



In collaboration with



Developing Metrics for Transition Finance

Discussion Paper

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1. Executive summary

Financial institutions have a critical role to play in accelerating the transition to a net-zero economy. Many banks have outlined their climate ambition, including through joining the Net-Zero Banking Alliance (NZBA), and have made commitments to financing ambitious climate action to transition the real economy to net-zero greenhouse gas emissions by 2050. Banks have been developing a set of metrics to report externally on their efforts towards meeting their ambition. Over time, this has led firstly to reporting of the volume of sustainable finance provided, supported by a range of international taxonomies (e.g. the EU Taxonomy), and, more recently, to measures of total financed emissions and sectoral decarbonisation targets that represent the climate impact of a bank's overall portfolio and how the bank plans to reduce it.

Banks' strategies for managing climate impact have also matured, with banks moving from exclusionary policies and targeted sustainable finance to more wide-ranging engagement with clients, especially large corporates. This engagement is helping to encourage companies to set transition plans and to accelerate those plans which, in turn, will support banks' net-zero strategies (if banks have existing exposures to these clients).

Financing provided to clients under such engagements is frequently described as "Transition Finance".

This paper discusses how banks may consider reporting their Transition Finance efforts. We see a need for additional specific metrics, as existing metrics may fail to provide a full picture of banks' approaches to decarbonising their portfolios.

1. Prevailing metrics, such as the volume of sustainable financing provided and sector-level decarbonisation targets, show the progress of banks' clients in their decarbonisation journeys, but do not explicitly capture the volume of financing provided to support companies to transition their businesses, nor the direct impact of this financing.
2. This is especially important for banks, who play an active role in the financial system through engaging with clients as part of financing specific activities. As such, banks can exert influence in addition to allocating capital. This active role in providing fresh funds is different from the more passive role of directing existing capital away from higher-emitting companies and towards greener companies.
3. There are cases where financing longer-term decarbonisation via Transition Finance could appear to conflict with more immediate objectives to decarbonise the financing portfolio, in particular with regards to meeting near-term (e.g. 2030) targets. For instance, if a bank were to finance a company with high current emissions but which has an ambitious plan to reduce them quickly, this could cause short-term increases in the bank's portfolio emissions metrics, causing the appearance of deviation from the pathway from now to the bank's 2030 targets.

This paper explores categories of Transition Finance reporting metrics that banks may consider reporting to provide additional transparency on their activities with transitioning companies:

1. **Input metrics** that reflect the volume of financing (new or in total) provided to companies that are providing climate solutions as well as transitioning companies. Volumes of financing may be split according to banks' Transition Finance taxonomies, which can be defined with guidance from industry bodies, such as the Glasgow Financial Alliance for Net Zero (GFANZ) which released guidance identifying "four financing strategies".
2. Measurements of **committed decarbonisation**. Several metrics exist to represent this, with simpler-to-calculate measures such as the total emissions (or emissions intensity) reduction committed through transition plans as a possible starting point.
3. A range of **supporting evidence**. This may include back-testing or validation of clients' committed decarbonisation plans, physical indicators of decarbonisation, and efforts to use transition numbers to forward project other measures such as sectoral net-zero targets.

The purpose of this paper is to advance the discussion of which metrics may be most useful for banks to publish to increase transparency on their Transition Finance activities. The paper does not seek to replace current metrics and thinking but looks to consider Transition Finance metrics which may sit alongside existing metrics. Transition Finance metrics are intended to add clarity around a bank's activity and not to replace portfolio emissions reduction metrics or decarbonisation targets to which banks have already committed.

In writing this paper, it is noted that there is a need to avoid unnecessarily expanding reporting, both to balance the burden on banks and to avoid confusing banks' external stakeholders by overloading disclosures. Additionally, this paper is not intended to be guidance which needs to be adopted by banks, but rather inputs to further evolve approaches to transition finance metrics and reporting.

In addition, while bank financing is a key enabler of the transition, the net-zero transition is dependent on supportive government policy and decarbonisation by real economy companies, which need to both define and execute on credible transition plans.

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2. The need for transition finance metrics

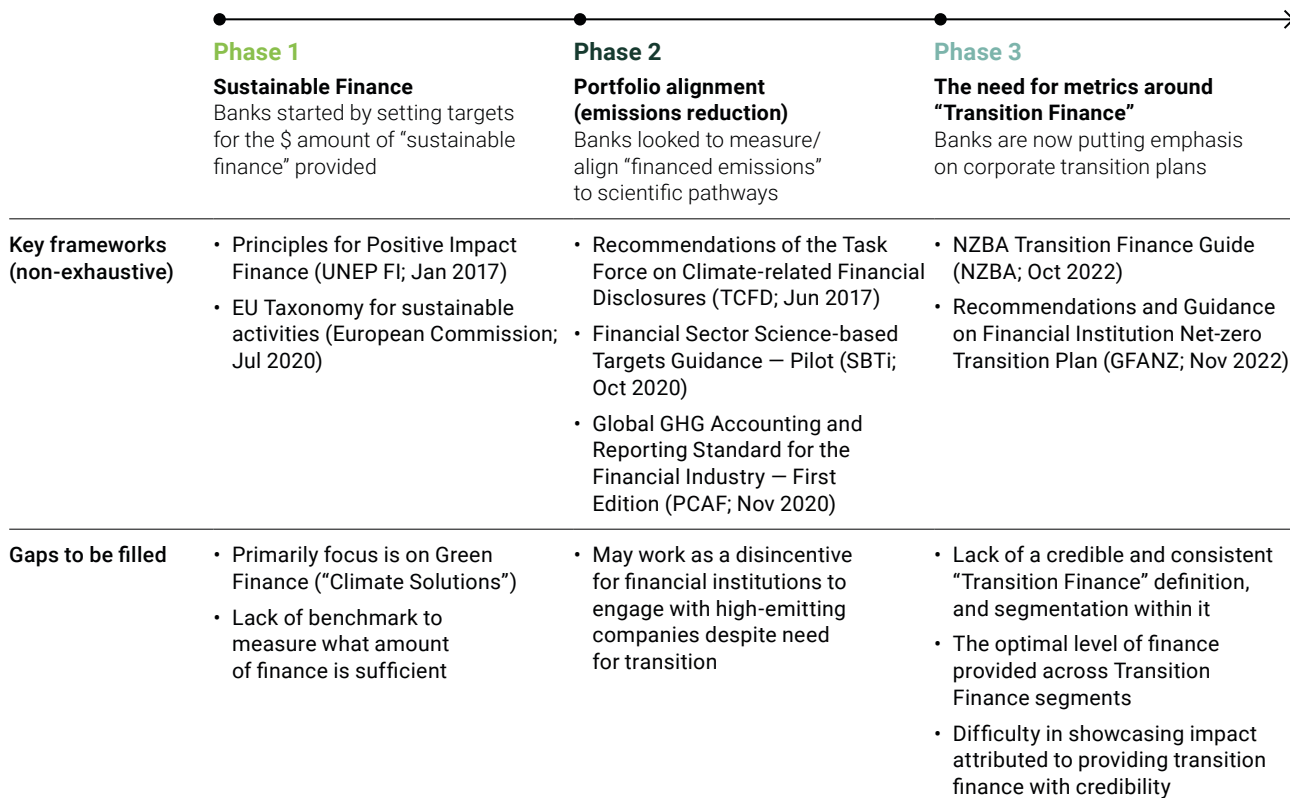
Recent years have seen an increase in global acceptance of the reality of manmade climate change and the urgency of addressing it; this is evidenced through an acceleration in private sector enrolment in bodies addressing climate change, such as the NZBA, which has 137 member banks as of the start of November 2023. Science-based scenarios from groups such as the International Energy Agency (IEA), the Network for Greening the Financial System (NGFS) and others have helped to map out the required technologies and pace of change in the near term for the world to stay within 1.5°C warming above pre-industrial averages.

