T20 Policy Brief

Task Force 03

REFORMING THE INTERNATIONAL FINANCIAL ARCHITECTURE

Transition Plans: Putting The G20 Principles into Practice

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TF03

Abstract

This policy brief urges central banks, financial regulators and supervisors and international standard-setters to play a (more) active role in supporting the G20's agenda on transition finance. In fact, the G20 has recognised the importance of transition finance to achieve the Paris Agreement and SDGs, adopting a principles-based approach.

Acknowledging that transition plans and planning are essential for all economic system participants - from national states to financial institutions to corporates - this policy brief focuses on financial institutions, central banks and financial supervisors as preparers and users of transition plans. The last two should 'lead by example' and become preparers of their own transition plans by incorporating climate- and nature risks into their own objectives and strategies and set clear expectations for financial institutions. It also urges the G20 to mandate the FSB and all international standard setters to foster convergence and interoperability.

Keywords: Climate And Nature-Related Risks; Transition Finance; Transition Plans; Science-Based Targets; Central Banking; Financial Supervision

Diagnosis of the Issue

The G20 has recognised the importance of transition finance to achieve the Paris Agreement and SDGs, adopting a principles-based approach (G20, 2020,7). In 2022, the G20 has also adopted a transition finance framework (G20, 2022, 26-40), which identified 22 principles across 5 pillars and highlights the importance of disclosure of information on transition activities and investments and the need for companies and financial institutions to *"disclose current transition plans featuring credible, science-based interim and long-term goals with timelines*" (pillar 2, principle 8). It also highlights the need to "*...encourage fundraisers to evaluate and mitigate the potential socioeconomic impacts of their transition plans and to disclose mitigation measures or net positive impacts*" (pillar 3, principle 14). More recently, the G20 has also reaffirmed the need to "*advanc[e] credible, robust and just transition plans*" (G20, 2024, 7-8).

Momentum around transition planning and transition plan disclosures as key tools for transition finance has grown among international standard-setters, which have set up working groups or published on this topic, including central banks, financial regulators and supervisors under the Network for Greening the Financial System (NGFS 2023, 26-33). More recently the NGFS conducted a deep-dive, which concluded that "*policy makers could consider co-ordinated global guidance that can be adapted for country-specific context to support the implementation of transition planning and transition plans across jurisdictions" (NGFS 2024, 18-21).* The Basel Committee is also seeking to address climate-related financial risks to the global banking system (BCBS, 2024, 1-2) by exploring whether (and how) banks should disclose information regarding their strategy for reducing and/or mitigating climate-related financial risks to which they are exposed, including through the disclosure of forward-looking quantitative metrics comprising forecasts and transition plans, where applicable. The Financial Stability Board (FSB) will also deepen its analysis of climate-related financial risks to financial stability and examine the relevance of transition plans for financial stability, reporting to the G20 on further progress on implementation of disclosures and reporting in line with international standards, in coordination with the International Sustainability Standards Board (ISSB), the International Organization of Securities Commissions (IOSCO) and others in November 2024 (FSB 2024, 3).

In addition, many G20 jurisdictions (including the UK, the European Union and the USA) have issued guidance or are in the process of adopting requirements at the national and/or regional level including sector-focussed strategies or data priorities (Kopp et al., 2024, 20-31), for a variety of constituents. In parallel, the G20's Data Gap Initiative has identified forward-looking physical and transition risk indicators related to climate change as one of 14 critical data gaps that impede G20 jurisdictions ability to develop economic and financial policies to address climate change, financial innovation and inclusive growth (G20 2023, 10-11).

Last but not least, more than 200 governments – including almost all G20 members – have committed to fully integrate biodiversity into policies, regulations across all levels of government (CBD 2022, 11 - target 15) and to take legal, administrative or policy measures to encourage and enable companies and financial institutions to regularly monitor, assess, and transparently disclose their risks, dependencies and impacts on biodiversity (CBD 2022, 11 - target 14).

