

PRUDENTIAL TRANSITION PLANS AND SCENARIOS



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Financing the green transition of the economy
FRDO Conference Brussels

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AGENDA

1. Introduction

2. Banks transition plans

Banks are in early stages of transition planning

3. Scenarios and target setting

Need to justify choice of benchmark scenario and target setting methodology

4. Supervisory role

Supervisor should assess credibility of transition plans

INTRODUCTION

- Transition plan: Setting **targets** and defining **actions**
- CSRD, CSDDD
- CRD prudential transition plan and EBA guidelines

TRANSITION PLANS FOR DIFFERENT PURPOSES

Table 1 Categories of transition plan use cases

| Actor requiring transition plans | Government | Corporate | | Financial Regulator | |
|--|--|--|---|---|--|
| Regulatory objective | Climate outcomes (e.g., Paris Agreement) | N/A | Market conduct / consumer protection | Financial Stability | Safety and Soundness of financial institutions |
| What is the primary objective of the transition plan? | Achieve national climate outcomes through corporate action | Inform shareholders and investors of a corporate's strategy in response to climate change and transition | Provide transparency to market actors e.g., maintain market integrity, prevent financial misconduct and/or greenwashing | Effective management of aggregate climate-related financial risks (externalities and systemic vulnerabilities) | Effective management of climate-related financial risks (institution level) |
| What is the primary tool to achieve that purpose? | Disclosure of strategy to meet climate targets | Disclosure of strategy to meet climate targets | Disclosure of strategy to meet climate targets | Aggregate report on the potential build-up of climate-related risks in the financial system | Report to micro-prudential authority on how the institution will manage climate related risks associated with corporate strategy |
| Who is the primary audience? | Public | Shareholders and investors | Market participants, consumers | Macro-prudential authorities | Micro-prudential authorities |
| Is the information publicly available? | Yes | Yes | Yes | Jurisdiction-specific decision to determine whether it needs to make the information public to meet regulatory objectives | Jurisdiction-specific decision to determine whether it needs to make the information public to meet regulatory objectives |

Focus of today

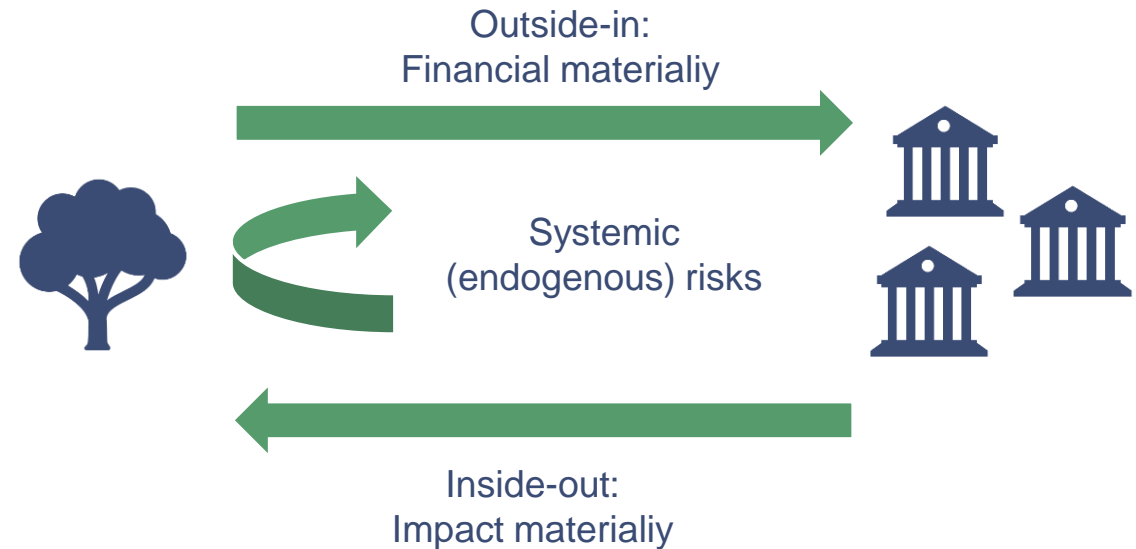
More Strategy Focused
Broader scope in content and application
Publicly available disclosure

More Risk Management Focused
Narrower scope in content and application
Not necessarily publicly disclosed

Source: [NGFS 2023](#)

DOUBLE MATERIALITY APPROACH TO PRUDENTIAL TRANSITION PLANS

- Alignment assessment is a method for quantifying transition risks
- Provides opportunity to deal with physical systemic risks (endogenous)
- An orderly transition is the best outcome for financial stability





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2. STATUS OF BANKS TRANSITION PLAN

STATUS OF BANKS TRANSITION PLANS



Banks remain largely not aligned with the goals of the Paris Agreement

However, there are notable regional differences.