The scale of the investment required is huge; estimates range from US\$3.5¹ to 6.7 TN² in additional annual investment to achieve the transition. This scale is beyond the means of governments alone; as such, in recent years, private sector financial institutions have pledged capital towards supporting the transition. In turn, this has created the need for frameworks to direct capital to the right places, measure the efforts of financial institutions, and ensure that the magnitude of pledged capital is sufficient in scale. This has led to an evolving picture of metrics and frameworks (see Figure 1 on next page).

1 Energy Transitions Commission. Financing the Transition: How to Make the Money Flow for a Net-Zero Economy. March 2023.

2 Bloomberg NEF. The \$7 Trillion a Year Needed to Hit Net-Zero Goal. December 2022.

Figure 1: Past trends surrounding sustainable finance



Source: Oliver Wyman analysis

Phase 1 – Sustainable Finance

Many banks started by setting targets for the amount of “sustainable finance” provided. This required definitions of what qualified as sustainable, which have been provided through taxonomies for sustainable activities. These taxonomies have been set externally, such as the EU Taxonomy for sustainable activities³ which came into force in July 2020,⁴ while many banks have also developed their own frameworks which define “green”, “sustainable” or “transition” lending. Financial institutions then set targets for the volume of sustainable financing they would provide according to their definitions. At the time of writing, NZBA members have collectively committed to provide over US\$16TN of sustainable and transition finance, with target years ranging from 2024 to 2030.⁵

These targets have several positive effects. They are directing capital towards low carbon activities, providing a ready supply of funding and lowering the cost of capital (which helps to lower and reverse the “green premium”). By measuring an absolute amount of financing, they also ensure more support is given. By referring to similar taxonomies, they provide metrics that are broadly comparable across financial institutions.

³ European Commission. EU taxonomy for sustainable activities. July 2020.

⁴ Other jurisdictions have followed suit, with a plethora of national and supra-national sustainable finance taxonomies now in force across the world.

⁵ Oliver Wyman analysis. September 2023.

However, sustainable finance targets alone are not a sufficient way of measuring climate action as a whole:

1. By focusing only on “green” activities, they do not explicitly limit financing that banks provide to the “brown” activities of high-emitting businesses or operations (e.g. power generated through coal-fired power plants (CFPPs)). Withdrawing financing from these activities can be an impactful lever financial institutions can use; the widespread exit from CFPP financing has raised the cost of capital and lowered its availability, which has led real economy actors to cancel projects and created the incentive to retire existing CFPPs early. However, it should be noted that CFPPs may be able to obtain finance from banks or non-banks with less strict or no net-zero targets.
2. These frameworks do not allow financial institutions or their stakeholders to calibrate whether efforts were sufficiently ambitious to be fully aligned with the global ambition to achieve net zero by 2050 and limit global warming to well below 2°C, and preferably below 1.5°C, above pre-industrial levels, in line with the Paris Agreement and Glasgow Climate Pact.
3. Sustainable finance targets do not recognise the value of lending to companies that are currently high-emitting but with ambitious transition plans. While some banks have included within their targets financing provided to support transition, it is often in a way which lacks sufficient definition or consistency, and only measures the volume of finance and not the impact of the finance. In addition, the information on impact from the lending to companies with ambitious transition plans is often not available which makes it difficult for various stakeholders to evaluate such efforts. Phase 3 metrics will help to improve visibility and increase recognition of finance provided to high-emitting companies with credible plans to become greener.

Phase 2 – Portfolio alignment to scientific pathways (emissions reduction)

The next set of metrics and targets to emerge looked at aligning “financed emissions” to scientific pathways aimed to limit global warming to a particular level. This was spurred by developments in carbon accounting standards, such as those set by the Partnership for Carbon Accounting Financials for financial institutions (PCAF), built from the Global GHG Accounting and Reporting Standard. These have been further promoted by groups like the Task Force on Climate-related Financial Disclosures (TCFD), which was set up by the G20 and the Financial Stability Board (FSB).⁶ These accounting standards allowed financial institutions to calculate the total amount of CO₂-equivalent emissions that they were financing, establishing the principle that financial institutions are in part responsible for those emissions. Financial institutions, including NZBA members, have since been setting targets to reduce their financed emissions over time in line with science-based models published by bodies such as the IEA. Some banks have chosen to reflect regional nuances in their reduction targets in line with regional differences that can be seen in the science-based models that they reference.

⁶ Financial Stability Board. Task Force on Climate-related Financial Disclosures. n.d.

At a total portfolio level, setting a target for a reduction in total financed emissions can, in some instances, be observed not to consider in sufficient detail the full range of issues that arise from the need to support a real economy transition. Targeting absolute reductions can create incentives for financial institutions to disengage with high-emitting sectors such as power, steel, cement and transportation which are precisely where most investment in the net-zero transition is needed. This has led banks to largely adopt sector-specific approaches that target differing levels of emissions reduction of financed clients per sector. Banks have largely set these targets in emissions intensity terms, committing to reduce the average intensity of their sector portfolio. These emissions intensity targets recognise financing to clean activities and withdrawal from the highest-emitting businesses or operations without encouraging disengagement. In some sectors (especially Thermal Coal, and Oil & Gas), banks have chosen to set sector exit policies or targets to reduce financed emissions directly, recognising that net-zero pathways require a reduction in output from these sectors over time.

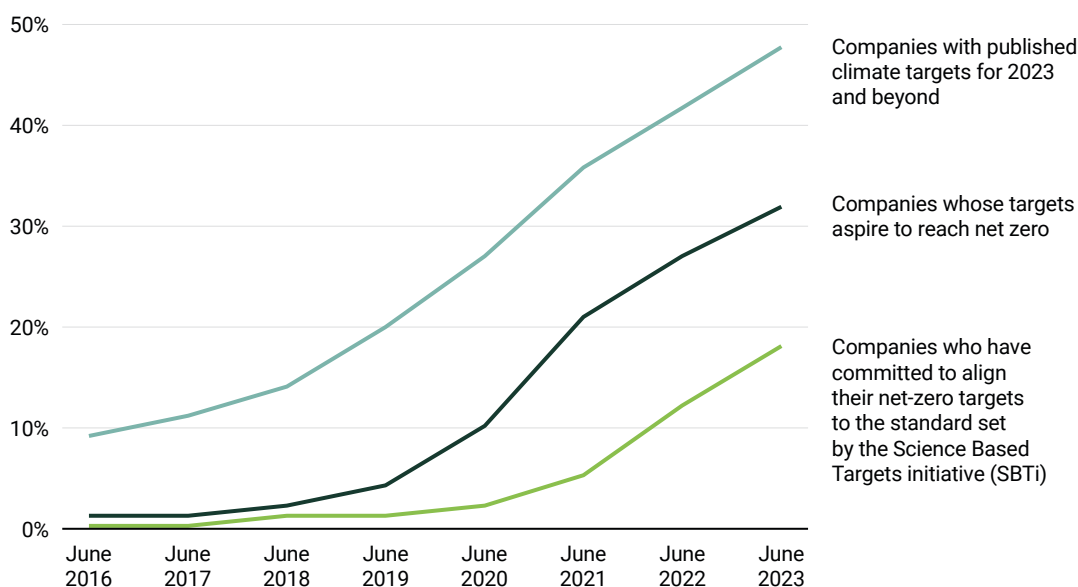
As additional targets, emissions reduction targets address a number of the challenges of individual Sustainable Finance targets; they can be directly compared to a scientific pathway to establish sufficiency and they take into account all of the activities and companies a bank supports in a sector, including the efforts of transitioning companies. By including the whole of a bank's financing to a sector, they have also served to move financing of the transition from a relatively niche activity to a core activity.

