Credit Suisse | Climate Bonds Initiative

Financing Credible Transitions:
Summary note

A robust framework: transition is ambitious

Many labelled "transition" transactions have come out over the past few years using different definitions of transition. As this market grows, investors want to be sure that this is not greenwash but that the label is being used to identify activities that are having an impact - i.e. are making a substantial contribution to reducing global emissions.

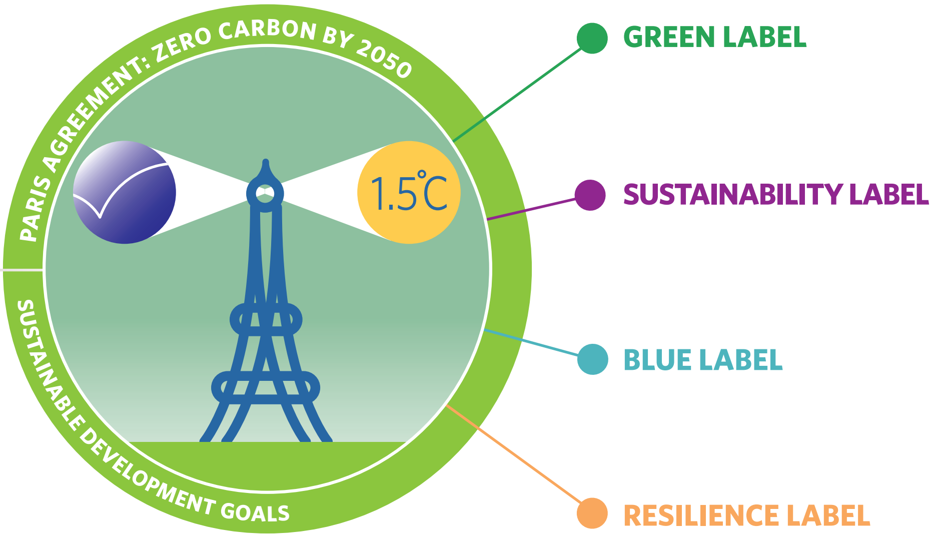
This is a summary note of a paper presenting an ambitious framework for identifying credible, Paris-aligned transitions. The aim is to support the rapid growth of a transition bond market as part of larger and liquid climate-related market. We seek to deliver confidence for investors, clarity for bankers and credibility for issuers. The full paper is available at www.climatebonds.net/transition-finance.

There are many pathways to Paris

TRANSITION LABEL

The Transition label is one pathway to achieving the goals of the Paris Agreement.

It is part of a wider universe of essential and ambitious Paris-aligned investments that includes other labels (not a focus of this paper). Regardless of the label, all are 'green' as they contribute to environmental objectives.



5 principles for an ambitious transition

1. In line with 1.5 degree trajectory
All goals and pathways need to align with zero carbon by 2050 and nearly halving emissions by 2030.

2. Established by science
All goals and pathways must be led by scientific experts and be harmonised across countries.

3. Offsets don't count
Credible transition goals and pathways don't count offsets, but should count upstream scope 3 emissions.

4. Technological viability trumps economic competitiveness
Pathways must include an assessment of current and expected technologies. Where a viable technology exists, even if relatively expensive, it should be used to determine the decarbonisation pathway for that economic activity.

5. Action not pledges
A credible transition is backed by operating metrics rather than a commitment/pledge to follow a transition pathway at some point in the future. In other words, this is NOT a transition to a transition.

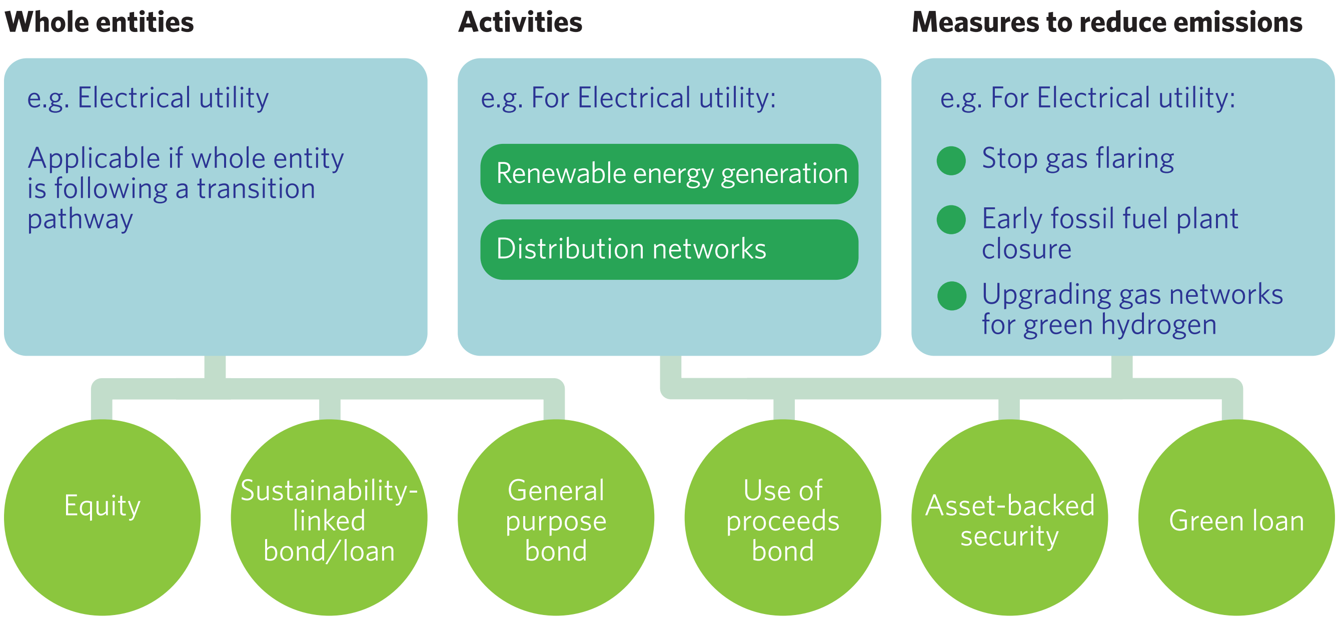
A flexible framework
applicable to whole entities and everything that they do

