Climate transition plan — a catalyst for reaching net zero

UL Solutions explores how a robust disclosure of a climate transition plan can add credibility to your preparedness for a low-carbon economy.

LET'S GO

UL Solutions

Safety. Science. Transformation.™

Contents

Introduction

Regular climate-change impact reports released by the Intergovernmental Panel on Climate Change (IPCC) over the last few years and the rise in stakeholder pressure to mitigate global warming risks have sparked a long-overdue uptake in companies' commitment to climate change action. Each year, more organizations commit to developing science-based targets to reduce their carbon footprint and contribute toward limiting global warming to 1.5 degrees Celsius by the end of the century.

However, with greenwashing concerns in the environmental, social and governance (ESG) space starting to grow, the diligence used by interested parties to gauge companies' performance against such criteria has started to change. This is especially prevalent in the matter of climate change, which sits under the environmental pillar of ESG.

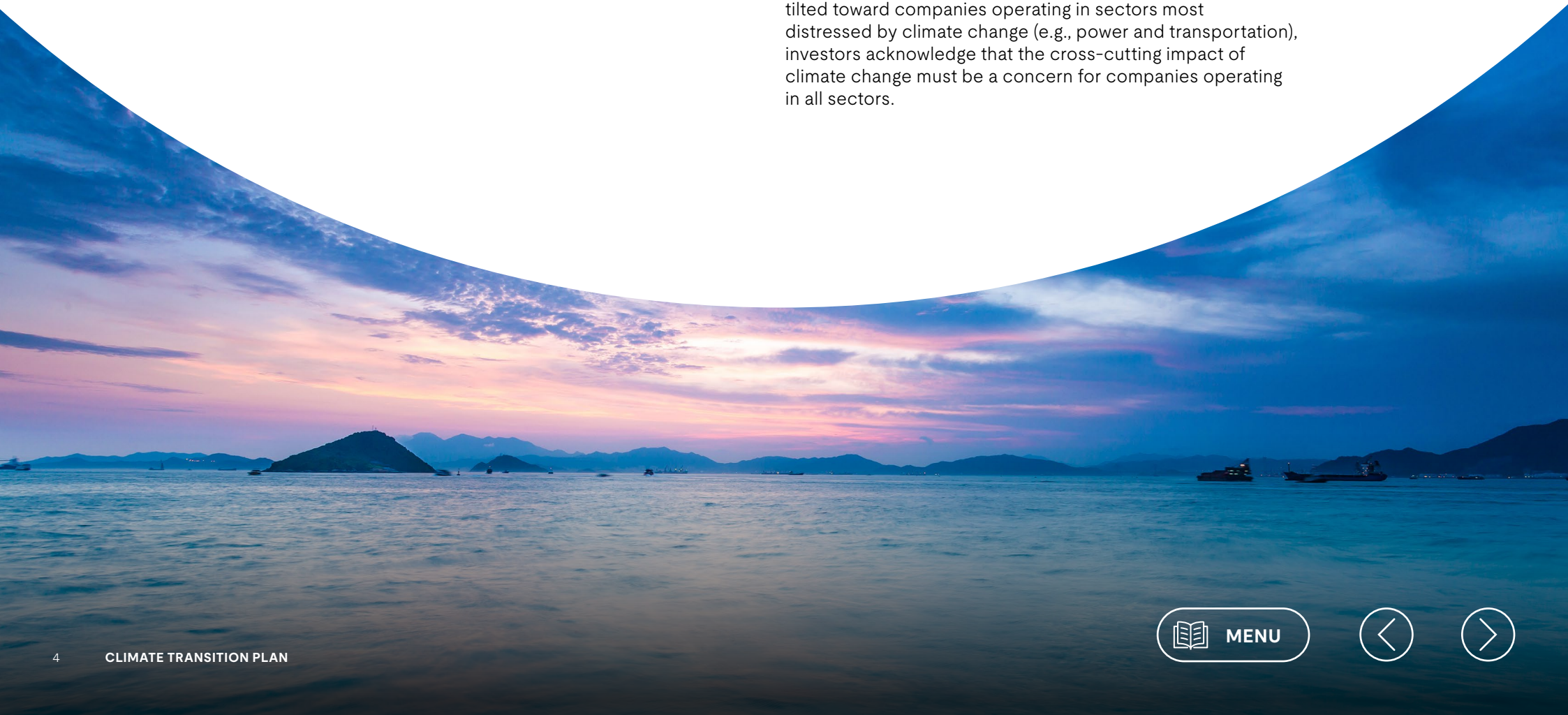
Today, research organizations and investors agree that despite the improved effort in climate-related reporting, public disclosures of many organizations still lack a credible action plan for how they will align their operations and execute long-term strategies in line with the Paris Agreement. Lack of credibility in publicly disclosed planning led to increased demand for the more comprehensive reporting of climate action known as the climate transition plan (CTP). Climate transition plans present a comprehensive set of strategic actions that go far beyond commitments and mid-term carbon performance improvements.