Increasing focus on financing of the transition has helped to commit more financing to the net-zero transition than that measured in Sustainable Finance directly. Nonetheless, emissions reduction targets themselves do not measure the volume of financing put towards the transition; they measure the *reduction of financed emissions* rather than the *financing of emissions reduction*. For instance, one strategy a bank can employ to reduce its financed emissions is to stop financing high-emitting clients without extending further financing to climate mitigation activities. This is a significant shortcoming as a key role of financial institutions in the net-zero transition is to ensure sufficient finance is directed to activities supporting the transition and reflecting financial and non-financial risks.

Phase 3 – The need for metrics around “Transition Finance”

In addition to sustainable finance and emissions reduction targets, it has become clearer that there is a need for complementary metrics and targets related to banks’ support to transitioning companies. Leading companies across all sectors realise the moral imperative and business advantage to transitioning and, as such, are setting themselves decarbonisation targets and plans to achieve them. Banks that are committed to support a transition to net zero are assessing and supporting such companies at scale, but these efforts are currently not well captured in either sustainable finance or emissions reduction metrics.

Figure 2: Upward trend of companies setting increasingly stringent climate targets (% of MSCI ACWI IMI⁷)⁸



Source: MSCI. The MSCI Net-Zero Tracker, July 2023

Financial institutions have become more sophisticated in how they think about the financing strategies they can deploy to support the transition. Alongside simple exit strategies, financial institutions are designing many other financing strategies through which they can support the transition. As an example, the Glasgow Financial Alliance for Net Zero (GFANZ) in 2022 identified four financing strategies – climate solutions, aligned, aligning and managed phaseout – while individual financial institutions are working on a range of other strategies (see Figure 3).

7 MSCI ACWI Investable Market Index (IMI) captures large, mid and small cap representation across 23 Developed Markets and 24 Emerging Markets countries with 9,152 constituents.

8 MSCI. The MSCI Net-Zero Tracker – A periodic report on progress by the world’s listed companies toward curbing climate risk. July 2023 update.

Figure 3: Key transition finance strategies set out by GFANZ⁹

1	2	3	4
Climate solutions	Aligned	Aligning	Managed phaseout
Financing technologies, services and tools that mitigate, eliminate or remove GHG emissions to expand economy-wide emissions reductions through the deployment of climate solutions	Financing entities that are already aligned to a 1.5°C pathway to support climate leaders and signal that the finance sector is seeking transition alignment behaviour	Financing entities committed to aligning to a 1.5°C pathway to encourage and support the implementation of net-zero transition plans	Financing high-emitting physical assets that can be phased out before end-of-life to accelerate emissions reductions in support of an orderly and just transition

Source: Glasgow Financial Alliance for Net Zero (GFANZ). Financial Institution Net-zero Transition Plans. November 2022.

Sustainable finance and emissions reduction metrics alone are not adequately nuanced to capture all of the sophistication in how financial institutions need to approach transition finance. In particular, while clearly positive for the net-zero transition, financing the managed phaseout of high-emitting assets leads to increased financed emissions and emissions intensity, and does not qualify as sustainable finance in existing taxonomies.¹⁰ Similar challenges exist for financing companies, rather than their direct assets or activities. Financing companies which are currently carbon intensive but have credible transition plans could lead to an *increase* in a bank's portfolio emissions in the short-term and create the view that the bank is not progressing in line with its stated emissions reduction targets.

This issue is especially important for banks (and strategic equity investors). Corporate banking businesses manage long-term relationships with their large corporate clients, with an advisory element and ability to direct finance towards specific projects of their clients, in addition to pure financing. Whilst asset managers invest in companies through trading in the secondary markets, banks provide primary finance and as such interact directly with company management. This gives banks a platform for engagement and influence – utilising this platform to accelerate decarbonisation is one of the most powerful levers available to climate-ambitious banks.¹¹

⁹ Glasgow Financial Alliance for Net Zero (GFANZ). Financial Institution Net-zero Transition Plans – Fundamentals, Recommendations, and Guidance. November 2022.

¹⁰ We note that some taxonomies including the ASEAN taxonomy, are beginning to include managed phaseout as taxonomy compliant.

¹¹ Whilst they are not the focus of this paper, this is of course also true strategic equity investors (i.e. those that invest through large or controlling stakes as is common in private equity or venture capital, for example), who can exert material influence on transition plans through their ownership but not necessarily available in scaling up transition finance.

As such, there may be value in building on current metrics used by bank to explicitly cover efforts to finance transition plans. The aim of these metrics will then be:

1. To better show the **magnitude** of financing provided to transitioning companies.
 - This is hidden in current measures, as emissions intensity improvements may be through a combination of different financing strategies.
2. To provide credible **forward-looking** guidance on the amount of decarbonisation being supported.
 - Existing metrics being widely used are all point in time or backward-looking. Transition finance metrics can add to this by providing a forward-looking view.
3. To act as a **complement to, not a replacement for**, existing metrics.
 - Both sustainable finance targets and emissions reduction targets remain critical and useful. The suggestions here are for additional reporting and not for alternatives to those approaches.

The next section of this report provides some suggestions for metrics that banks may consider for reporting their transition finance activities. Such metrics would need careful construction and contextualisation of what they do and don't show, and that there is potential for conflicts between these measures and emissions reduction targets.