These national and regional efforts underway could and should be underpinned by a common and coherent set of standards, rules and regulations within the financial system to enhance stability, sustainability, and equity on a global scale, which are currently being considered as part of a broader overhaul of the international financial architecture discussed within Taskforce 03 (TF03) under the Brazilian Presidency.

However, recent data compiled by WWF (WWF 2023a, 88-92) shows that many gaps remain across G20 jurisdictions (see Figure 1 below). In particular, implementation of macro- and micro prudential supervision of the banking sector proves challenging.

FIGURE 1. Banking supervision, central banking and enabling environment for transition plans in the G20 countries*

Indicators fulfilment per category in G20 countries (as of July 2023)[1]

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[1] **Note:** Criteria related to transition plans and forward-looking targets are included, among others in many areas of the SUSREG assessment framework across a broad range of key performance indicators for banking supervision, and central banking activities and to assess the enabling environment. The number displayed in the table represents the average result for climate and environmental assessment, excluding social assessment. In cases where an indicator is divided between climate and environment and/or between investment and underwriting. The results were given equal weight. Partially met criteria allow for a 50%, while fully met criteria result in a 100% fulfilment. For central banking criteria 2.2.3, only climate and environment. The social criteria were not taken into account.

SUSREG assesses the maturity of supervisory expectation in using various tools and measures to ensure both the safety and soundness of individual banks, (re)insurance companies and the financial system stability, with regards to climate, environmental, and social risks. It also includes measures that regulators and supervisors themselves can take to show leadership and better understand these risks and their implications for the financial sector (see methodological supplement and examples in the summary table in Appendix (WWF 2023b, 12-87; 95-105;106-112).

Key findings from WWF's research include:

- Banking supervisors across almost all G20 countries are starting to require banks to set climate science-based targets to a certain extent. However, there are significant differences in the way central banks and supervisors publish official environmental, social and governance (ESG) strategies or roadmaps outlining science-based transition plans with associated measures for contributing to a net-zero and nature-positive financial sector, in line with their mandates.
- Significant shortfalls remain with respect to standards on how financial and non-financial companies are required to publish science-based transition plans.

Moreover, other authors have highlighted that there is a serious gap in the conceptualisation and reporting of ambitious, credible, and feasible corporate climate transition plans so as to ensure 'interoperability' across jurisdictions (Colesanti et al, 2024,8) and have offered guidance (WWF 2022a, 2-4; OECD 2022, 60-81; Kopp et al. 2024, 20-41)

As a result urgent coordinated action is needed at G20 level to strategically ensure consistency and clarity across jurisdictions and preparer category or use case, including regulatory, so as to prevent risks of fragmentation and arbitrage, thus increasing the risk of a disorderly transition.

An essential starting point is to create consensus around what a robust transition plan looks like (Ryan, 2023).

Recommendations

Strengthening the resilience of the financial system to climate change and other environmental risks and supporting the transition to a sustainable economy is part of central banks' and financial supervisors' mandate

Deepening work on sustainability-related risks is a priority for the Brazilian G20 Presidency (FSB 2024,3), which has requested the FSB to present a stocktake on current or planned regulatory and supervisory initiatives related to the identification and assessment of nature-related financial risks at the G20 Finance Ministers and Central Bank governors meeting in July 2024 (FSB 2024,3). The FSB will also report on further progress on implementation of disclosures and reporting in line with international standards, in coordination with the International Sustainability Standards Board (ISSB), International Organization of Securities Commissions (IOSCO) and others in November 2024.

Strengthening the resilience of the financial system to climate change and other environmental risks and supporting the transition to a sustainable global economy is already at the core of central banks and financial supervisors' mandate (NGFS 2022,4). The ECB, for example, recently stated that the fact that "*climate and nature-related risks are a source of financial risk is established consensus among central banks and supervisors worldwide. This implies that accounting for climate and nature-related risks is squarely within our mandate*" (Elderson, 2024). Transition plans are a key tool for an orderly economy-wide transition and are increasingly receiving global attention from both international standard-setters and voluntary market-led initiatives.