Average score of banks on the Net Zero Banking Assessment Framework (NZBAF)

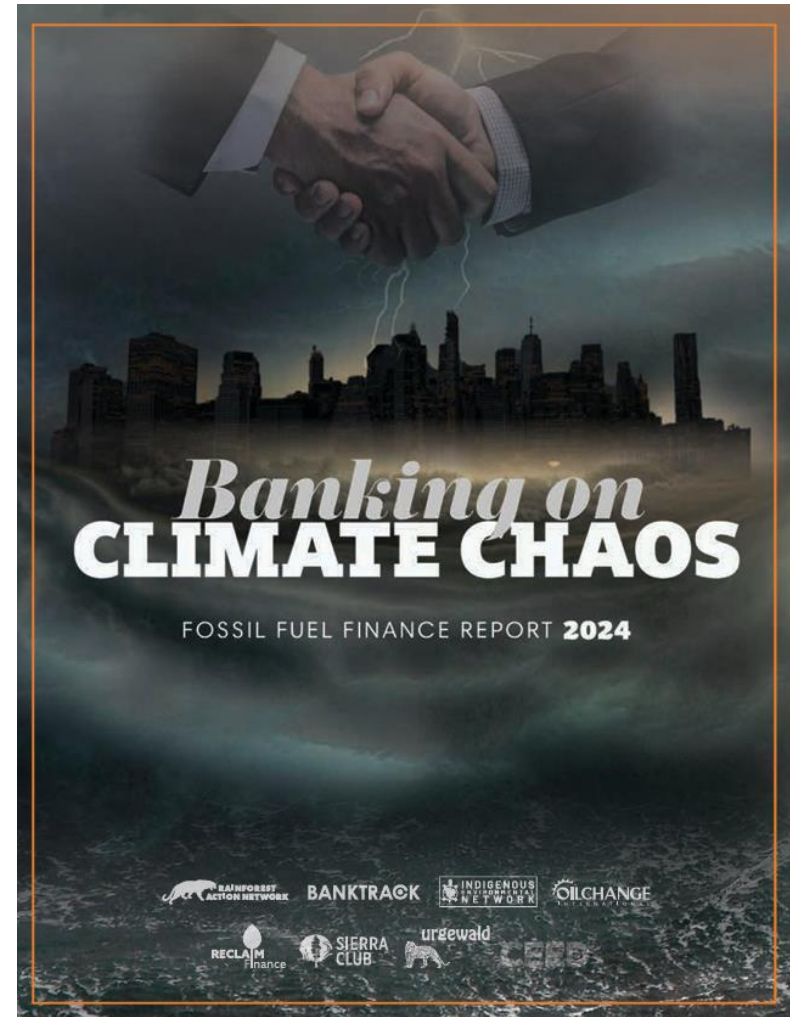


Source: [Transition Pathway Initiative](#)