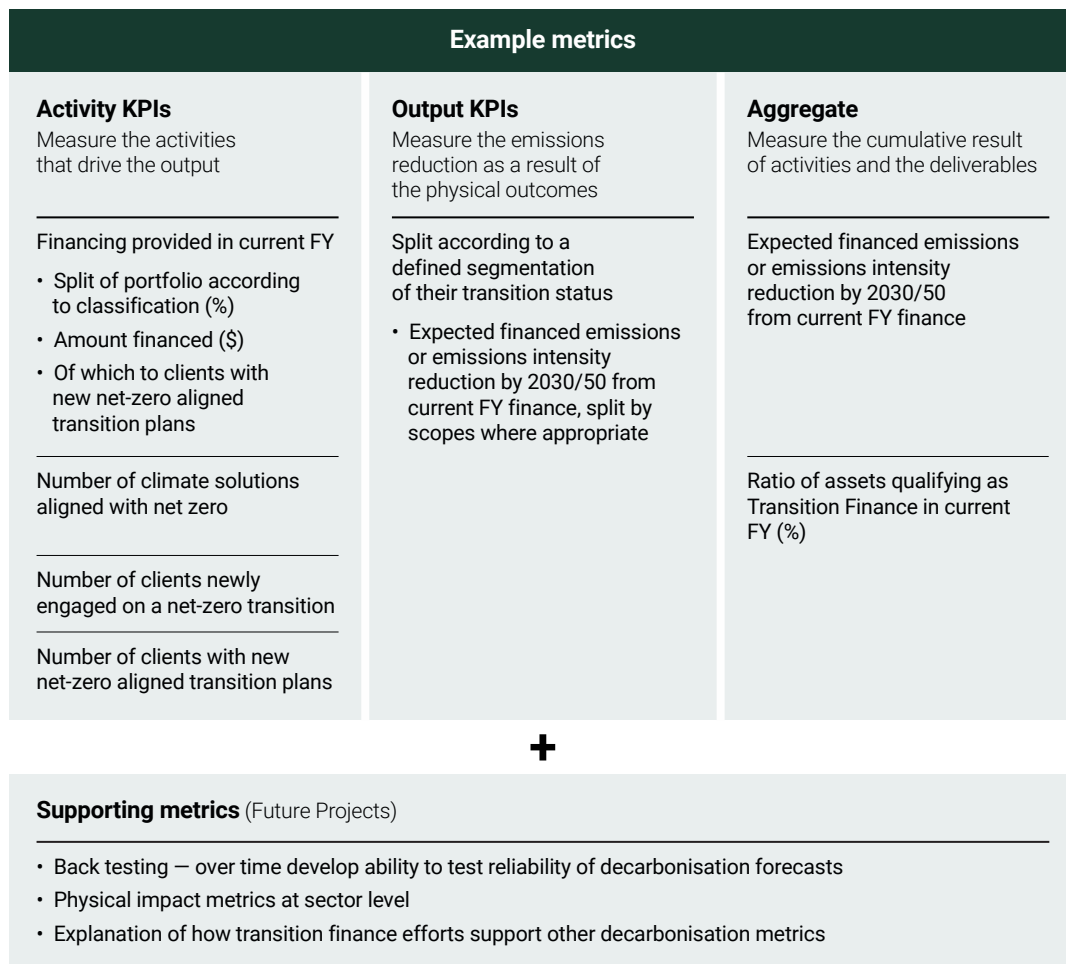
A note on the status of this paper

This paper is intended to push forward the discussion of which metrics would be most useful for banks to publish to increase transparency on their Transition Finance activities, and the impacts of those. As such, the paper makes suggestions that NZBA members may consider using to track and report transition finance activities and impacts; however, **the suggestions in this paper are not mandatory reporting requirements for NZBA members and should not be considered or implied as such**. Members may choose to follow some of the suggestions in this paper, follow their own, different approaches for reporting, or even choose not to report on Transition Finance at all. The purpose of this paper is to provide frameworks and suggestions for banks considering reporting around Transition Finance to help support comparability between them.

3. Outline of a reporting framework for transition finance

This section suggests some potential ways that banks could consider reporting Transition Finance, as depicted below:

Figure 4: Transition finance example metrics framework



Source: Oliver Wyman analysis

3.1. Input metrics – how much finance is provided to whom?

Banks can provide further transparency on the amount of financing that they are providing to companies who are actively transitioning, according to a defined segmentation of their transition status. For example, it could be beneficial to differentiate between companies which are already 1.5°C aligned vs. companies which are in the process of aligning to net-zero or have set targets but those targets are not yet ambitious enough, or where specific funding is provided to climate solutions. An example of an industry framework which seeks to define financing in this way is the “four financing strategies” defined by GFANZ which can provide a starting point for banks to report their transition finance efforts. GFANZ proposes the following categories – “climate solutions”, “managed phase-out”, “aligned” and “aligning”. This could provide transparency on the scale of new money being provided to transitioning companies in a given time period (e.g. January – December), and over time allow stakeholders to track how this is evolving from non-aligned to aligned or aligning companies or climate solutions. Conversely, reporting the amount of financing to companies or activities that are not transitioning or “not-aligned” can also be considered.

Banks considering this approach are encouraged to consider:

1. Classification

- Banks opting to report these metrics will need a way of classifying corporates into different categories. For example, banks may use some of the following, non-exhaustive, options:
 - Using GFANZ’s financing strategies (or other appropriate classifications).
 - Distinguishing clients that have made public net-zero commitments that have been validated by a third party (for example, SBTi), clients whose net-zero commitments are unvalidated, and clients that have not made any net-zero commitments at all.
 - Differentiating between financing that is provided to clients with specific use of proceeds restrictions for transition activities, assets or projects (e.g. “green CAPEX”), and finance for general purposes.
- Banks should consider whether to include a sector scope into its classification of Transition Finance.
- Standards are evolving and a number of banks have published their own approaches to assessing client transition status and plans in order to classify their clients. However, many assessment frameworks have been published, many of which remain high level and principles-based, which could lead to them being open to interpretation. Banks should provide transparency on the definitions they have followed to classify their clients by transition status. When creating their own definitions, banks may make reference to publications from global bodies such as the NZBA,¹² ISSB,¹³ ICMA,¹⁴ the G20,¹⁵ the Climate

¹² Net-Zero Banking Alliance (NZBA). NZBA Transition Finance Guide. October 2022.

¹³ International Sustainability Standards Board S1 and S2 standards. June 2023.

¹⁴ International Capital Market Association (ICMA). Climate Transition Finance Handbook. June 2023.

¹⁵ G20. 2022 G20 Sustainable Finance Report. October 2022.

Bonds Initiative¹⁶ and GFANZ,^{17, 18} as well as regional efforts from bodies such as the Asian Transition Finance Study Group¹⁹ or the ACMF.²⁰

2. Due diligence

- Corporate transition plans differ in both the degree of climate ambition they entail and in the robustness of the planning. Additionally, real economy companies are not yet widely referencing the standards mentioned in the prior paragraph when developing their own transition plans, leading to a lack of consistency in their format and contents. The best plans have a detailed and credible technological roadmap, with near and medium targets, which is clearly costed and has a financing plan. These best-in-class plans are regularly reported on, well governed and independently validated. Other companies have plans that may be similarly ambitious, but do not contain the same detail around how they will be executed.
- Banks opting to report the extent of their transition finance will therefore need to:
 - Undertake additional assessments of their clients' transition plans in order to classify them, and
 - Define their own standards for what makes a sufficiently credible transition plan (e.g. benchmarking against science-based emission reduction pathways), and/or
 - Leverage third party transition plan assessments as an additional input (e.g. Transition Pathway Initiative, World Benchmarking Alliance).
- Assessing the credibility of clients' transition plans will enable banks to understand whether their clients are likely to deliver the degree of decarbonisation promised, which can be an important component in the classification assessment of whether clients qualify for transition finance. Banks making such assessments will need to evaluate factors such as the maturity of their clients' plans and their clients' track-record of delivery against their plans.
- Some banks may decide that assessing credibility of clients' transition plans is important to enable the bank to form its own opinion on the quality of its clients' commitments. Others may choose to take clients' disclosed plans directly with little challenge, on the basis that their clients will separately be held to account on their commitments (e.g. by their own stakeholders).
- Setting an aspirational standard for the level of credibility that banks look for in their clients' transition plans could help to push corporates to improve the quality of their transition plans; however, an unrealistically high bar would limit the effectiveness of targeting aligned and aligning companies. What is realistic will also differ by sector and geography. It may be appropriate to assess the ambition of the transition plan and execution risk of the plan separately.
- Banks may consider applying a range of differing standards, consolidating and strengthening their approaches over time.

