ITALIAN G7 PRESIDENCY: THE CRITICAL ROLE OF TRANSITION PLANS AND THE NEED FOR A SYSTEMIC APPROACH TO FINANCE

POLICY BRIEFING

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TABLE OF CONTENTS

STRATEGIC CONTEXT

Given the imperative to mobilize private investment at the scale required to address climate change, the effective deployment of funding, policies, and frameworks becomes paramount (COP28). Research underscores the potential for larger future growth in private climate finance compared to public finance, considering the substantial presence of private capital in the global financial system alongside the persistent scarcity of public funds.

For instance, the commitment of $870 billion annually by the 30 largest global banks to finance climate solutions highlights the significant role of the private sector, despite slower progress among asset owners and managers in setting public climate investment targets. Both domestic and international private finance must be bolstered to meet climate action needs, with a particular focus on increasing international private finance to Emerging Markets and Developing Countries (EMDC) by more than 15 times current levels to achieve climate mitigation goals.

In this context, **it is imperative to place Transition Plans (TPs) at the heart of the G7 finance agenda as primary tools to re-orient and re-design private and public choices towards resilient and sustainable economic systems.**
If correctly implemented and appropriately integrated in regulatory frameworks, TPs become key instruments in guiding public and private capital flows. They enable all economic market players – from governments to financial institutions and companies – to align their strategies with clear objectives, to meet their low-carbon commitments. This alignment contributes to emissions reduction, the effective and orderly management of climate-related risks, and as a driver of innovation and competitiveness. Importantly, they translate targets into concrete plans which then shape the size of new markets and enable investable projects to surface.

The context in which G7 operates requires to look beyond national borders and adopt coordinated approaches on a global scale. While the G20 remains the chief forum for global economic coordination, the G7 plays a critical role in influencing the international debate through setting standards and ambition. This is even more relevant in 2024 considering the G20 Task Force on a Global Mobilization against Climate Change (TF-CLIMA) set up by Brazil. The TF-CLIMA puts national transition plans and financial frameworks aligned with the Paris Agreement at the heart of the G20 Finance, Climate and Sherpa tracks. In order to make the most of this new setting, the G7 finance and climate tracks should align their strategy, find a common position and support a systemic approach to financing national transition plans. This systemic approach developed by G7 is critical to give confidence, build trust and inform the next set of finance and climate decisions at COP29 and COP30 on the

New Collective Quantified Goal on Climate Finance (NCQG) and the Nationally Determined Contributions (NDCs).

STRENGTHENING THE 2024 COMMUNIQUÉ: FOUR KEY OUTCOMES

Continuity with the work of the Japanese G7 is crucial to develop shared international approaches that create coherence among global initiatives. Past G7, G20 and COP commitments have underscored the importance of aligning and mobilizing financial flows for sustainable and climate-resilient development. Attention is now shifting towards the need of the private sector to design and implement credible net-zero transition plans and accelerate the disclosure of both financial and non-financial climate-related information. The welcomed creation of sustainable taxonomies emphasizes the need of investment decisions aligned with climate objectives.

The past two Japanese ministerial declarations of 2023 (Finance Ministers, Climate, Energy and Environment Ministers and Finance Track) identify transition finance as fundamentally important for all countries, emphasizing the need to consider the specific circumstances of each economic market, differences in regulatory environments, objectives, regulatory frameworks, and the availability of data and metrics.