Here we take a closer look at what climate transition plans are, why they are rapidly gaining stakeholders' interest and how companies across the world should prepare to disclose them.

What is a climate transition plan?

A CTP is a detailed, long-term plan of action your company will take to achieve its strategy while aligning with the most ambitious requirements of climate science. The plan must articulate how the company's entire business model, along with its assets and management's strategic decisions, will be deployed to effectively respond to climate-related risks and opportunities during the transition to a low-carbon economy. Transition is usually associated with a date no later than 2050, which is also aligned with the long-term science-based carbon targets aimed at limiting global warming to 1.5 degrees Celsius by the end of the century.

Although the importance of CTP disclosure is naturally tilted toward companies operating in sectors most distressed by climate change (e.g., power and transportation), investors acknowledge that the cross-cutting impact of climate change must be a concern for companies operating in all sectors.



CTP adoption and key elements of disclosure

While there is no single framework for developing and reporting a credible CTP, in recent years, some organizations have begun laying a path toward effective CTP disclosure. In 2015, the French Agency for Ecological Transition (ADEME), together with the Carbon Disclosure Project (CDP), launched an initiative called Assessing Low Carbon Transition (ACT), which led to the development of methodologies for setting and assessing the all-encompassing climate transition plans of companies in various sectors. Later, some of the ACT assessment criteria were further integrated into CDP's annual climate change survey. Similarly, the Task Force on Climate-Related Financial Disclosures (TCFD) in 2021 issued separate guidance for effective reporting of CTP as part of its broader framework for disclosing climate-related financial information.

Many other organizations, initiatives and frameworks significantly contribute to this topic, such as Climate Action 100+, the Investors Group on Climate Change (IGCC), the International Carbon Association Partnership (ICAP) and the Transition Pathway Initiative (TPI), to name a few. While they do not aim to create methods to report on all aspects of CTP, they do include CTP-relevant elements in their climate reporting guidance.

Other emerging topics have been slowly finding their way into transition planning. Among them are responsible lobbying practices on policy decisions and the Just Transition framework aimed to promote social responsibility during the change process. However, while some initiatives are making encouraging progress in promoting these additional elements and sharing practical guidance, they have not yet been widely adopted by companies around the globe.

On the whole, such initiatives and frameworks tend to stress the importance of the following disclosure elements, which constitute robust climate transition planning:

- Effective climate governance is in place that describes specific processes and their frequency for monitoring climate-related risks and opportunities at board and management levels.
- A strategy to achieve net zero is clearly articulated.
- Targets are science-based and in line with the Paris Agreement.
- Scope 1, 2 and 3 emissions accounting is supported with verification.
- Risks and opportunities brought by climate change are assessed.
- Climate scenario analysis is used to stress test the organization's resilience by identifying how plausible future events at various levels of global warming might affect business operations.
- Financial planning is aligned with a science-based decarbonization rate.
- Engagement with supply chain partners to drive carbon reduction across wider company operations is made an inseparable part of transition initiatives.

Why should companies design a credible CTP?