STATUS OF BANKS TRANSITION PLANS

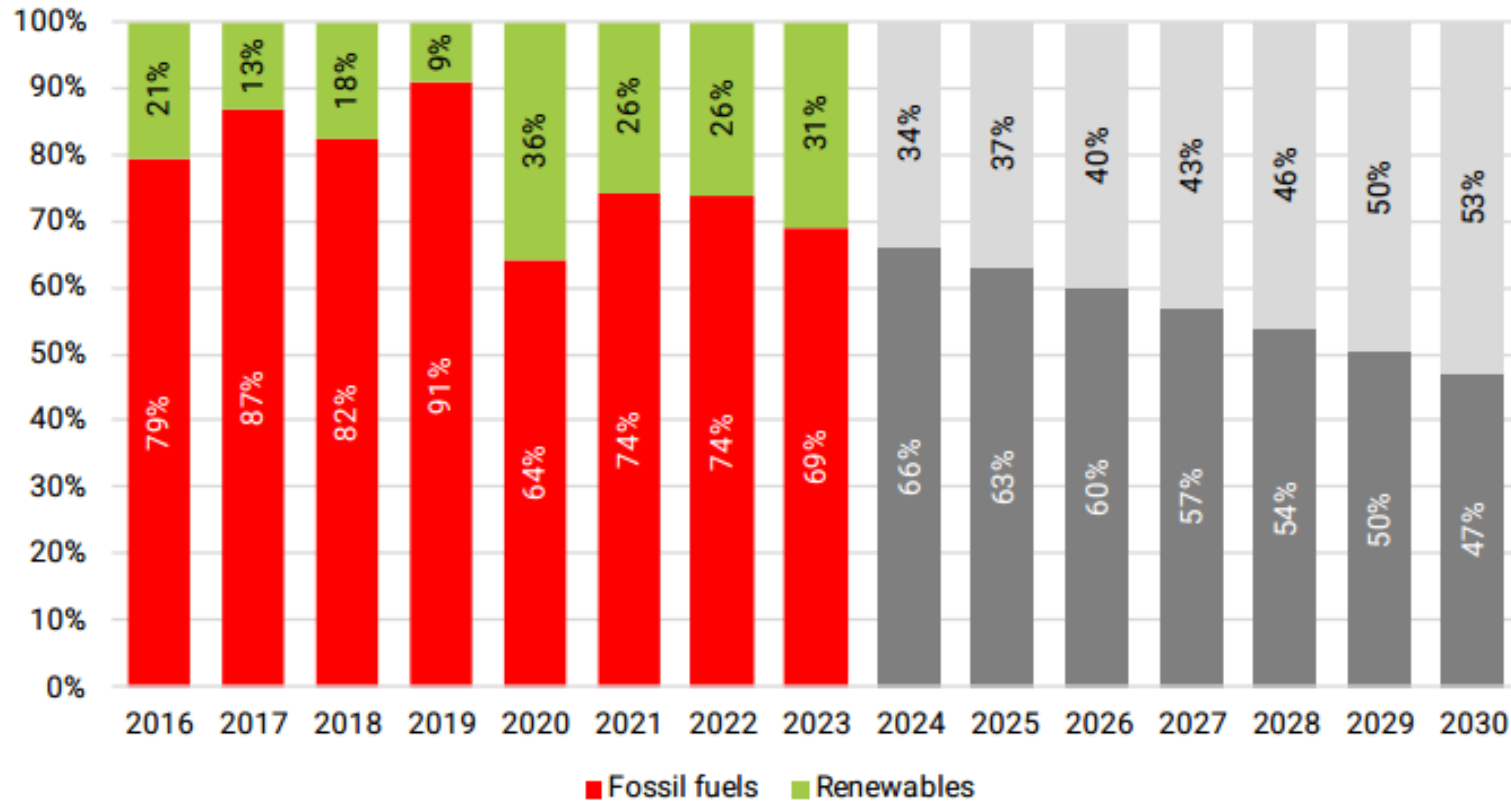
Banks worldwide have issued \$7 trillion in loans to fossil-fuel companies since the Paris Agreement

[Banking on Climate Chaos](#)



STATUS OF BANKS TRANSITION PLANS

Figure 2 Banks' proportions of loans and underwriting by energy source (2016–2023, forecast 2024–2030)



Source: [Financiële sector: meer dan 80% van investeringen in energiesector nog altijd naar fossiel | www.eerlijkegeldwijzer.nl](https://www.eerlijkegeldwijzer.nl)

