EU requirements to implement transition plans and implications for third country financial institutions

Introduction

Transition plans are a tool for companies and financial institutions to communicate their business strategy with respect to how they are planning to adapt their businesses to a low-carbon economy. Global financial institutions generally take a global, group-wide approach to strategic transition planning, and the financial industry is taking a proactive approach to implementing transition plans through a range of global industry-led initiatives, such as the Net-Zero Banking Alliance (NZBA), the Net Zero Asset Managers (NZAM) initiative and the Glasgow Financial Alliance for Net Zero (GFANZ).

As part of their commitment to NZBA, member banks are expected to develop transition plans that outline how they will achieve their net-zero emissions target by 2050. These plans will include interim science-based targets for reducing emissions across the banks' portfolios in line with the temperature goals of the Paris Agreement, as well as details on the strategies and tools that will be used to achieve those targets. NZAM's members commit to reaching net zero emissions by 2050 or sooner across all assets under management and setting interim targets. Moreover, since its launch in April 2021, GFANZ has been developing tools and methodologies to support the broader financial sector's efforts to turn net-zero commitments into real action. In November 2022, GFANZ published the Financial Institution Net-Zero Transition Plans report with recommendations and a pan-sector framework for financial institutions' transition plans.

However, transition plans are still in their early stages of development, and adoption of transition plans will not result in the desired climate outcomes in the absence of shifts in government policy, consumer demand, and technological innovation. It is important to recognise that the ability of the financial industry to facilitate and finance the transition will depend on the availability of real economy transition opportunities to finance and invest in, and that real economy transition opportunities will be largely dependent on external factors such as government action that shift the relative economic attractiveness of clean energy and net-zero technologies. Real economy transition plans will therefore provide the financial sector with more data that may be helpful in identifying opportunities to provide finance and investment in support of the transition.

EU climate transition plan requirements for financial institutions under CSDDD and CRD VI

The EU is currently finalising two legislative frameworks introducing mandatory climate transition plans: (i) the Corporate Sustainability Due Diligence Directive (CSDDD) for the entire economy; and (ii) the Capital Requirements Directive (CRD VI) for financial institutions. In addition, further to the new disclosure obligations in the Corporate Sustainability Reporting Directive (CSRD), if an entity has a transition plan in place it will be required to disclose the information set out in the European Sustainability Reporting Standards (ESRS) E1-1.

The CSDDD will set obligations for in-scope companies to have in place a transition plan ensuring that the business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement. On top of this, financial institutions will be mandated under the CRD VI to implement transition plans with a supervisory focus on the management of climate-related risks. The details of the transition plans will be defined by European Banking Authority (EBA), and the plans will be reviewed and discussed with the competent authorities.

Third country initiatives

Other jurisdictions are currently introducing obligations to adopt transition plans. For example:

- The UK's Financial Conduct Authority (FCA) already requires listed issuers, including many financial services firms, to disclose transition plans on a comply or explain basis, and the UK government will soon consult on requiring disclosure of transition plans for large private companies. To that end, the UK Transition Plan Taskforce (TPT) is developing a disclosure framework[1] and implementation guidance[2], which are aligned with GFANZ and build on the Task Force on Climate-related Financial Disclosures (TCFD) recommendations and the IFRS Foundation's International Sustainability Standards Board (ISSB) climate disclosure standard. The TPT's framework is being developed with the goal of maximising alignment and interoperability with international and jurisdictional frameworks. The presence of GFANZ and the IFRS Foundation in the Taskforce facilitates this objective.
- Switzerland introduced mandatory disclosure obligations for large companies based on the recommendations of the TCFD and based on a 'double materiality' perspective as of 2024[3]. The mandatory disclosure includes a requirement on transition plans.
- The Monetary Authority of Singapore (MAS) has also announced that it will set supervisory expectations to steer financial institutions' transition planning processes to facilitate credible decarbonisation efforts by their clients.[4]

Many other jurisdictions have also signaled that they will adopt the IOSCO-endorsed ISSB climate disclosure standard, which includes transition plan disclosure.[5]

Implications for third country financial institutions

Third country financial institutions with subsidiaries in the EU will be faced with two EU legal obligations to implement transition plans, one from the CRD VI and one from the CSDDD. The CRD VI obligation will apply only at the level of their EU subsidiaries, while the CSDDD obligation may apply at both the EU subsidiary level and the group level. Thus, not only will multiple entity-specific transition plans be required for financial institutions, but they may be subject to different reporting standards (i.e. one set by the EBA and one set in the ESRS adopted by the European Commission) even for the same entity. They may also be potentially subject to different supervision as the European Central Bank (ECB) and National Competent Authorities (NCAs) will supervise transition plans subject to EBA guidelines (CRD VI), and ESMA and NCAs will likely supervise plans subject to the CSDDD.

At the same time, third country financial institutions may be subject to additional home country obligations deriving from specific requirements to introduce transition plans or TCFD and ISSB

[1] https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Disclosure-Framework.pdf
[2] https://transitiontaskforce.net/wp-content/uploads/2022/11/TPT-Implementation-Guidance-1.pdf
[3] https://www.admin.ch/gov/en/start/documentation/media-releases.msg-id-91859.html
[4] https://www.mas.gov.sg/news/media-releases/2023/mas-to-set-expectations-on-credible-transition-planning-by-financial-institutions
[5] https://www.ifrs.org/content/dam/ifrs/publications/pdf-standards-issb/english/2023/issued/part-a/issb-2023-a-ifrs-s2-climate-related-disclosures.pdf?bypass=on

implementation. This creates additional challenges where financial institutions are taking a global approach and implementing group-wide transition plans rather than entity specific plans.