Transition plans and the comprehensive information presented in them will play a fundamental role in driving progress toward a 1.5 degrees Celsius global economy and better-informed decision-making by stakeholders. Among the main reasons for companies to disclose a robust CTP are shareholder pressure, tightening environment regulation and the financial potential of favorable borrowing terms.

Shareholder pressure

Investors are particularly concerned about the credibility of companies' climate commitments and the quality of their transition plans. This can be explained by the fact that climate risk entails financial risk, which makes investors more cautious about their risk assessment techniques and capital allocation decisions. According to Principles for Responsible Investment (PRI), the results of 2022 proxy season in the U.S. showed that shareholders had filed twice as many resolutions addressing emissions as they had in 2021. And 2021 saw a significant increase in the number of proposals for preparing climate transition plans and putting them to a shareholder vote. This trend is an outcome of investor-specific doubts about companies' ability to meet net-zero goals.

Tightening environment regulations

The U.K. recently became the first country to announce mandatory transition plan reporting for the largest traded and public companies, as well as certain financial sector firms, beginning in 2023. The plan will need to set targets to mitigate climate risk, including interim goals between today and 2050 and actionable steps to meet them. Although the special task force is still working toward finalizing the reporting requirements, it is known that the TCFD framework and its guidance on CTP disclosure will form the basis of the new regulation. Similar regulatory developments, with the initial focus on CTPs from the largest companies, are expected to be introduced soon by other jurisdictions, too.

Favorable borrowing terms

Whether organizations are aiming to mitigate climate risks or capture opportunities associated with climate change, the rapid development in sustainable finance is opening access to new financial products aimed at easing companies' transition to a low-carbon economy. From sustainability-linked bonds (SLBs) to sustainability-linked loans (SLLs), company climate transition plans are playing an increasingly important role in the due diligence process of capital providers. For example, selecting relevant key performance indicators (KPIs) and calibrating targets are core principles of SLL frameworks.

Before using SLBs and SLLs to lend money, banks will seek confirmation that a borrower's chosen KPIs are material, and its targets are ambitious and consistent with the overall sustainability of its strategy. A robust CTP with outlined actionable steps would form a strong foundation for such an evaluation. By providing a bank with clear-cut, convincing information, a company can strengthen its eligibility for sustainability-linked financing. Moreover, SSL interest rates often fluctuate in conjunction with the target, such as reducing GHG emissions. Consequently, a company that can demonstrate accelerated decarbonization and performance well above its interim target may be rewarded with a lower interest rate on its remaining debt balance.

The current state of CTPs and their reporting

Of the 13,000 companies around the globe that responded to CDP's climate change questionnaire in 2021, only 4,002 claimed to have developed a low-carbon transition plan. In their special report, the research organization stated that fewer than 1% of companies reported on all 24 key indicators of a climate transition plan identified in the questionnaire. From a target-setting perspective, fewer than 35% of emissions reduction targets were found to be credible or validated by the Science Based Targets initiative (SBTi), and only 6% of all reporting organizations revealed details of a net zero target.

The World Benchmarking Alliance (WBA), in partnership with the CDP and ADEME, in 2021 assessed the transition of the largest companies in different sectors using methodologies from the ACT initiative. In the automobile sector, they identified that not enough companies are supporting their transition plan with financial commitments (e.g., adequate capital expenditure or revenue associated with green activities) and that targets are not ambitious enough to put companies on a path to a 1.5 degrees Celsius economy. For example, only two of the 30 most influential automotive manufacturers have set the sales target for low-carbon vehicles to reach a required 64.5% of the total sales mix by 2030. They also found that 188 of the world's 350 largest food and agriculture companies did not have any GHG reduction target, while only 26 companies were aligned with a 1.5 degrees Celsius trajectory. The state of transition plans in the electric utility sector did not seem to fulfill the expected level of transition progress either. The WBA's benchmark for this sector indicated that the low-carbon performance of 70% of the assessed companies could be expected to worsen soon. The reason: persistent reliance on fossil fuels for electricity generation is likely to cause 98% of companies to exceed their carbon budgets by 2035.

