Climate transition plans: How EU standards can help companies to focus on the right data

Climate change is a critical issue that no company can afford to ignore. The goal of limiting the temperature increase to 1.5°C has become the standard. This implies net-zero emissions by mid-century. Hence, it is becoming essential for companies’ success and survival to align their business models with a net-zero future. As BlackRock’s CEO Larry Fink wrote in his last letter to CEOs: “The conventional wisdom was the pandemic would divert attention from climate. But just the opposite took place, and the reallocation of capital accelerated even faster than I anticipated.”

To align their business models and strategies with a net-zero emissions goal, companies need to develop comprehensive climate transition plans that address core aspects of their business strategy. And companies increasingly do so as Paul Polman, former CEO of Unilever, pointed out: “The proliferation of corporate decarbonization plans and sustainability initiatives has now reached an impressive crescendo.” But at the same time he adds: “Regrettably, the same can also be said of greenwashing (...). So far, corporate ESG data has been lacking in quality, consistency, and comparability, which makes it difficult for asset managers to determine where to direct investments.”

As the EU Sustainable Finance Strategy aims to channel an additional EUR 500 billion of private investments each year into sustainable business activities, companies need to focus on and report the right data to be able to harness this opportunity. To help them do so, the EU is replacing its legislation on ‘non-financial reporting’ with a new Corporate Sustainability Reporting Directive (CSRD), which will be accompanied by EU sustainability reporting standards. While the Non-Financial Reporting Directive (NFRD) provided some guidance, it left many details unaddressed. The EU Sustainability Reporting Standards will provide companies with clarity on how to report on their climate transition towards a net-zero economy, how to conduct scenario analysis, and on the key metrics to assess risks, opportunities, performance, and impacts. Meanwhile, investors will rely on companies to provide this information, as they will disclose associated information and data in accordance with the EU Sustainable Finance Standards.

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Key issues that the EU sustainability reporting standard needs to address

Despite the urgency and its implications for businesses, companies struggle to analyze climate risks and opportunities and provide the right data about their climate transition plans as research by the Alliance for Corporate Transparency on 1,000 company reports shows. This also holds true for Germany. The German Environment Agency assessed data of 228 German companies, showing that although more than 80 percent of the companies disclosed climate-related information in 2019, only 30 percent mention climate strategies and only 19 percent mention climate-related risk and opportunities.

Figure 1: Climate and environmental reporting by German companies.

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The right data for climate transition plans

Climate change transition plans are essential for companies to set up their strategies to contribute to and thrive in a transition towards a net-zero economy. Net-zero refers to the goal of achieving zero net emissions of greenhouse gases. The European Union has set this goal for 2050, Germany for 2045 even. Thus, a climate transition plan needs to set out the pathway of how ‘net zero’ will be achieved by the company – with milestones and clear measures along the way – to ensure it meets its objective.

So far, there is not yet a standardized framework to develop climate transition plans. This lack of standardization has prevented the comparability of already existing transition plans, esp. across sectors (see table 1).

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<th>HeidelbergCement</th>
<th>EnBW</th>
<th>Deutsche Bank</th>
<th>Allianz</th>
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<td>• Net-zero concrete by no later than 2050.</td>
<td>• Net-zero by 2035.</td>
<td>• By 2025, the volume of ESG financing and the portfolio of managed assets in sustainable investments are expected to increase to a total of more than EUR 200 billion.</td>
<td>• Exclusion of coal-based business models by 2040 and exclusion of corporates with high ESG-risks indicating no sign of engagement success.</td>
<td>• Development of transition plan with long- and short-term targets, based on Science Based Targets Initiative.</td>
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<td>• Emission reduction target of 30 percent by 2025.</td>
<td>• Cut emissions in half by 2030.</td>
<td>• The definition of sustainable engagement is based on the EU taxonomy for sustainable activities.</td>
<td>• Net-zero by 2050.</td>
<td>• Financing only renewable energy in the energy sector; through direct lending (EUR 1,653 million) and investments through company’s funds (EUR 234 million).</td>
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<td>• Target of less than 500 kg CO2 per ton of cementitious material for 2030.</td>
<td>• By 2030 only the newest coal-fired power plants will be up and running.</td>
<td>• Emission reduction of 25 percent by 2025 compared to 2019.</td>
<td>• Align all real estate investment with a 1.5°C-pathway by 2025.</td>
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Table 1: Specific examples of key strategies of companies’ own understanding and development of climate transition plans.10

Thus, to obtain comparable climate transition plans, companies need clarity on key reporting elements, methodologies to be followed, and sectoral specifications for indicators in order to develop relevant and comparable data. Table 2 displays the main elements that should be considered in climate transition plans.