16 Climate Bonds Initiative (CBI). Transition Finance for Transforming Companies. September 2022.

17 Glasgow Financial Alliance for Net Zero (GFANZ). Expectations for Real-economy Transition Plans. September 2022.

18 Glasgow Financial Alliance for Net Zero (GFANZ). Defining Transition Finance and Considerations for Decarbonization Contribution Methodologies – Consultative Document. September 2023.

19 Asia Transition Finance (ATF) Study Group. Asia Transition Finance Guideline. September 2022.

20 ASEAN Capital Markets Forum. ASEAN Transition Finance Guidance. October 2023.

3. Reporting flow or new funds, and total stock

- There is value in understanding both how new money is being directed (“flow”) and how the total exposure in a sector is allocated (“stock”). This “flow versus stock” is especially important for banks as the vast majority of financing by banks will go directly to clients (or projects clients undertake).
- As any such reporting will be novel, banks may take time to reclassify their clients and finance and may therefore consider reporting only flow metrics initially. Over time, this would allow them to construct a view on the stock of their exposure to a sector as they continue to measure exposures that are being made from now onwards, while the existing, uncategorised portfolio reduces.

4. Sectoral or total portfolio level

- Banks may consider reporting these metrics either at a sector level or for the total portfolio. Sectoral reporting will have the advantage of aligning with emissions reduction measures which will improve stakeholder understanding of how banks are achieving their emissions reduction targets. However, total portfolio measures provide a more comprehensive and comparable view on total financing support.
- Banks may wish to start measuring and reporting at the portfolio level, with sector level breakdown figures further in the future.

3.2. Output metrics

Banks that go through the effort of collecting and assessing their clients’ transition plans may then also consider reporting the aggregate decarbonisation that they are financing. This would involve aggregating the decarbonisation impact (i.e. future emissions reduction) supported within a given timeframe and reporting this alongside other metrics.

A number of metrics may be considered for reporting forward-looking emissions reduction, though we note that methodologies are at a very early and exploratory stage and continue to evolve. As such, they should be used with notable care, should be contextualised, and should only be used as complementary metrics to the core emissions reduction targets set by banks and not replacements thereof. These include:

1. **Expected Emissions Reduction (EER) metrics,²¹ such as Avoided Emissions²² or Emissions Reduction Potential (ERP).** Sometimes referred to as “Scope 4” emissions, these metrics attempt to calculate the amount of emissions that will be avoided as a result of financing a given company or activity. This involves setting a baseline for what emissions would be expected to occur if the bank did not provide financing, and then consider the expected difference between this baseline and the actual emissions that are expected to occur as a result of the bank’s finance.

21 Glasgow Financial Alliance for Net Zero (GFANZ). Defining Transition Finance and Considerations for Decarbonization Methodologies. September 2023.

22 See “Guidance on avoided emissions”, World Business Council for Sustainable Development and Net Zero Initiative. March 2023

These metrics can be powerful indicators of the impact of a bank's finance but also present a significant greenwashing risk if not developed and applied in a rigorous manner.

As of the time of writing of this report, no commonly accepted methodologies exist to perform a robust calculation of an EER metric. Such a metric will continue to require methodological sophistication and assumptions, as well as higher levels of data in order to be robustly calculated. Therefore, these metrics should be treated with caution in external reporting to ensure that what they show is contextualised, evidenced and based on recognised methodologies.

- 2. Committed Emissions Reduction (CER).** This is a simpler metric in which a bank directly measures the emissions reductions committed by its clients as a result of the bank's financing, and aggregates that up to a portfolio-wide view on emissions reduction. For specific use of proceeds finance, a bank could request that its clients report their target emissions reductions and progress. For transitioning companies that a bank finances, using general purpose finance, this metric may be harder to compute as it is difficult to clearly correlate a bank's financing and what is being used for. If such traceability is not possible, a bank could choose to measure the total volume of emissions reduction committed to by the company and then recognise its fair share of that emissions reduction, for example by using the attribution factor from the PCAF greenhouse gas accounting standard.²³ The CER metric has lower methodological complexity than EER metrics, though does mean that the CER of clients without their own reduction targets will always be zero, whereas EER may be non-zero if the bank has developed other ways to forecast client emissions. Similar considerations regarding the lack of agreed methodological approaches and consequential greenwashing risks apply to this metric too.

Banks opting to apply such metrics will need to consider methodological nuances in how they are calculated, such as:

1. Absolute emissions vs. Emissions intensity

- Companies with transition plans will typically aim to reduce the emissions intensity of their activity over time, and may also commit to total emissions reduction.
- Banks can view EER and CER metrics in either absolute emissions or emissions intensity terms. This choice affects the aggregation method, as absolute emissions reductions figures can be summed to portfolio level, whereas emissions intensity reductions need to be averaged to portfolio level. Additionally, banks may choose to recognise cumulative emissions reductions over the lifetime of the project, of their finance to it, or more simply an annual snapshot.
- The emissions intensity view is useful for banks to match the EER or CER metric to sectoral targets. For example, where a bank has a target to decarbonise the average emissions intensity of its clients in the power sector, it could complement that with a measure of forward-looking emissions intensity reduction from the companies it has identified as transitioning. Reporting implied reduction in emissions intensity will better align to sectoral emissions reduction metrics.

²³ The Global GHG Accounting and Reporting Standard for the Financial Industry, PCAF, second edition. December 2022.

- An absolute metric allows for aggregation across sectors and will provide context to the total financed emissions banks report in their TCFD reporting. For banks considering reporting input metrics for the total portfolio (i.e. Sector agnostic), it may be appropriate to track and report absolute emission figures.

2. Isolating the impact of the bank's transition finance

- Banks face a choice when trying to isolate the effect of a financing decision, in particular when applying the EER metric. Such an approach would drive up the sophistication level of the metric and potentially give a clearer indication of the bank's impact.
- This isolation is less relevant for the CER metric which relies on the client's commitments. The impact can be isolated only to the extent that clients may have set commitments contingent on the bank's finance.

3. Impact of maturity and amortisation on projections

- Bank debt is provided with limited maturity which is frequently significantly shorter (5 years or less) than the time horizon of clients' transition plans (which may be 10 years or longer).
- Banks may consider a variety of approaches, including a static balance sheet approach, recognising that, while specific debt will mature fairly frequently, their overall client relationships will not, or take into account the impact of loan maturity when projecting forward the funded decarbonisation.
- Banks should carefully consider which of these approaches best fits with their overall emissions reduction objective and provide transparency on their methodology and rationale.
- Where appropriate and in specific, justifiable situations, banks may consider including the decarbonisation impact that occurs after a loan has matured, provided that banks disclose how these calculations are made along with a credible rationale for such a claim (e.g. financing that brings forward the managed phaseout of coal power plants may nonetheless only result in that plant being decommissioned after the financing arrangement has ended).