The G7 Italian Presidency of 2024 provides an opportunity to advance reforms of the international financial architecture, which would not be possible without addressing the crucial role of transition finance in aligning investments with climate goals. **Italy can and should take a leadership role in ensuring that this transition is inclusive, reflecting the specificities of diverse global markets and building upon previous work, particularly the G20 Sustainable Finance Working Group** (Indonesia, India).
Coordinating efforts within the G7 finance and climate tracks is vital for shaping G20 outcomes. The Italian Presidency in 2024 should therefore aim to achieve four outcomes:

1. **Acknowledge Transition Plans as the primary strategic tool for market actors to address climate risks.**
2. **Explicitly recognize the responsible entities for crafting and implementing Paris-aligned Transition Plans (States, Corporates, and Financial Institutions) and ensure tight and strategic interconnections, emphasizing a systemic approach.**
3. **Mandate to develop a common Paris-Aligned TP framework, applicable to all G7 members, that is specific to each entity of the economic system.**
4. **Make Transition Plans mandatory in each G7 member.**

1. MITIGATING CLIMATE-RELATED RISKS: INTEGRATION OF LONG-TERM RISK MANAGEMENT INTO TRANSITION PLANS

According to the European Central Bank, there is a growing consensus among policymakers and supervisors that climate change poses real financial risks. According to the 2023 Global Risk Report of the World Economic Forum, climate and environmental risks are at the forefront of global risk perceptions for the next decade, however indicating a clear lack of readiness and progress on climate action. These risks identified by market actors highlight the need of political support. Similarly, the 2024 Munich Security Report highlights how climate change is the most non-traditional rising threat perceived by the security community as well as citizens. For Italy, it shows that *"among the G7, Italians are the most concerned about the threat posed by climate change. Environmental issues – extreme weather and forest fires, the destruction of natural habitats, and climate change generally – make up Italy's top three threats, as they did last year."*

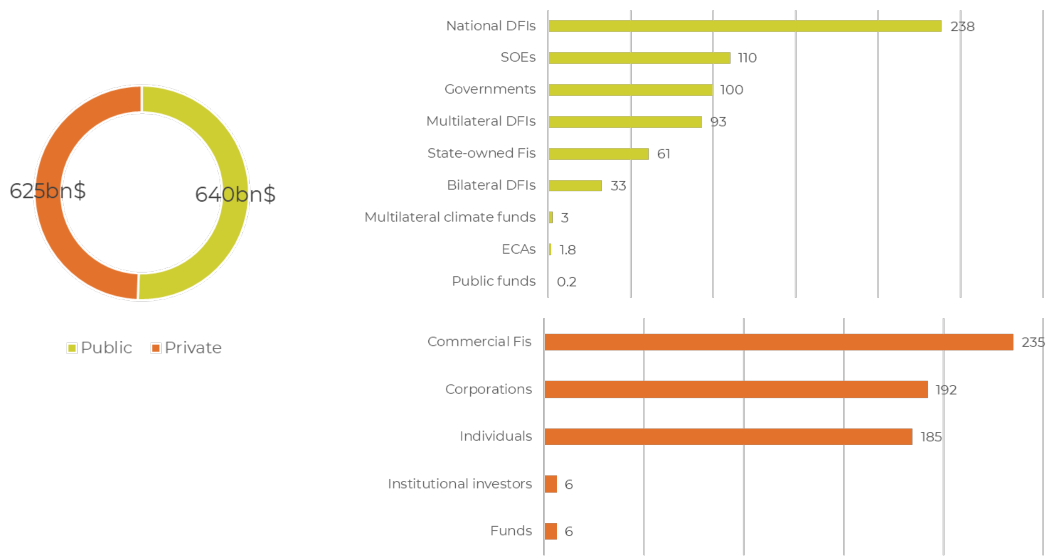
Transition plans emerge as the most appropriate tool of a precautionary approach that all economic actors should adopt to effectively mitigate climate risks.

The prevailing tendency to treat climate risks as short-term issues overlooks their long-lasting impacts, with climate change not only amplifying existing systemic risks but also emerging as a systemic on its own. For this reason, in order for TPs to be effective, they should stem from robust risk assessments that take in account short-, medium- and long-term scenarios, for physical and transitional climate-related risks. Integrating a granular analysis of climate risks into current Risk Management Systems is crucial in order to identify the economic repercussions of climate change on market actors across different time horizons.