STATUS OF BANKS TRANSITION PLANS

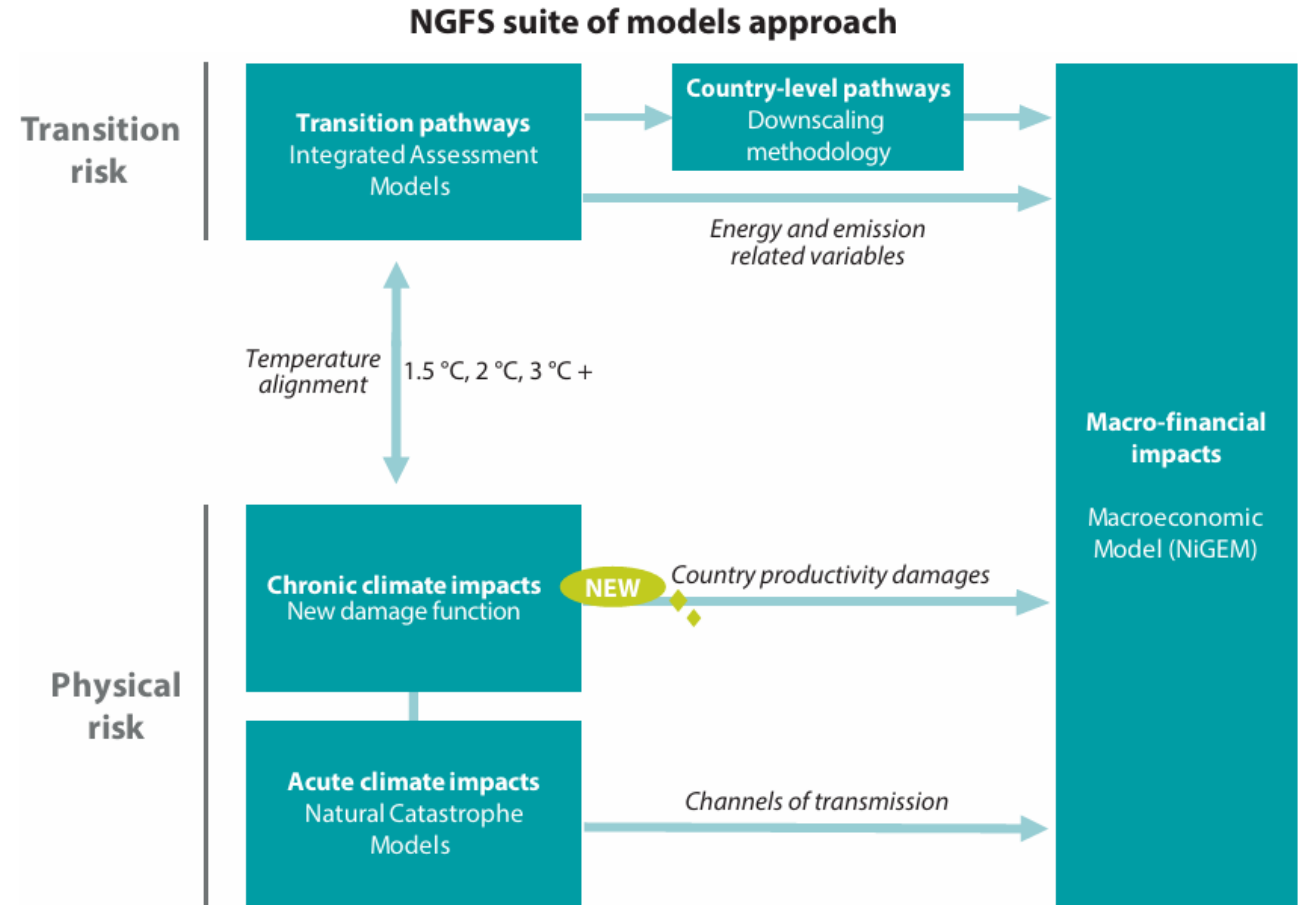
“The euro area **banking sector shows substantial misalignment** and may therefore be subject to increased transition risks, and around 70% of banks are also subject to elevated reputational and litigation risk.” - [ECB 2024](#)

“Our analyses shows that the action plans **vary widely in terms of content and design**, which complicates their comparability” - [DNB, 2024](#)

3. SCENARIOS AND TARGET SETTING

CLIMATE SCENARIOS

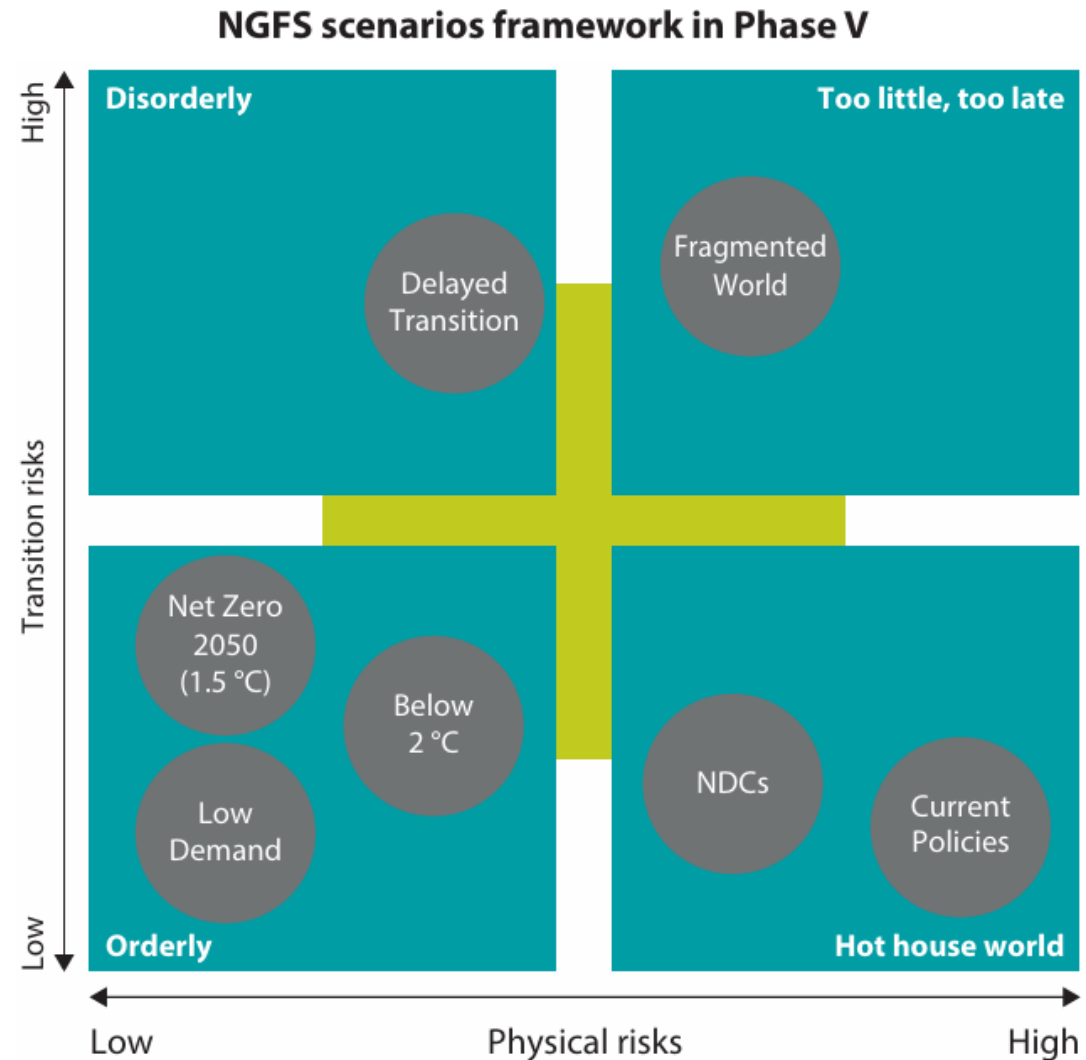
Modelling global warming, and our society's reaction to it, to assess physical and transition risks under a range of possible future scenarios is hugely complex
- The Emperors new climate scenarios