Banks may also wish to combine the input and output metrics by measuring the return (in emissions reduction) on their investment (in terms of the financing provided) through a ratio such as "Emissions Reduction Return on Investment" (ERROI), thus providing a link between the dollar amount financed and the impact made. Such a measure would need careful construction and interpretation and is not a "silver bullet"; projects in "hard to abate" sectors and with relatively immature technologies will typically have a lower ERROI, but financing is still needed and highly valuable to the transition of these sectors. Nonetheless, banks may wish to use such a metric to compare within a sector to ensure they are getting the most climate impact for the financing they are providing.

3.3. Additional supporting metrics

Reporting future decarbonisation expectations faces a credibility challenge; such reports may be met – at least initially – with a degree of scepticism, in part because, without a globally standardised set of definitions or frameworks, metrics will initially require a high degree of banks' own definitions.

Banks should therefore consider ways to support the credibility of their forward-looking metrics. Three possible approaches may be:

1. Ensuring that transition finance metrics are additional and not replacements for existing metrics

- Banks' science-based emissions reduction targets are key commitments that banks should continue to use as a primary steer.
- However, there are situations where supporting the transition may conflict with short-term emissions reduction targets (see Chapter 4).
- There is value in having transition finance metrics as incremental information to add further credibility on top of metrics reporting progress updates against emissions reduction targets and/or portfolio alignment targets.

2. Including simpler measures of the technological impact achieved

- For example, banks may indicate the MWh of renewable energy generated, tonnes of green steel or number of financed electric vehicles created as a result of their financing by assessing the share of a company's production that the bank is responsible for via its financing. Whilst difficult to interpret in isolation, holding such metrics constant over time will help banks to build a time series of increasing impact resulting from its transition finance.
- While it should be noted that there may be some technical challenges in order to collect, calculate and aggregate this data, banks may benefit from asking these questions as part of due diligence processes. This might, for instance, allow banks to assess whether reporting these metrics are useful for external stakeholders (and if so, with what qualifications).

3. Back-testing assessments of EER and CER metrics

- As databases of forward-looking emissions and achieved emissions reductions for corporate clients are built over time, banks may consider back-testing their calculations of EER and CER against their actual experience of achieved decarbonisation in their sectors portfolios.
- This may help banks to refine how they assess the credibility of their clients' plans and the extent of decarbonisation that can be expected from any newly announced plans.
- A reported backward-looking number and back-test may also help to improve credibility of forward-looking projections. Banks that are able to compare predicted decarbonisation with actual decarbonisation in a period and show that these are close to each other can demonstrate greater credibility in their forward looking prediction.

4. Managing conflicts between transition finance and emissions reduction metrics

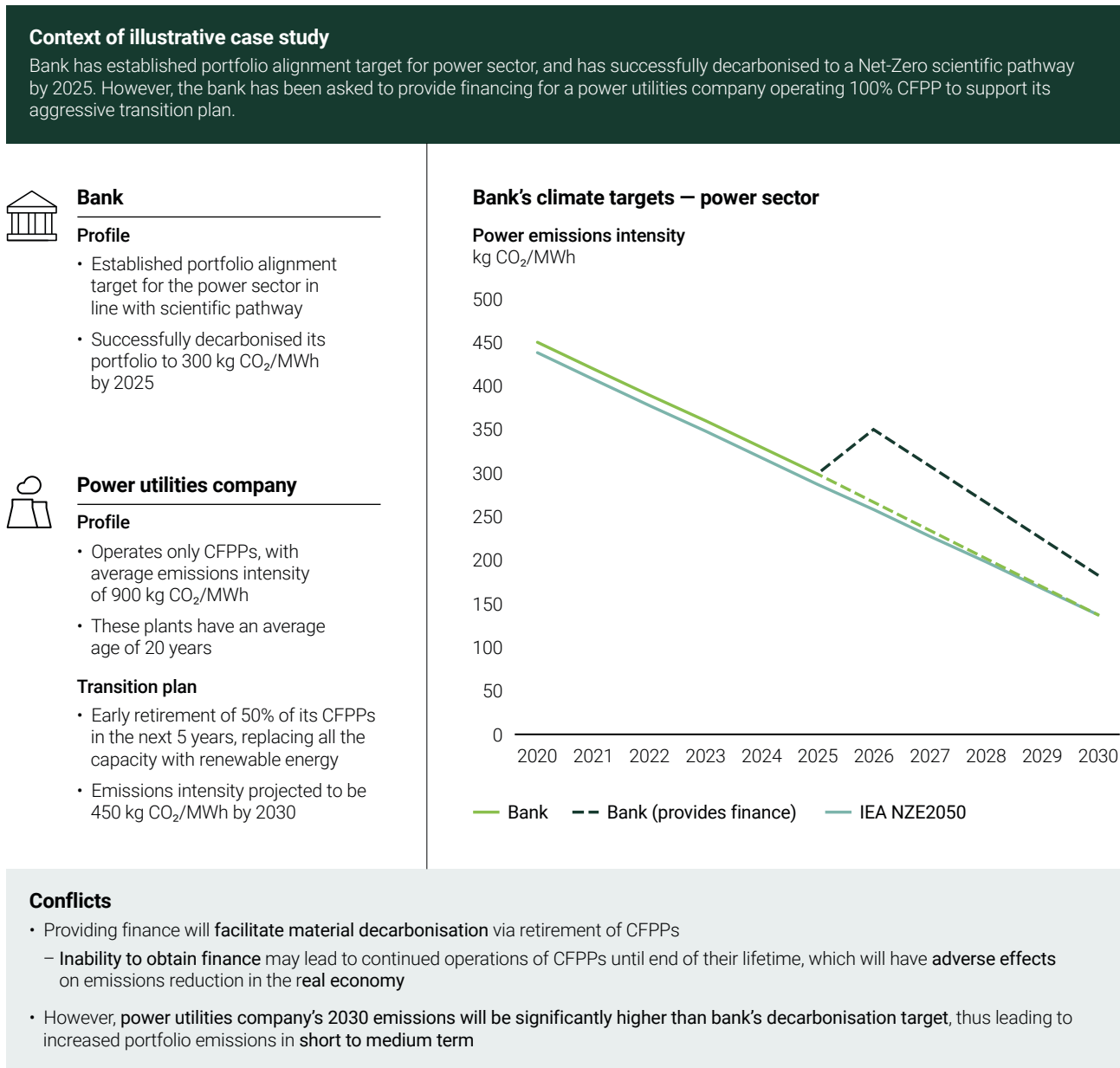
As noted above, the primary purpose of this document is to suggest concepts and a potential framework for reporting transition financing efforts that is complementary to existing climate targets. This is the objective for many NZBA banks who aim to provide sufficient finance to climate solutions (low-carbon technologies), align their portfolios to net zero, and to use their finance to help their corporate clients with transition-aligned or aligning plans to meet and accelerate their plans.