Building on evidence provided in this policy brief, compiled by the NGFS (NGFS, 2024,18-21) and complementary evidence under preparation by the FSB (FSB 2024, 3), central banks and financial supervisors should take advantage of this growing momentum and publicly commit to managing climate- and nature-related risks strategically through transition planning.

What Central Bankers And Financial Supervisors And G20 Governments Could And Should Do To 'Put The G20 Principles On Transition Plans In Practice'

Central banks, financial supervisors and G20 governments could and should *'put the G20 principles on transition plans in practice'*. By 'walking the talk' and showing how transition plans can be operationalised as a lever for change they can contribute a great deal to promoting the interoperability of international standards for transition plans in four ways:

- **Recommendation #1: Set clear guidance and expectations for all supervised entities.** Central banks and financial supervisors across the G20 should:
    - require all regulated financial institutions to set and disclose credible transition plans with clear, quantifiable and time-bound climate and biodiversity goals for 2025, 2030, 2040, and 2050, covering all their business lines (investment, lending, and underwriting) (SBTI 2024).
    - engage clients and/or portfolio companies with clear expectations to set and disclose credible targets and transition plans and act on escalation processes in the event of no or insufficient action to achieve them.

- **Recommendation #2: Monitor and track implementation of transition plans.** Central banks and financial supervisors should also track the implementation of supervised entities' transition plans (see, for example: ECB 2024, 5-9) to ensure alignment of financial institutions with national transition plans, the Paris Agreement and Kunming Global Biodiversity Framework (CBD, 2022, 11).

- **Recommendation #3 - Lead by example**: Central banks and financial supervisors should themselves lead by example and provide the necessary clarity and forward guidance to financial market actors by publishing their own clear and detailed transition plans (with quantifiable climate and biodiversity goals for 2025, 2030, 2040, and 2050), covering all central banking, financial regulation, and supervision activities (WWF 2022a, 28-29). Forward-looking nature- and climate-related targets could provide two new nominal anchors alongside existing inflation targets, namely: the 1.5°C global warming ceiling which requires that greenhouse gas emissions are reduced to net zero by 2050, and a qualitative target of fully recovering and restoring biodiversity by 2050.

- **Recommendation #4 - Mandate the FSB and all international standard setters to foster convergence and interoperability of transition plans.** This should build on existing best practices, and the goal should be to establish a clear global baseline for transition plan disclosure, while taking due account or making space for potential emerging market and developing economies' (EMDE) concerns or specific circumstances, where applicable. G20 governments should also mandate the FSB and all international standard setters to reinforce the international financial regulatory framework to take into account climate and nature-related financial risks, so as to foster convergence and interoperability. The G20 should explicitly recognise that climate change and nature loss pose a threat to international financial stability and, as a result, take action to strengthen regulation and supervision, inspired by the G20 leaders' response to the financial crisis in 2008 (G20, 2009, 3).

Scenarios of outcomes

This section and Table 1 below explore expected outcomes, as well as potential trade-offs (and measures to mitigate unintended effects).

Closing the data gap through policy convergence enabling strategic management of environmental risks across the financial system

One positive outcome would be the mainstreaming of transition plans and planning into micro-prudential authorities' mandate, supervisory toolkit, and the overall prudential framework. It assumes that the recommendations are implemented swiftly and in full by central banks and supervisors across the G20 in a coordinated way, accelerated by policy backing through a clear request under the G20 finance track to mandate standard setting bodies (such as the FSB, BCBS, IAIS, and IOSCO) to accelerate their respective work on transition plans and planning in a coordinated manner.