CLIMATE SCENARIOS

Use of scenarios:

- **Set targets in transition plans**
(benchmark scenario)
- Test the resilience of banks to climate transition or physical risks

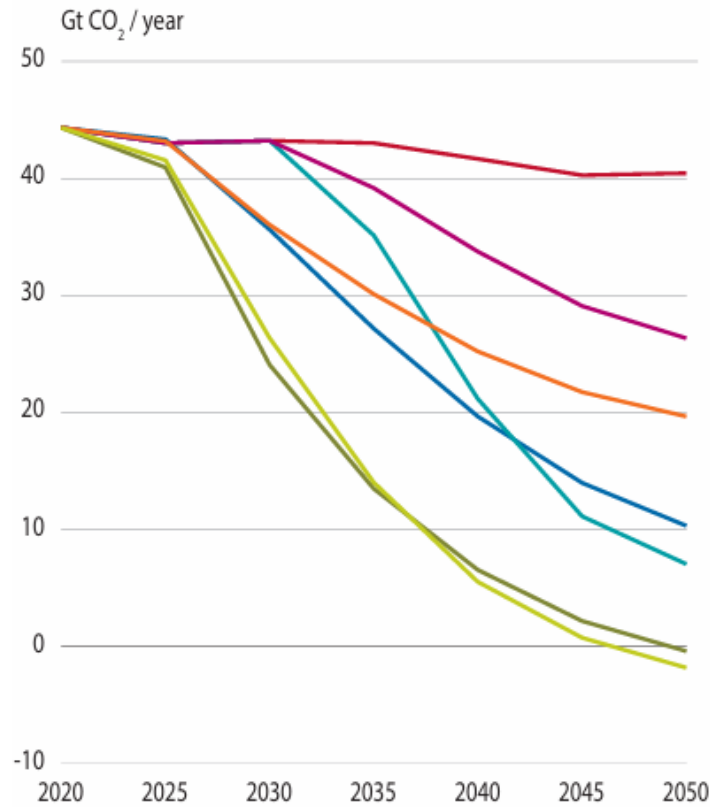


Source:
[NGFS](#)

