived for different strategies, and backtesting and verification are addressed as particular areas of focus, cautioning that there is considerable need for further work, the negative implications of attempting to net the EER measure with Scope 1, 2, and 3 emissions, and the need for verification of underlying assumptions, data, and methodologies.

EER may also be used to develop new KPIs and/or integrate with existing measures in support of financial institutions in their assessments (e.g., dashboard approaches).

Illustrative EER adoption road map



Transition-related metrics for input to internal analysis



Areas for further work

Areas for further work

The Areas for Further Work section summarizes areas the GFANZ Secretariat identified, through own analysis and public feedback, as warranting further research, analysis, and development of methodologies and standards.

Many of the complexities were related to methodological issues and concepts – this section highlights a few key areas: EER methodology and application, regional and sectoral considerations, Climate Solutions, and Aligned and Aligning

Key areas of further work

Relationship to other frameworks and methodologies	Encourage stakeholders to support further development of the concepts and approaches identified in this Note
Data availability, consistency, and quality	Encourage further research and analysis by sector and industry experts to develop more consistent approaches for the real economy and financial sector
Methodology issues and concepts	Expect ongoing refinement and development of concepts presented in this Note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