Major outcomes include:

- **Enabling of urgent action lacross the financial system by closing the data gap.**

The urgency and a pressing need for better availability, comparability and reliability of climate-(and nature-related) data has been highlighted repeatedly by both public sector stakeholders (e.g., NGFS 2022, 12-21) and private sector stakeholders (e.g.,GFANZ 2023, 10). Government-led transition finance guidance across the G20 is currently incomplete, fragmented and dominated by national or regional initiatives, which might delay swift implementation at global level. Convergence of policy frameworks towards common, harmonised standards at G20-level, building on and accelerating the G20 Data

Gap Initiative's recommendation to develop forward-looking physical and transition risk indicators (G20, 2023, 10-11) as well as international market-led voluntary initiatives and guidance and government-led taxonomies, will prevent further market fragmentation potentially leading to and presenting risks to financial stability, market integrity and consumer protection.

- **Global leadership towards nature-related policy goals and targets.** By aligning momentum on transition plans with global UN-led initiatives such as the Global Biodiversity Framework (CBD, 2022, 11) simultaneously with climate-action, the G20 would contribute to promoting environmental stewardship in the finance sector and enhance the effectiveness of policy frameworks aiming to prevent nature-related financial risks.
- **Amplify and accelerate market-led initiatives.** (Voluntary) action by central banks and supervisors themselves to publish their own transition plans, according to a template that is consistent with those for financial- and non-financial companies, would amplify the momentum of both market-led voluntary initiatives and guidance (such as the GFANZ transition plan initiative) and accelerate implementation of enabling policy measures.
- **Enhanced financial stability.** Incorporating transition planning into central banking activities and financial supervision in a globally coordinated way will lead to better awareness and management of climate- and nature-related financial risks across the global financial system.

The table on the following page presents a summary of potential trade-offs that should be taken into consideration, along with potential avenues to mitigate these effects.

TABLE 1: Potential trade-offs eventually generated by the adoption of the proposal and possible mitigation measures

Potential trade-offs	Mitigation measures
Reluctance to move beyond principle-based approaches by certain G20 members. The international policy dialogue on transition plans currently remains timid and principle-based. A broad range of companies and financial institutions, dominated by 'business-as usual' considerations of incumbent market participants, might be reluctant to embrace prescriptive standards.	**Implementation in a phased approach, with clear a roadmap and timeline for all G20 jurisdictions, but starting with a 'coalition of the willing'.** Due to variable degrees of exposure to climate- and nature-risks, and divergence of views on short-term priorities and resource availability, some central banks and supervisors across G20 jurisdictions might wish to move faster than others. The proposed policy measures enable implementation in a phased approach (e.g., early action by a "coalition of the willing" among G7 countries), provided that international standards are defined as a matter of urgency.
Complexity of nature-related risks. The Integration nature-related risks might be perceived as too complex and complicated by some G20 members.	**Reducing complexity through cooperation with UN-led policy frameworks, including sustainable finance taxonomies.** The majority of G20 leaders understand the important role that government-led sustainable finance investment frameworks (also called "taxonomies"): 14 sustainable finance taxonomies are currently being developed across G20 countries. Out of the 17 countries hosting more than 70% of the planet's terrestrial biological diversity (megadiverse countries), only Brazil, China, Colombia, Malaysia, and South Africa have adopted a sustainable finance taxonomy in 2022. Out of the remaining megadiverse countries, India, Indonesia, and Mexico are currently developing taxonomies and Australia, Peru and the Philippines have initiated similar processes. (WWF 2022c, 6-7). Ongoing efforts on sustainable finance taxonomies can be amplified and leveraged for transition finance frameworks on climate and nature.
Currently the transition finance agenda is dominated by developed economies (e.g., EU, UK, etc.). As a result, trade-offs with emerging markets and developing economies (EMDE) policy priorities might be perceived as conflicting.	**A window of opportunity for emerging markets and developing economies.** The Brazilian G20 presidency in 2024 and the forthcoming South African G20 presidencies in 2025 present a unique window-of-opportunity for EMDE to shape the G20 transition finance agenda during a 2-year period, taking into account perspectives from emerging markets and developing economies.

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