CLIMATE SCENARIOS

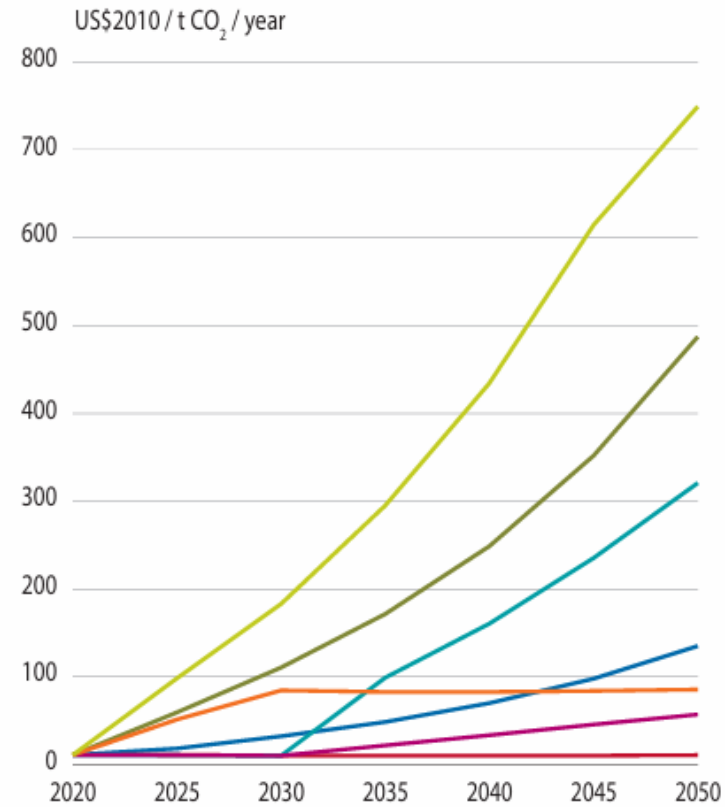
Global Yearly CO₂ Emissions

REMIND



Shadow Carbon Price

REMIND



— Delayed Transition
 — Fragmented World
 — Current Policies
 — NDCs
 — Net Zero 2050
 — Below 2 °C
 — Low Demand

TARGET SETTING

Target setting:

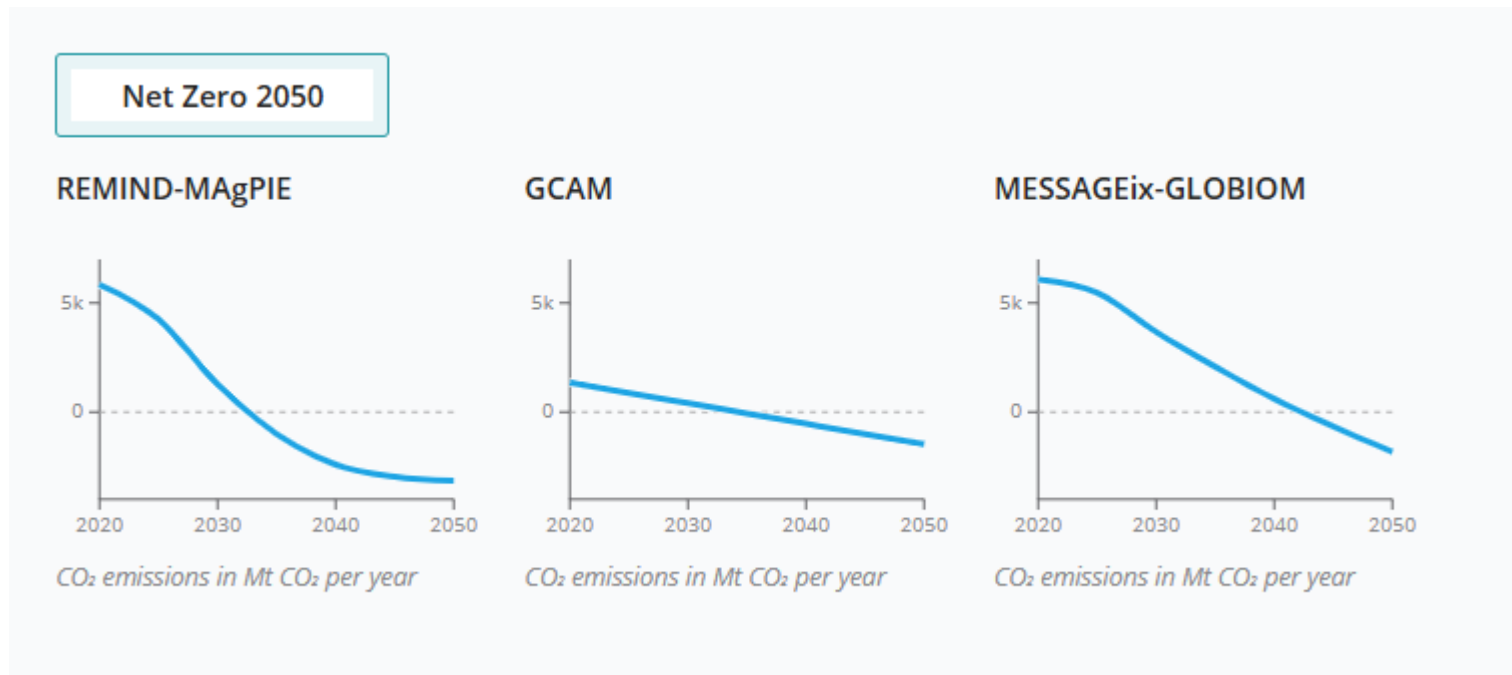
- Combination of **benchmark scenario, target metric** and **alignment methodology**
- Sensitive to the choice and characteristics of such methodologies and scenarios
- Need for a common language between climate policy makers, climate scenario providers, climate-related assessment methodology providers and financial market stakeholders