Overall, the findings reveal that companies do not communicate well about actionable plans for achieving their climate-related ambitions. This explains investors' increased demand for more transparent reporting on long-term transition strategies. Ultimately, companies across all sectors need to improve their development of credible plans. Most of today's transition plans are insufficient, with many elements that lack robustness and science-based backing.

<1% of companies reported on all **24 key indicators of CTP**

<35% of emissions reduction targets were found to be **credible by the SBTi**

6% of all reporting organizations revealed details of a **net zero target**

26 of 350 largest food & agriculture companies were aligned with a **1.5 degrees Celsius trajectory**

70% of the assessed electric utility companies could see their **low-carbon performance worsening soon**

2 of the 30 most influential automotive manufacturers have ambitious enough sales targets for **low-carbon vehicles by 2030**

How to compile a robust CTP

The Task Force on Climate-Related Financial Disclosures provides thorough and practical guidance for compiling a robust CTP. The recommendations cover every step, from plan development and strategy execution to periodic reporting. Following its framework can help ensure your company's CTP remains relevant and rigorous throughout the years. Below are some suggested actions you can take to bolster your climate transition plans.

Anchor your plan with quantitative elements

Tailor your plan by including climate-related metrics and targets. Ensure selected KPIs are material, well understood across the organization and tracked regularly. Targets and the actions to achieve them must be consistent with broader economic or sector-wide science-based pathways to a low-carbon economy. Following SBTi's guidance is a good first step to adding significant robustness to your CTP. In addition, attention to and communication of the financial impact of your actions can fuel shareholder satisfaction. Investors always appreciate information about planned capital expenditures and expected revenues from green products and services.

Use specific details to communicate your plan of action

Describe specific initiatives you are planning to meet set targets. For example, explain how you will drive decarbonization by working with key suppliers to reduce your Scope 3 GHG emissions. Or describe how investment in new technology to expand demand for low-carbon products will contribute to the company's long-term climate transition strategy.

Seek independent verification of GHG emissions

Carbon reduction plays a crucial role in managing climate transition risk, which makes it inseparable from climate transition planning. Third-party verification of GHG emissions helps increase the credibility of your carbon data. This will help demonstrate that your GHG reductions and overall carbon footprint are real, reducing the risk of greenwashing accusations and increasing investor trust.

Stress test your organization using climate scenario analysis

Conducting an analysis of plausible future climate events under different global warming scenarios and quantifying their impact on an organization's strategy and financial performance can provide an additional level of insight into a company's preparedness to manage climate risks and opportunities. Companies could start this forward-looking analysis by comparing risks under two very different future climate states — a 2 degrees Celsius scenario and a more than 4 degrees Celsius scenario, also widely called a "business as usual" scenario. Assumed environmental consequences under each climate pathway, which are necessary to assess the potential impact on the company's operations, could be borrowed from publicly available global reference scenarios developed by the IPCC and the International Energy Agency.

It's important to emphasize that explored impacts of both physical risks (e.g., increased flooding or heatwaves) and transition risks (e.g., changes in climate policy or market conditions) must be done in the context of the company's specific operations and assets subject to such events. Overall, the inclusion of scenario analysis with organization-specific nuances will not only strengthen your CTP but also enhance the organization's critical strategic thinking and cross-departmental collaboration.

Where to disclose your CTP

Climate transition plans can be disclosed in a variety of forms. While there is still no global or regional consensus on the optimal channel of communication, transition plans are best placed with other climate-related information. The most popular approaches companies use to communicate this annual information to their stakeholders are:

- Stand-alone climate transition plan reports
- Reports aligned with TCFD-recommended information
- Sustainability reports
- CDP Disclosure Platform (climate change questionnaire)
- Dow Jones Sustainability Indices/Corporate Sustainability Assessment (DJSI/CSA) Annual Reviews

Learn more about how UL Solutions can help with your climate transition plans at UL.com/esgadvisory

BACK TO THE FIRST PAGE

ASP22CS610274