OECD Roundtable on High-Level Principles for Transition Finance

8 November 2021 | OECD COP26 Virtual Pavilion

SUMMARY RECORD

KEY TAKEAWAYS

On 8 November 2021, the OECD hosted the **Roundtable on OECD High-Level Principles for Transition Finance**, as part of the OECD COP26 Virtual Pavilion. The event, held under the Chatham House Rule, convened over 60 senior representatives from ministries of finance and the environment, banks, financial regulators and other key stakeholders. The Roundtable aimed to provide a platform to: (i) **build shared understanding** on the principal commonalities and divergences across emerging transition finance approaches; (ii) exchange views on the **implications of these differences and potential options for bridging them** where appropriate; and (iii) initiate discussions on the **possible scope and key elements** of the proposed OECD High-Level Principles.

Key takeaways from the discussion include the following:

- Some participants noted that transition commitments by market participants seeking to borrow transition finance should align with the temperature goal of the Paris Agreement. Some further underscored that **alignment with Nationally Determined Contributions (NDCs) might not be deemed sufficient.**
- Participants highlighted that transition finance approaches (taxonomies, regulations and other sets of principles and standards) **should be tailored to each country's domestic context and starting point.** Some noted that such approaches can integrate the "do no significant harm" principle.
- A successful global transition will require **more effective coordination and collaboration** across ministries and public authorities as well as with relevant private stakeholders.
- Corporate **net-zero pledges, transition plans and targets should be science-based, measurable and time-bound**. Progress should be frequently reported and independently reviewed.
- Sector-specific pathways, targets and technical roadmaps are key to an orderly transition. **Dynamic and forward-looking corporate disclosure based on scenario analysis** should be promoted across short, medium and long-term time horizons.

- Transition finance needs to go beyond debt. In particular, **equity investments will be needed** to support the transition.
- Future efforts should focus on **improving consistency and fostering inter-operability** of different frameworks and approaches.
- The **social implications of the transition should be carefully assessed and mitigated**. There is a need for an inclusive social dialogue to anticipate impacts of the transition on employment and to develop and provide adequate support measures.

SUMMARY OF DISCUSSIONS

Part I: Issue 1 - Aligning with the Paris Agreement

Transition finance normative approaches and taxonomies can be useful tools for signposting, and can provide clarity for and facilitate target setting by market participants. Many approaches attempt to strike a balance between ensuring transition activities contribute to achieving the temperature goal of the Paris Agreement and accommodating different national and regional circumstances. Several approaches reflect the multi-dimensional 'do no significant harm' principle, first adopted by the EU Taxonomy. While some participants shared the understanding that transition activities/sectors are those that currently lack a technologically *and* economically viable green substitute, others noted that technological feasibility is the main factor to consider when determining eligibility of activities for transition finance.

Several participants stressed the need for companies seeking transition finance to have entity-level transition commitments, supported by a credible plan on how they intend to meet such commitments in a time-bound manner. Views varied on whether alignment with Nationally Determined Contributions (NDCs) is deemed sufficient to exhibit alignment with the temperature goal of the Paris Agreement, as in most cases NDCs lack the required ambition.[1] Moreover, significant divergence exists across NDCs and net-zero pledges in terms of scope, timelines, sectorial plans and targets. Another important consideration underscored by participants was the need to avoid locking-in emission-intensive activities.

Participants highlighted the importance of dynamic and forward-looking disclosure, accompanied by a robust verification process. The availability of credible and verified information will provide clarity, enhance market transparency and build market confidence.

Participants also emphasised that the low-emissions transition should be inclusive, orderly and just. As sectors with high GHG emissions gradually shift towards lower emissions technologies and/or business models, some assets will become stranded and jobs will be lost. It is therefore critical to factor in the social implications of the transition by fostering an inclusive social dialogue. Concerns about the capacity of SMEs to remain competitive and resilient throughout the transition were also highlighted. Given that the low-

[1] Recent IEA analysis taking into account all net zero emissions pledges made by governments as of 3 November 2021, as well as other commitments made at COP26, estimates that if they are met in full and on time, they would have the effect of holding the rise in global temperatures to 1.8 °C by the end of the century. https://www.iea.org/commentaries/cop26-climate-pledges-could-help-limit-global-warming-to-1-8-c-but-implementing-them-will-be-the-key

emissions transition spans multiple sectors and has economic, environmental and social ramifications, it is important to ensure effective coordination and collaboration across ministries and public authorities as well as with relevant stakeholder groups.

Part I: Issue 2 - Designing transition trajectories

Participants highlighted the importance of science-based transition finance strategies to ensure credibility. Some participants emphasised that corporate net-zero pledges should be underpinned by scientific evidence, be aligned with the temperature goal of the Paris Agreement and follow global sector-specific pathways. However, some sectors still lack precise guidance for decarbonisation, e.g. oil and gas. Efforts are underway to develop sector-specific guidance and criteria, and to update scoring methodologies to include an assessment of proposed OPEX and CAPEX against transition plans and commitments.