BENCHMARK SCENARIOS

- Transition scenarios model different climate policy choices e.g. in energy use, land use and GHG emissions
- Modelling of different sectors
- IEA NZE scenario mostly used and recommended by EBA

BENCHMARK SCENARIOS

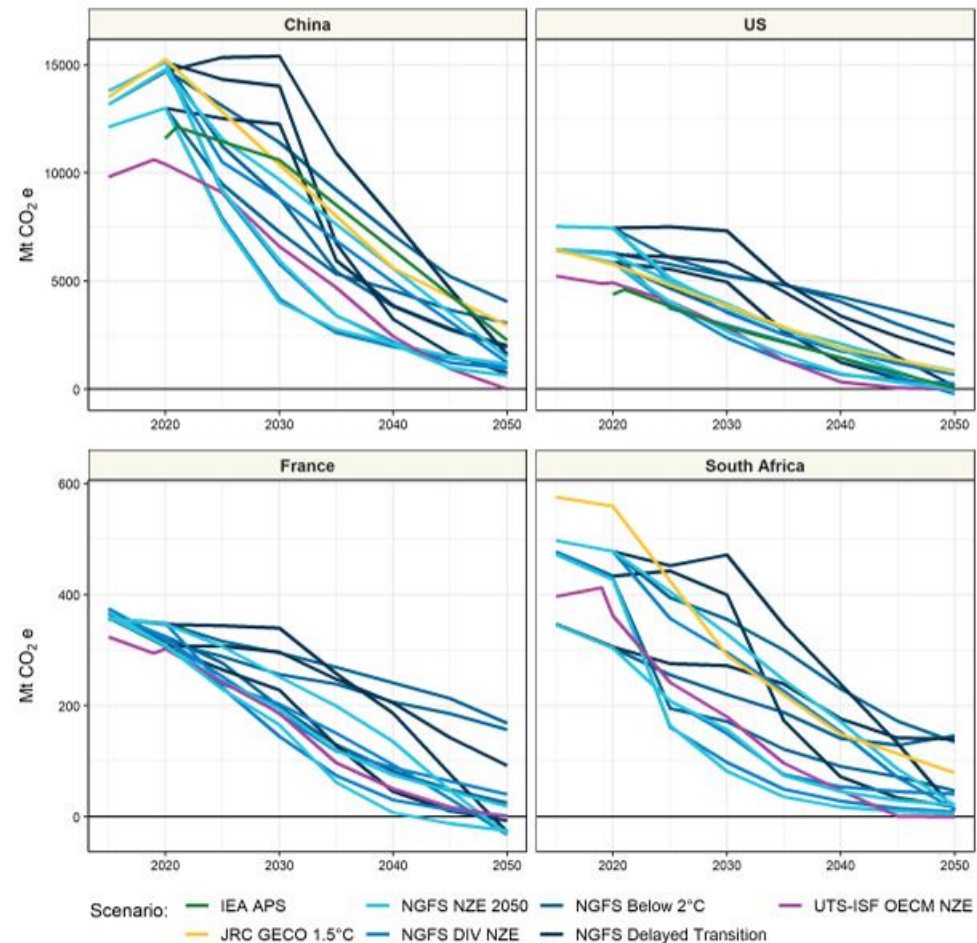
Outcomes are sensitive to the underlying assumptions and models:



[NGFS Scenarios Portal](#)

BENCHMARK SCENARIOS – GEOGRAPHICAL GRANULARITY

Figure 4.4. Geographically granular GHG emissions pathways for China, France, South Africa, US



Source: [OECD, 2023](#)

BENCHMARK SCENARIOS

Considerations

- **Alignment with Paris:** overshoot risks or outdated scenarios
- **Coverage** of GHG emissions and emissions sources
- Sector and geographical **granularity**
- Socioeconomic, technological and political **assumptions**
- **Mitigating strategies** e.g. reliance on carbon dioxide removal or limited demand side reductions
- **Use of scenarios:** mix and benchmark year