The transition concept (and label) is applicable for both whole entities and all of their activities and therefore goes beyond the use of proceeds model common in the green bond market.

We propose that the transition concept is applicable to entities if the entire company is on a transition pathway. We do acknowledge, however, that the work to map out and certify whole entity transitions is still at a nascent stage.

The implication of this is that the framework is applicable to a broader range of financial products.

- For whole entities: equity investments, general purpose bonds and sustainability-linked loans/ bonds.
- For activities: asset-backed securities and use of proceeds bonds (already well-used in the current green bond market).



An inclusive framework
promoting an economy-wide transition

Only a few economic activities operate at or near zero emissions today.

For some high-emitting activities, feasible low/ zero-emissions solutions are possible within a reasonable timeframe - transition should be towards those solutions.

For others, there are no such solutions. Instead, substitute low-emission activities are in development - transition should be away from existing activities towards the better alternatives.

To account for these differences, economic activities can be categorised based on two factors:

- Is it needed post 2050?
- Can it be decarbonised in line with the Paris Agreement?

This gives rise to 5 categories:

NEAR ZERO
Activities already at or near net-zero emissions that may require some further decarbonisation but not a significant transition - e.g. wind power generation.

PATHWAY TO ZERO
Activities needed beyond 2050 and have a clear 1.5-degree decarbonisation pathway – e.g. shipping

NO PATHWAY TO ZERO
Activities that are needed beyond 2050 but at present, do not have a clear 1.5 degree decarbonisation pathway to 2050 – e.g. long-haul passenger aviation.

INTERIM
Activities currently needed but should be phased out by 2050 – e.g. production of energy from municipal waste

STRANDED
Activities that cannot be brought into line with global warming targets and have an alternative, low-emissions substitute - e.g. electricity generation from coal.

Who should use the transition label and how?

Following the five principles outlined ensures investments are aligned with the Paris Agreement and could be viewed/labelled as ‘green’. But, there is a useful distinction between activities that do not have a long term role to play in a low carbon economy and those that do. This is the foundation of a demarcated ‘transition’ label. In broad terms, we propose that:

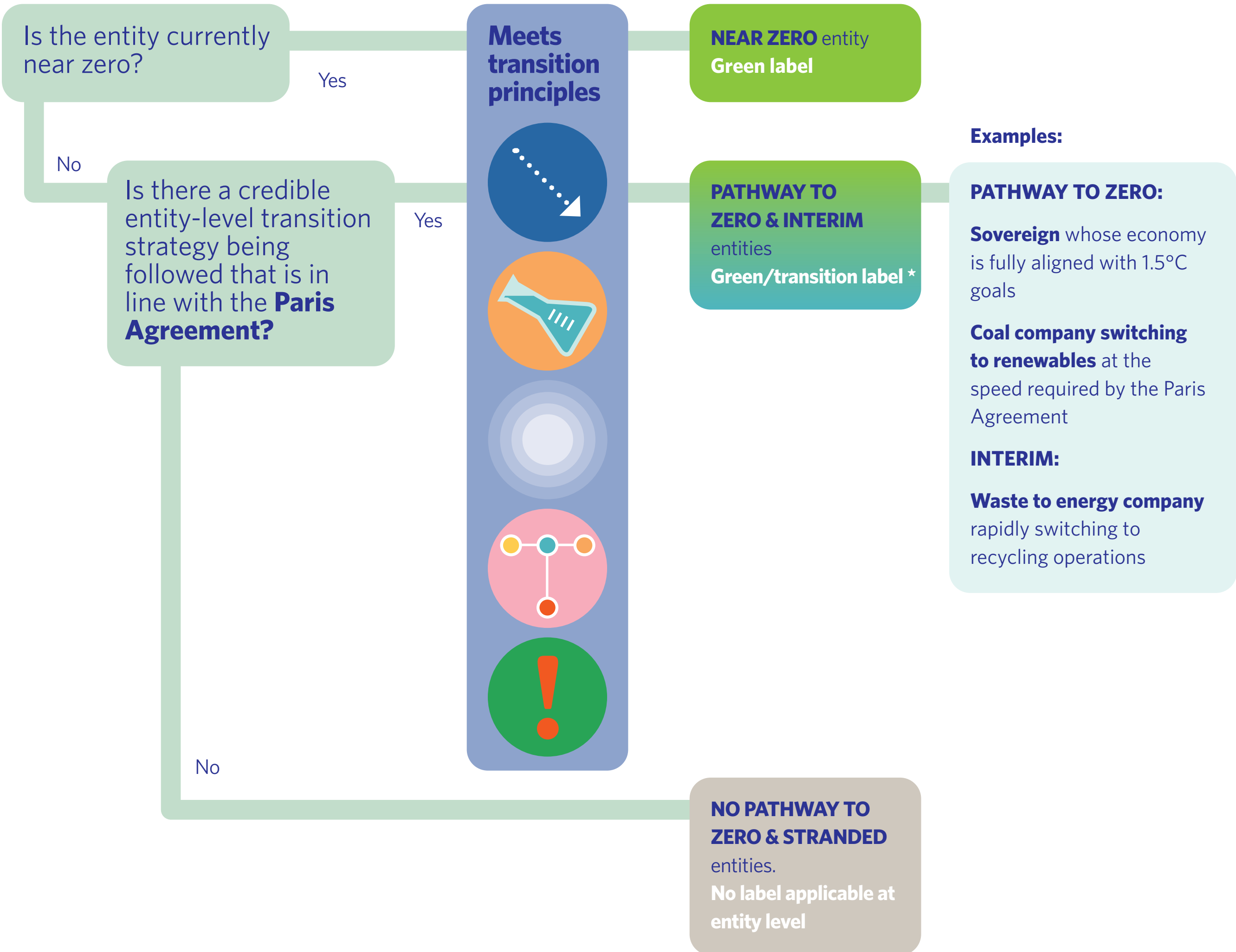
The **green label** be used for investments that have a long-term role to play in the low carbon economy and are near zero or following decarbonisation pathways in line with the Paris Agreement.

The **transition label** be used for investments that:

- are making a substantial contribution to halving global emissions by 2030 and reaching net zero by 2050 but do not have a long term role to play; OR
- will have a long term role to play, but at present the pathway to net zero is not certain.

The following decision trees can be used to classify entities and activities within this Transition Framework

For entities:



***Why can green or transition labels be used?**

This proposal leaves open whether ‘pathway to zero’ investments be labelled as green or transition. In theory, they can be labelled as green as they are aligned with the Paris Agreement. However, given the current lack of consensus on appropriate, viable transition pathways for some activities, flexibility is built in if a more cautionary approach is preferred in the short term.

For activities:

Activity provides a product or service needed up to and **beyond 2050** (as no viable substitutes exist)

Already net-zero

NEAR ZERO
Green label

Yes

Activity can be aligned with **Paris Agreement** global warming target

Not as yet

Meets transition principles

Yes

PATHWAY TO ZERO
Green/transition label*

Yes

NO PATHWAY TO ZERO
Transition label

By definition, the activity cannot be aligned with the Paris Agreement. Therefore the only eligible investments are measures that **significantly** reduce emissions in the short to medium term

Not as yet

Activity provides a product or service **needed in the interim** until viable alternatives are available

Yes

Yes

INTERIM
Transition label

Yes

STRANDED
Transition label

By definition, the activity is not needed post 2050. Therefore the only eligible investments are measures that **significantly** reduce emissions in the short to medium term and no lock in of high carbon technology

Not needed

Not as yet

No Label
Activities that do not meet the principles are not eligible for a label

Examples:

Steel production meeting decarbonisation pathway

Credible measures to decarbonise activity may include:

Retrofits of airline fleets to operate with a maximum biofuel or synfuel mix

Operation of plastics recycling facility until sunset date

Capture and utilisation of gas leakage from closed landfill

Decommissioning of a coal-fired power station early

ENABLING ACTIVITIES
Green/transition label*

These are essential goods and services in supply chains and cut across all of the categories. Their appropriate label depends on what they are essential to.

Find the full paper at:
https://www.climatebonds.net/transition-finance

Design: Godfrey Design

Climate Bonds Initiative

Credit Suisse

Written by Climate Bonds Initiative
Supported and funded by Credit Suisse