However, there are possible circumstances when these metrics may come into conflict with each other. Such conflicts might occur when companies that are currently heavily reliant on high-emitting technologies seek financing to support rapid decarbonisation. The following is a hypothetical case study where:

1. A bank has established an emissions reduction target for its Power sector portfolio that requires it to lower the average emissions intensity of its financing from 450kg CO₂/MWh of power produced in 2020 to 138kg CO₂/MWh in 2030 (in line with the IEA's Net Zero Emissions by 2050 Scenario from 2021).²⁴
2. By 2025, the bank has successfully decarbonised its portfolio to an average emissions intensity of 300kg CO₂/MWh.
3. The bank is then asked to provide financing to a power utility to finance a rapid decarbonisation plan. The power utility currently runs only coal-fired power plants, with an average emissions intensity of 900kg CO₂/MWh. These are young plants with an average age of 20 years, but the company nonetheless has a transition plan that involves retiring 50% of its plants early in the next 5 years and replacing all of this capacity with renewable power. Financing is needed for this transformation which would halve the company's emissions intensity to 450kg CO₂/MWh by 2030. As coal-fired power plants today typically run for 45–50 years, this is an extremely ambitious transition plan.
4. The bank clearly faces a conflict here: providing the financing will lead to material decarbonisation, accelerate the retirement of coal-fired power plants and would be reflected positively in a transition finance metric as outlined in the previous section (i.e. it would be a meaningful contribution towards reducing the actual global CO₂ emissions). On the other hand, providing this financing would lead to an immediate increase in the bank's average emissions intensity for its Power sector portfolio in 2025 and would continue to raise its average in the medium term (as the 2030 level of 450kg CO₂/MWh in 2030 is also above the bank's target level).

²⁴ International Energy Agency (IEA). Net Zero by 2050 – A Roadmap for the Global Energy Sector. May 2021.

Figure 5: Hypothetical case study on how banks face conflicts when providing transition finance



Source: Oliver Wyman analysis

How should banks resolve such conflicts? Withdrawal of financing from high emitting activities has proven an effective lever in accelerating the transition in some regions, and banks should be wary of weakening this position. Therefore, banks should attach a high burden of proof to financing decisions to ensure the finance results in climate-positive outcomes. The following principles may be useful in navigating such situations:

1. Ensure that financing is better than not financing

- Whilst the simplified hypothetical case study in Figure 5 clearly describes a transition which reduces global emissions, this is not automatically the case. Expanding the case study, if the Power Utilities company were in a competitive market with several other Power Utilities which are rapidly growing generation and currently operate renewables and gas generation, then choosing not to finance the company might have a bigger emissions-reduction global impact than financing it. Financing the company would lock in an amount of emissions for some time, while financing instead the other companies in the market could push the company currently running only CFPPs to shut some of them down even earlier as they become uneconomical to run.
- However, it may be that, by not financing the company, alternative banks, private capital and government money will instead continue to support the utility, leading to an elongation of the life of its assets.
- Banks providing transition finance to high-emitting but rapidly transitioning companies should ensure that they are not involved in prolonging the life of high-emitting assets when providing transition finance.

2. Consider options in the structure of financing

- Faced with higher costs and lower availability for financing conventional power, many power companies have created legal entity structures that separate their renewable power assets into an ongoing business, whilst housing the conventional assets in another for accelerated run-down. This allows them to continue to attract advantaged funding for the new investments into renewable energy. In the example above, such a structure would allow the bank to lend only to the “NewCo”, which would lower its average emissions intensity and support its emissions reduction goals.
- These structures are useful for banks to direct their financing towards where it is needed.
- As an alternative, the bank may also choose to put strict use-of-proceeds restrictions on its financing, which would allow it to support only the new assets. These could be recorded as binding covenants in transaction documentation and subject to diligence and monitoring.
- In some cases, this will not be sufficient: e.g. financing may still be needed for the “OldCo” to ensure that assets are retired earlier than otherwise planned.

3. Define strict rules, enshrined in associated policies and processes, to govern “Managed Phaseout” transactions, and consider reporting these separately and transparently from emissions reduction targets

- GFANZ’s work on Managed Phaseout of high-emitting assets^{25, 26} identifies similar conditions in which financing may help accelerate the retirement of high-emitting assets. Such deals should be subject to specific and strict diligence and reported separately (as suggested above).
- Where correctly identified and well governed, banks may consider reporting separately such deals from their portfolios subjected to emissions reduction targets. This could be done through reporting two sets of numbers for a sector with and without MPO deals included.

25 Glasgow Financial Alliance for Net Zero (GFANZ). The Managed Phaseout of High-emitting Assets – How to facilitate the early retirement of high-emitting assets as part of a just transition to a net-zero world. June 2022

26 Glasgow Financial Alliance for Net Zero (GFANZ). Financing the Managed Phaseout of Coal-Fired Power Plants in Asia Pacific – Public Consultation: Guide to support the financing of the early retirement of coal-fired power plants as part of a just net zero transition. June 2023

Figure 6: Rocky Mountain Institute – suggestion for separate disclosure for managed-phaseout transactions²⁷

Financed emissions	Baseline 2021		FY 2022 (actuals)		Target 2025		Target 2030	
	Mt CO ₂ e	kg CO ₂ e/ MWh	Mt CO ₂ e	kg CO ₂ e/ MWh	Mt CO ₂ e	kg CO ₂ e/ MWh	Mt CO ₂ e	kg CO ₂ e/ MWh
Power-sector portfolio	4.5	351	6.0	402	3.6	301	2.0	125
Power-sector portfolio (excluding managed phaseout)	2.9	290	2.9	290	2.0	125	2.0	125
Coal managed phaseout sub-portfolio	1.6	1015	3.1	1072	1.6	1015	0.0	0

In the example above, the bank could therefore provide financing to the new renewables investments through ringfenced financing (and possibly managed phaseout structures) to the power utility without also impacting its emissions reduction metrics. As banks and clients become more aware of such conflicts, it could be expected that innovative structuring solutions will allow transition finance to be supported without creating a conflict. However, some situations may remain where this is not possible, i.e. where corporate level financing is required and where the alternative to financing is simply the continuation of the high-emitting assets. In such cases, banks should make efforts to publicly explain why emissions intensity has increased and targets missed. This may include:

1. Asking for a confidentiality waiver on such deals to report the transitions supported. Most “bilateral” bank loans are subject to confidentiality agreements and are not individually disclosed. In cases where a loan is expected to have longer term decarbonisation benefit but might cause targets to be missed in the short term, the bank may consider asking for its clients’ permissions to disclose publicly the support that it has given to them, and to explain why these loans will be positive in the longer term while causing targets to be missed in the short term.
2. Seeking independent audit review of such deals to ensure that alternatives have been explored.
3. Highlighting within the forward-looking transition metrics mentioned in the previous section the share of decarbonisation committed that is provided by companies with currently high emissions intensities as well as the impact this has on the bank’s average emissions intensity.

²⁷ Rocky Mountain Institute (RMI). Working Paper – Managed Coal Phaseout: Metrics and Targets for Financial Institutions. January 2023.