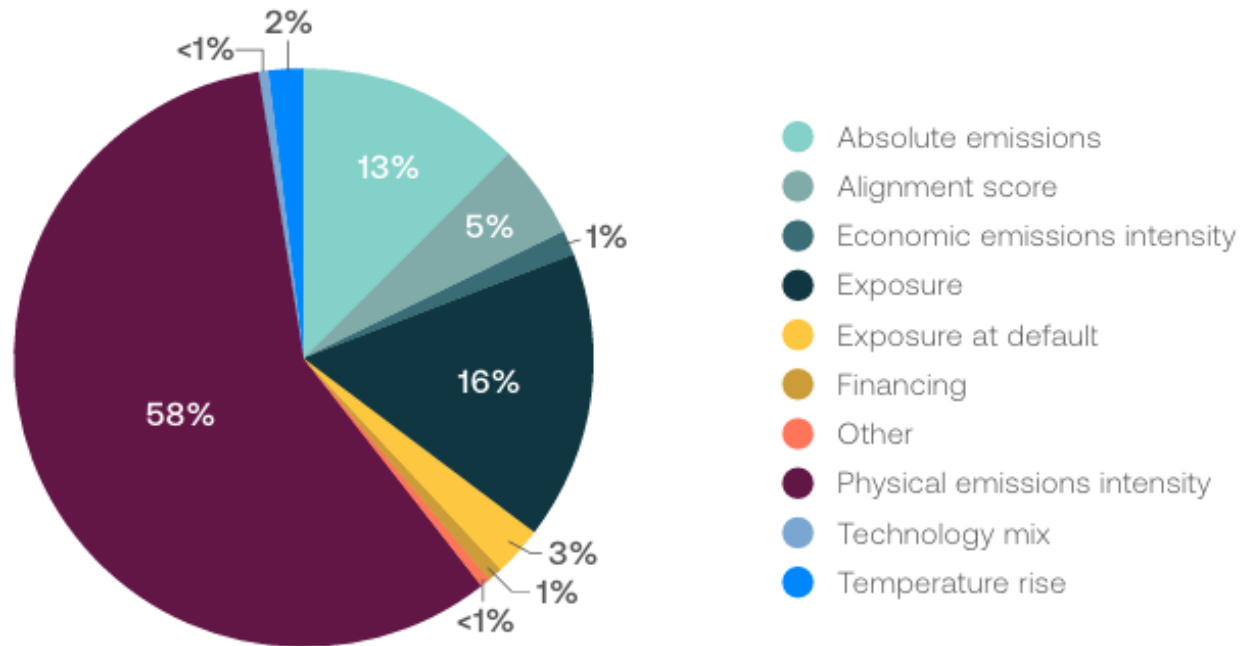
BENCHMARK SCENARIOS

Conclusions:

- Need for **justification of methodology**
- Understanding and disclosure of **underlying assumptions and limitations**
- Knowledge on **real economy transition**
- **Sensitivity analysis** on different scenarios
- Relying on **more than one scenario**

TARGET METRICS

Decarbonisation target metrics



Absolute metrics:
the total amount of GHG emissions emitted over a specific period

Intensity metrics: the amount of greenhouse gas emissions per unit of some activity or output.

Source: ShareAction analysis of the climate targets published by the 20 largest listed European banks.

4. SUPERVISORY ROLE

SUPERVISORY PROCESS UNDER DISCUSSION

“(…) As a result, validating a financial institution’s climate objectives and related target setting activities, such as setting GHG emission reduction targets, is generally outside micro-prudential mandates.”

“That said, the NGFS recognizes the need to discuss the relevance of climate-related target setting to the micro prudential perspective.”

NGFS, 2024

SUPERVISORY ROLES

| Maturity in supervisory roles | Focus |
|--|--|
| Assess climate risks: Assessing climate risks practices without considering transition plans | Financial materiality Micro perspective |
| Use transition plans to assess risk management: Assessing actions with respect to risk management: e.g. governance, engagement, actions | Financial materiality Micro perspective |
| Assess risk management + require targets: Requiring banks to set decarbonisation targets and to use them for risk management, but not to validate | Double materiality Micro perspective |
| Assess credibility: Requiring banks to set decarbonisation targets and to validate targets and actions | Double materiality Micro perspective |
| Steering: Validate transition plan on credibility and 'punish' for misalignment | Double materiality Macro perspective |

Using protentional of transition plans for risk management supervision

Acknowledging systemic/endogenous risks

Acknowledging complexity of the methods and the limitations to quantification

Acknowledging coordination problem and the need for orderly transition (for financial stability)

CONCLUSION

Conclusion

- Banks are in the early stages of transition planning and not on track to meet Paris goals
- Target setting comes with complexities

For banks

- Improve the plans and substantiate methodological choices
- Accept that methodologies are not perfect and define actions to reduce emissions as soon as possible

For supervisors

- Build capacity and assess the credibility of both targets and actions
- Consider additional measures to speed up the transition

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