Given the wealth of scientific research underscoring the economic and social consequences of climate change, it becomes critical that national and supranational policies recognise the economic and security relevance of transition plans. **The G7 has a pivotal role in acknowledging transition plans as the primary strategic tool for market actors in addressing all climate-related risks.** If constructed with a clear focus on building resilience to an increasing uncertain world, they would go beyond mere communication tools for carbon footprints or signalling reduction targets. Instead, they should become concrete action – indeed transformation – plans to manage the economic and security interests of nations, companies, and financial institutions.

2. THE IMPORTANCE OF A SYSTEMIC APPROACH

In order to meet the Paris Agreement objectives, it is crucial for all entities within the international financial architecture to play a role in achieving the goals set by the agreement. The data clearly indicates a relatively even distribution in 2021/2022 of global climate financing between public and private entities, with private actors contributing 49% of the total financial flows.



Source: Climate Policy Initiative 2023

This landscape shows the importance of adopting a systemic approach: all agents of the economy can and must be called upon to develop transition plans to achieve climate goals and mobilise the investment needed.

It is thus crucial that the G7 explicitly recognise the actors responsible for crafting and implementing Transition Plans, and ensure that these plans are tightly and strategically interconnected. These actors are:

- **States** through NDCs and National Energy and Climate Plans (NECPs) in the case of the European Member States. National transition plans work as a pivotal tool in steering the country's decarbonization pathway and the transition away from fossil fuels agreed at COP28 in Dubai. They are key to providing guidance and support for private actors and regulators in developing their own Transition Plans, underpinned by sectoral pathways and supportive policies. The governance of national plans, policies, and incentives plays a crucial role in interpreting the mandates and the work undertaken by the national financial and economic architecture.
- **Corporates**: Empowered and guided by the strategies of their respective Governments, every individual company must craft its own transition plan. These

plans should be tailored to the specific technical features of each sector, designed for the specificities of each company, setting out how that company is going to support the delivery of nationally determined contributions by aligning to sectoral pathways through the decarbonisation of its products or services.

- **Financial institutions:** It is essential for every type of financial entity to implement transition plans for the entire value chain, encompassing activities from upstream to downstream (such as investments and exposures), to articulate how they are going to support the real economy transition and meet climate finance commitments. Beyond banks, insurance, investment funds and asset managers, regulatory bodies and central banks must consider the impacts of climate change on the entire economic system, which is crucial to ensure financial stability, monetary stability, long term economic growth and systemic risk management.

3. HARMONIZING TRANSITION PLANS FOR GLOBAL COMPETITIVENESS

The increasing recognition of the strategic significance of Transition Plans has led to a proliferation of frameworks across various institutions and nations in recent years. A most prominent example is the framework developed by the Transition Plan Taskforce (TPT), initiated by the UK HM Treasury in April 2022, which is now recognized as the golden standard for private sector climate transition plans and that relies upon the international Financial Institution Net-zero Transition Plans, drafted by GFANZ. Another key tool, the Task Force on Climate-related Financial Disclosure (TCFD) Framework, provides comprehensive guidelines for reporting information on climate risks, opportunities, and the associated strategies and governance.

Equally crucial is the ESRS1 on Climate Change, a mandatory standard for companies within the European Corporate Sustainability Reporting Directive (CSRD) scope. It offers guidance on reporting and encompasses processes for identifying and assessing material climate-related impacts, risks, opportunities, and targets related to both mitigation and adaptation. Internationally, the Science-Based Targets initiative (SBTi) standard is widely used to set science-based targets aligned with the objectives of the Paris Agreement.