5. Potential next steps

This note sets out methodologies that banks may employ to report their efforts around transition finance. However, each bank must assess its own approach independently and individually based on its own judgement and business goals (subject to, and consistent with all fiduciary and contractual duties, laws and regulations) because of the range of methodological options and the range of maturities in real economy transition plans. Banks aiming to comprehensively disclose their transition finance activity may want to consider a range of near-term actions:

- 1. Start collecting data.** A prerequisite to reporting on transition finance is to understand the extent of transition that is being supported. That will require systematically collecting the transition plans of clients, or details on specific green projects being supported, either from third party data sources (currently limited but expanding) or through the origination process. Additionally, banks can already consolidate and report on transition financing activity where it can already be readily identified (e.g. project finance, explicit use of proceeds lending).
- 2. Start recording and classifying clients at the point of origination.** To begin, this may involve banks defining their own categories (e.g. “aligned”, “aligning” and other required categories), and assessing clients against them. Over time, the aim should be to harmonise a market-wide definition of transition finance categories to promote consistency across banks. Assessment to classify clients may involve enhanced due diligence of clients’ transition plans to ensure those plans are robust, consistent and credible, and are aligned with international guidance. Banks may consider additional elements of due diligence on top of these standards to meet their own internal requirements.
- 3. Start tracking clients against their own plans.** To back-test and gain confidence in transition commitments, banks may want to be able to track progress against plans. To do so will require a systematic effort to compare commitments collected against clients’ achievements. This will take time; as such, banks may wish to start these efforts now so as to have the required data in the future.
- 4. Develop transition targets.** Once confident with the data, banks may consider the appropriate level for targets, be they expressed in terms of input (absolute financing provided) or output (emissions reduction financed) or other measures. This will involve making choices between the options for metrics and calibrating those metrics as forward-looking targets.
- 5. Develop policies, strategies, products and services.** Targets drive action and banks managing towards a set of transition support targets will then want to translate these into client approaches, be that in the form of more detailed policies, client targeting, or through the development of products and services aimed at supporting transitioning companies.
- 6. Develop reporting processes and begin disclosing.** Banks may then wish to report their transition support. This will involve integrating with existing metrics, explaining how different targets complement and reconcile with each other.

The above will require a significant effort and may not be appropriate for all banks. Nonetheless, there is significant benefit in the banking sector providing further disclosure here and we encourage banks to consider how they may better systematise and report their transition finance efforts.

Appendix

A. Examples of physical-based metrics per sector (non-exhaustive)

Potential physical-based KPIs to showcase transition		
Sectors	Improvements in green technology	Reduction in carbon-intensive assets
Agriculture and land use	<ul style="list-style-type: none"> • Hectares of forestry established • Tonnes of protected urea fertiliser used • Tonnes of slurry spread using low emissions slurry spreading • Number of cows fed with methane suppressants • Amount of sustainable palm oil accredited to bodies such as RSPO²⁸ 	<ul style="list-style-type: none"> • Hectares of land converted from forest or grassland to arable • Hectares of land degraded or desertified
Aluminium	<ul style="list-style-type: none"> • Tonnes of green/secondary aluminium produced • Number of smelters with low-carbon anodes • Carbon Capture, Utilisation and Storage (CCUS) capacity added 	<ul style="list-style-type: none"> • Tonnes of aluminium produced by fossil fuel-based electricity
Cement	<ul style="list-style-type: none"> • Tonnes of green cement produced • CCUS capacity added 	<ul style="list-style-type: none"> • Tonnes of clinker manufactured in wet kilns • Average clinker to cement ratio
Chemicals	<ul style="list-style-type: none"> • Tonnes of chemicals produced using processes whose energy was provided by green energy sources (e.g. on-site burning of green hydrogen) • Tonnes of chemicals produced from recycled feedstock (e.g. waste plastic) • Tonnes of plastic produced from CO₂ recovery of exhaust gases 	<ul style="list-style-type: none"> • Tonnes of naphtha/crude oil used for thermal decomposition
Commercial and residential real estate	<ul style="list-style-type: none"> • MWh of solar panel added to roofs • m² of EPC A/B-rated buildings constructed • Number of existing buildings retrofitted with low emissions technologies such as energy-efficient heating/cooling systems, better insulation, etc. 	<ul style="list-style-type: none"> • Embodied carbon in construction materials

²⁸ Roundtable for Sustainable Palm Oil.

Potential physical-based KPIs to showcase transition

Sectors	Improvements in green technology	Reduction in carbon-intensive assets
Iron and steel	<ul style="list-style-type: none"> • Tonnes of green primary iron/steel produced (e.g. using Direct reduced iron-electric arc furnances (DRI-EAF) with green hydrogen as the reducing agent) • Tonnes of secondary iron/steel produced by EAF (potentially subdivided where the EAF is powered by renewable electricity) • CCUS capacity added 	<ul style="list-style-type: none"> • Tonnes of steel produced using blast furnaces • Tonnes of metallurgical coal used in the steel-making process
Oil and gas	<ul style="list-style-type: none"> • Quantity of sustainable fuels produced (SAF, low-emission biofuels, hydrogen, ammonia; etc.) – measured in MJ of energy content, tonnes produced, barrels of oil equivalents, etc. 	
Power generation	<ul style="list-style-type: none"> • MW of renewable energy generation capacity added (split by production type), or MWh of renewable energy generated • CCUS capacity added 	<ul style="list-style-type: none"> • MW of fossil fuel-based power generation capacity, or MWh of renewable energy generated • Average age of Coal Fired Power Plant (CFPP) retirement
Transport – aviation	<ul style="list-style-type: none"> • Tonnes of Sustainable Aviation Fuel (SAF) used 	<ul style="list-style-type: none"> • Tonnes of jet fuel consumed
Transport – automobile	<ul style="list-style-type: none"> • Number of EVs produced in total or as a percentage of manufacturers' annual productions • Number of EVs financed in retail Auto portfolios 	<ul style="list-style-type: none"> • Distance driven in Internal Combustion Engine (ICE) vehicles • Litres of conventional petrol/diesel consumed
Transport – shipping	<ul style="list-style-type: none"> • Tonnes of Liquid Natural Gas (LNG) used in the short term as a transition fuel • Tonnes of sustainable fuel (ammonia, green hydrogen, biofuels) used in the longer term 	<ul style="list-style-type: none"> • Tonnes of bunker fuel consumed

About the Net-Zero Banking Alliance

The industry-led, UN-convened Net-Zero Banking Alliance brings together a **global group of banks**, currently representing over 40% of global banking assets, which are committed to aligning their lending and investment portfolios with net zero emissions by 2050 in line with limiting global warming to 1.5°C.

Combining near-term action with accountability, this ambitious commitment sees **signatory banks** setting intermediate targets for 2030 or sooner using robust, science-based guidelines.

NZBA is the flagship climate initiative under the **Principles for Responsible Banking** to accelerate science-based climate target setting and develop common practice. As the banking alliance within the global efforts on net zero across the finance industry brought together under the Glasgow Finance Alliance for Net Zero (GFANZ), the NZBA is open to all banks globally, including banks that are not UNEP FI members and Principles for Responsible Banking signatories.

The Alliance reinforces, accelerates, and supports the implementation of decarbonisation strategies, providing an internationally coherent framework and guidelines in which to operate, supported by peer-learning from pioneering banks. It recognises the vital role of banks in supporting the global transition of the real economy to net zero emissions.

The Alliance is convened by the **UN Environment Programme Finance Initiative** and is a part of the **Race to Zero**.

Learn more here: www.unepfi.org/net-zero-banking/

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