Challenges for global decarbonisation efforts

It is also important to note that, given the different transition pathways of each jurisdiction, transition plans developed according to the EU rules might not be compatible with those developed according to third country frameworks. For example, the EU has set a target of reducing greenhouse gas (GHG) emissions by at least 55% below 1990 levels by 2030, and is currently considering the emissions reduction target for 2040. However, other jurisdictions might have different trajectories to achieve net zero emissions by 2050. The United States, for instance, set the target of reducing GHG emissions 50-52% below 2005 levels by 2030, while Switzerland has a 50% target below 1990 levels by 2030. The UK, on the other hand, aims to reduce emissions by 68% below 1990 levels by 2030. Japan aims to reduce its emissions by 46% below 2013 levels by 2030.

Overlapping and potentially conflicting requirements will make it more difficult for third country financial institutions to develop a coherent and consistent plan to align their businesses, portfolio and operations with a net zero economy, undermining the overall decarbonisation effort.

Most importantly, applying EU-based transition plan requirements to financial institutions' global operations could inadvertently create challenges for global decarbonisation efforts, both through impacts on developing countries and impacts on clean energy supply chain financing and investment. Given the urgent need to provide enormous amounts of financing for developing economy transition, it will be important to ensure that EU transition plan requirements do not undercut global efforts to finance the transition in developing economies. For example, transition plans developed according to EU rules may create challenges in providing financing for developing economies with different transition pathways. As another example, clean energy supply chains are global, and applying EU-based transition plan requirements globally could impact the ability of financial institutions to provide much-needed finance for clean energy supply chains in APAC jurisdictions with different net zero pathways (e.g. China has set a goal of achieving net zero by 2060).

Policy asks

We invite the European Commission and the co-legislators to **recognise that net-zero transition planning is a group level consolidated activity informing business strategy**, which financial institutions use to ensure their business model and operations align with the transition to a net-zero economy. The key aspects of a transition plan for financial institutions, e.g. governance frameworks, engagement and stewardship with clients and investee companies, interim targets setting, are normally set as part of an organisation's net-zero transition strategy at group level and implemented throughout the subsidiaries of the group. Prescriptive requirements to introduce transition plans at the subsidiary level in the EU, as in the proposed CRD VI, might therefore interfere with the ability of an international financial institution headquartered outside the EU to implement a group-wide transition plan, which could be subject to home country regulations and the need to align with a home country's decarbonisation pathway.

Applying prescriptive EU-based requirements to third-country financial institutions' global transition plans also could have serious implications for global decarbonisation efforts, both through impacts on developing countries and impacts on clean energy supply chain financing and investment. Specifically, we would like to offer the following policy recommendations:

- **CRD VI:** The European Commission and the co-legislators should highlight the aforementioned issues with the ECB and the EBA in the context of the CRD VI and the mandate given to the EBA to develop guidelines specifying the content of transitions plans. Firstly, the **EBA should**

guarantee enough flexibility for the subsidiary level transition plan to fit into the overall group-wide transition plan. Secondly, the **supervision of transition plans implemented by the EU subsidiaries of third country financial institutions should reflect deference to group-wide transition plans, including the supervision of those plans by third countries authorities.**

- **CSDDD**: Given the potentially serious implications of imposing EU transition plan requirements at a global level, we believe the **Commission should limit the specifications of such plans to the information included in the draft ESRS E1-1** (which contains the information that must be disclosed as part of the new Accounting Directive disclosure obligations introduced by the CSRD, *if* the relevant entity has a transition plan in place).

- **Industry standards:** We would like to highlight that transition planning is, at present, a voluntary market-led process and that extensive work has already been conducted across the financial industry, in particular within groups like GFANZ, NZAM and NZBA. The bar for an effective transition plan is continually being raised as industry approaches evolve and mature. Prescriptive specifications of the characteristics of transition plans risk constraining financial institutions' global business strategy and ability to support the transition in other jurisdictions. Instead, **we invite the European Commission to monitor the development of these market-led frameworks and potentially provide recognition as they evolve.**

- **International cooperation**: Since other jurisdictions are currently discussing mandatory requirements to introduce transition plans, the **European Commission should discuss with international partners how to ensure compatibility between different obligations to avoid conflicting requirements**, which could be detrimental to the overall decarbonisation efforts. In this respect we welcome the Financial Stability Board (FSB) and IOSCO's decisions to set up dedicated workstreams on transition plans under their respective leadership, which will hopefully support a consistent and inter-operable approach to transition planning across jurisdictions[6]. The end goal should be achieving mutual recognition with other major jurisdictions' frameworks and developing frameworks that support rather than inadvertently create challenges for the global transition. International financial institutions play an important role within an interconnected global system where the action of one group will be greatly amplified if aligned with others.

[6] https://fwww.fsb.org/wp-content/uploads/P130723.pdf