The existence of various voluntary frameworks and guidelines points to the need for finding consensus among G7 for a unified approach. The development and implementation of a common Transition Plan approach serves not only to enhance the credibility of individual plans but also to ensure comparability of information. Importantly, from a business competitiveness standpoint, **having comparable information at the G7 level represents a significant opportunity. It enables market**

players to benchmark themselves against global standards, fostering transparency and accountability. **This creates a level playing field, promoting healthy competition and encouraging companies to strive for ambitious and credible plans** and minimise reporting burdens on entities operating across multiple jurisdictions. In essence, the standardization of Transition Plans would give market players valuable information to understand where they are on sustainability and to enhance their competitive edges.
Likewise, **supervisory bodies, Central Banks, regulators and Governments face significant challenges in identifying and addressing the risks associated with climate change due to the lack of available and comparable data.** Without comprehensive information provided through TPs, the ability of these entities to effectively manage the consequences of climate inaction is severely hindered. There exists a crucial link between the technical work of data collection and the development of a robust policy framework that encourages, supports, or mandates the disclosure of TPs. This connection is vital for ensuring that decision-makers have access to accurate and reliable information to formulate effective policies and regulations. Without such data-driven insights, regulatory and governmental efforts will fail on their mandate to protect the public interest, leaving financial systems and economies vulnerable to the impacts of climate change. **Fostering collaboration between technical experts, policymakers, and financial market participants is essential to bridge the gap between data collection and policy development, ultimately enhancing the resilience of financial systems. Integrating TPs into the supervisory and regulatory toolkit requires adherence to the proportionality principle and the tailoring of approaches to the size, relevance and exposure of financial institutions to transition risks.**

4. MAKING TRANSITION PLANS MANDATORY

Despite one-third of major public and private corporations have committed to net-zero pledges, less than 10% are currently making substantial progress toward achieving these goals. While 565 financial institutions, as members of the Glasgow Financial Alliance for Net Zero, have announced some form of net-zero targets for their financing activities and portfolios, fewer than half have established well-developed goals with specific targets and timelines, resulting in a situation where substantial capital remains unutilized (CPI, 2023).

If Governments are serious about addressing climate change in time according to science and want to ensure that all economic actors play their fair share, the G7 must forge a consensus – starting from themselves – for the adoption of mandatory transition plans globally.

Many countries are already doing in this direction: the **EU** Corporate Sustainability Due Diligence Directive indicates a growing commitment to mandating the implementation of climate transition plans for companies and financial institutions. The **UK** Companies Act is already asking for a TCFD-aligned report and is expected to align its disclosure rules with the International Sustainability Standards Board's (ISSB) standards, integrating the disclosure requirements with several provisions relevant to transition planning, and the UK Financial Conduct Authority is expected to adopt ISSB and TPT outputs for its listing rules. In 2022, the **US** Securities and Exchange Commission proposed rule changes that would require a registrant to disclose information on the management processes of climate-related risks, the impacts that these climate-related risks have on business and on transition activities. Other major economies like **Japan, Nigeria, and Singapore** are also set to adopt ISSB's S1 and S2 disclosure standards, encompassing requirements related to transition plans. **Australia** is actively consulting on the disclosure and implementation of standardized, internationally aligned requirements for disclosing climate-related financial risks and opportunities, emphasizing the global shift towards mandatory transition plans:

- At the national level, mandatory TPs would serve as a catalyst for comprehensive climate action, aligning governments with the global commitment to combat climate change.
- For companies, the obligation to adopt and implement TPs ensures that they proactively assess, disclose, and address their climate-related risks and opportunities. This would also foster transparency, allowing stakeholders to make informed decisions and promoting responsible business practices.
- For financial institutions, a mandatory TP provides a standardized methodology for assessing climate risks, enabling them to make informed investment decisions aligned with sustainable practices. This harmonization also facilitates comparability across different institutions, contributing to the stability of financial markets.

Mandating TPs at the G7 level goes beyond a mere regulatory requirement: it can foster fair competition and collaboration to achieve collective climate goals. By establishing a standardized and compulsory framework for states, firms, and financial institutions, the G7 would ensure that all actors across borders are held accountable to the same standards. Such standardization would create a level playing field, thus preventing actors in jurisdictions with lower standards to gain unfair competitive advantage.

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