With respect to sector-specific criteria, an important challenge is the limited regional and country-level granularity of climate scenarios and global pathways currently available. While it is important for corporates' pledges to be consistent with country-level goals, national climate policy objectives are typically not specific enough for corporates to align with, as these objectives often lack sector and/or sub-sector targets. It is therefore important to have national sector-specific transition pathways (for instance the industry roadmaps being developed by the Government of Japan), taking into account the dynamic nature of GHG emission pathways. Transition finance approaches should seek to ensure coherence between policy makers' and investors'/corporates' commitments and plans.

Some participants also discussed the key role that banks and other financial institutions can play by engaging with their clients. Some banks are beginning to demand auditable corporate net-zero pledges and plans concerning structural decarbonisation. Corporate plans may take orientation from Glasgow Financial Alliance for Net Zero (GFANZ)'s guidance, Race to Zero's criteria and Race to Zero Partners' initiatives. Some participants highlighted that credible transition plans should have minimum reliance on offsets. Alongside SASB Standards and those to be developed by the International Sustainability Standards Board (ISSB), the TCFD Guidance on Metrics, Targets, and Transition Plans is considered a key reference.

Some participants stressed that the debt market alone will not be sufficient to mobilise enough capital for the low-carbon transition – equity investments will be needed. In particular, private equity and venture capital could play a much bigger role, e.g. to finance breakthrough low-emissions innovations. Greater use of hybrid instruments such as convertible bonds combining features of sustainability-linked instruments also could be considered.

In light of the urgency of the transition, developed countries and multilateral institutions have a key role to play in supporting emerging economies and developing countries and mobilising capital for the low-carbon transition. This includes support for developing science-based green and transition finance taxonomies and other normative and regulatory approaches.

Part I: Issue 3 - Managing geographical variability and avoiding path dependency

Participants agreed on the need for inter-operability of different frameworks and definitions across jurisdictions, taking into account divergences in starting points and pathways. Efforts to foster inter-operability should consider the needs of developing countries, which differ significantly from those of developed countries.

There was broad acknowledgement of the challenges corporates face in developing transition pathways that are aligned with national transition plans. Corporate transition strategies could take national transition plans as a starting point while striving to raise ambition. There are a few interesting examples of green bond issuances by listed companies with criteria more stringent than those prescribed by the EU taxonomy.

It is also important that net-zero commitments and goals be measurable. Ensuring measurability will require standardisation, transparency and frequent disclosure that takes into account the rapidly evolving nature of the transition. Corporates should disclose multi-annual transition plans, OPEX and CAPEX financed to advance specific targets of the transition strategy, as well as associated governance and assurance mechanisms.

Part II: Discussion and brainstorming on key elements and considerations to incorporate in the OECD High-Level Principles for Transition Finance

Part 2 of the Roundtable gathered a variety of views and perspectives on the key elements and considerations to consider in the development of the OECD High Level Principles for Transition Finance. It is envisioned that the Principles will be developed to allow different transition finance approaches to co-exist and "speak to each other", by providing a common framework and shared understanding. They will seek to facilitate inter-operability among different approaches and drive transparency and convergence in the transition finance market to avoid 'transition-washing' and market fragmentation. The Principles will seek to address international priorities (e.g. those of the G20 Sustainable Finance Working Group) relating to transition finance and will complement existing efforts and initiatives in this field.

Taxonomies are one of the most common forms of transition finance approaches. However, while some taxonomies include transition-related components, they do not focus on such key factors as entity-wide transformation and sector-specific technical pathways. Disclosure frameworks in their current form also have drawbacks as a means for supporting transition, as disclosure requirements differ across several dimensions, such as nature of disclosure (static vs dynamic), level of reporting (corporate-level, project-level, etc), among others. It may prove difficult or impossible to develop a universal taxonomy/transition finance approach. Instead, efforts should focus on improving consistency, for instance by adopting a building blocks approach that takes into account the diversity in development process, pathways and timelines among countries.

Comprehensive approaches are starting to emerge to assess the alignment of financial institutions' portfolios with the objectives of the Paris Agreements, using forward-looking metrics measuring current and projected emissions performance along a pre-specified trajectory. Several methods exist to guide portfolio alignment with climate scenarios and assess potential temperature rise associated with GHG emissions of a given company or portfolio. Roadmaps on how each sector can achieve carbon neutrality are needed. These should be frequently revised and updated to reflect new developments.

Better incentives should be provided by governments, regulators and sectorial authorities to facilitate access to resources to enable a just low-emissions transition and develop robust markets for transition finance.

BACKGROUND

Successfully delivering the Paris Agreement requires a plurality of approaches to decarbonisation, and efforts not only to upscale industries and activities that are near-zero or low-emissions, but also to support emission reduction efforts in high-emitting and hard-to-abate sectors. The OECD Working Paper *Transition finance: Investigating the state of play* takes stock of approaches and instruments pertaining to transition finance emerging at the national, regional and industry levels. Building on this stock-take, as well as other initiatives on transition finance, the OECD aims to design OECD High-Level Principles to facilitate inter-operability among different approaches and help drive transparency and convergence in the market.

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