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<table>
<thead>
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<th><strong>Main elements that should be considered in climate transition plans</strong></th>
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| Carbon emission reduction targets | • Targets on overall emissions, including:  
  ○ milestones for the short (2025/2030), medium (2035/2040) and long-term (2045/2050)  
  ○ alignment of the company's net-zero ambition with the 1.5°C objective, and information on the source and details of the scenario on which the plan is based  
  (financial companies should focus on the carbon footprint of their investments) |
| Climate action plans | • Short, medium, and long-term horizons, including:  
  ○ site-level transition plans for the main sources of emissions  
  ○ constraints identified in the implementation |
| Investment targets | • Target for investment in or development of products and services substantially contributing to climate change mitigation or adaptation  
  • EU taxonomy exposure targets |
| Capital allocation | • Capital allocation, including CAPEX plans on:  
  ○ new sustainable/taxonomy-eligible activities  
  ○ retrofit/decommission harmful activities |
| Metrics | • Greenhouse Gas Emissions and Intensity: Scope 1 (direct); 2 (indirect from energy); 3 (indirect that occur in value chain)  
  • Energy: Consumption and/or production from renewables; overall consumption and efficiency (in high-consumption sectors)  
  • Share of turnover and CAPEX associated with Taxonomy-aligned activities substantially contributing to climate change mitigation and adaptation  
  (financial companies need to provide corresponding indicators regarding the impacts of their assets related to the value of the investment) |

Table 2: Main elements that companies, investors, insurers and banks need to consider in their transition plan.

In absence of a clear, standardized framework so far, companies should already carry out two assessments to be prepared to **develop** their respective **climate transition plan**:

1.) An **analysis of the entire value chain** to identify where the **main impacts**, as well as **risks and opportunities** are (in the sense of a **double materiality** perspective). Not only is this increasingly expected by providers of financial capital and by regulation, but it is also important to understand the resilience of business models and for setting the right focus.

2.) In addition, an **analysis of climate-related risks and opportunities**. This is crucial for identifying investment needs and gaps for a transition towards climate-neutrality. A very **common framework** for such an assessment is provided by the **Task Force on Climate-related Financial
Disclosures\(^1\) (TCFD), whose recommendations were globally endorsed and provide a basis for the development of European standards.

### What is still missing in the current CSRD proposal?

1. **Clarification on what is meant by net-zero target** as well as **key reporting elements and methodologies** (see table 2) — including the activities and types of emissions covered by such a definition. But also clarification on the additional information companies should disclose in this sense, including interim objectives and related timelines, and capital alignment.

2. **Sector-specific calculation methodologies of greenhouse gas intensity and Scope 3 greenhouse gas emissions (carbon footprint)**. Clarification on the methodologies used by companies, especially for scope 3 emissions. This is particularly problematic in light of the increasing relevance of value chain-related emissions for the climate policies of both public and private investors.

### The right data for climate-related risks, opportunities and governance

According to CDP\(^2\), **200 of the world’s largest listed companies** forecast that **climate change could cost them a combined total of almost USD 1 trillion**, with the majority of costs to become material in the next five years. On the other hand, **opportunities will arise**. The **value of low carbon opportunities such as** through higher demand for electric vehicles and green infrastructure identified by **882 European companies has reached EUR 1.22 trillion, more than six times higher than the investment cost** of EUR 192 billion, as shown by another CDP study from 2020\(^3\). In addition, the Business Commission for Sustainable Development reported **that meeting the UN Sustainable Development Goals (SDGs), would create market opportunities of EUR 10 trillion per year by 2030**\(^4\).

**Understanding these climate-related risks and opportunities is essential for a company’s ability to define a meaningful strategy.** It allows calculating the costs of inaction, prioritizing the right investments, and attracting capital in favor of their low-carbon transition. While this holds true for all sectors, especially companies in high-impact sectors need a comprehensive analysis to understand what lies ahead of them.

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\(^1\) TCFD (2021); *"TCFD Recommendations*", https://www.fsb-tcfd.org/recommendations. Last retrieved: 2021-05-17.


To understand risks and opportunities, the analysis and an according disclosure should cover the following:

- **Principal risks for short, medium and long-term horizons**, differentiated between:
  - **Transition risks** facing the company’s business model in a 1.5°C scenario, taking into account the EU net-zero strategy and milestones and the company’s targets. This allows companies to understand whether their own targets are ambitious enough and aligned with international objectives, as well as the costs of inaction.
  - **Physical risks**, such as extreme weather events and environmental changes threatening the company’s assets or value chains. This analysis should take into account various other scenarios beyond 1.5°C.
  - **Litigation risks** for companies become increasingly material, as seen by the Dutch court decision that Shell needs to bring its emissions in line with the Paris climate targets. At the same time, rulings against state governments as seen by the German Constitutional Court that recently demanded the German government to raise its 2030 emission reduction targets have in turn effects on increasing transition risks.

- Integration of the **assessment of climate risks and opportunities in the governance** of the company, which is critical for the company’s ability to consider the need for major changes to its business model and strategy. It represents an important proxy reflecting the company’s seriousness and maturity in terms of managing risks and opportunities and integrating them in the company’s overall strategy. Details on how to advance governance-related disclosures can be found in our previous article “What needs to be reported on sustainability-related Governance (of ESG)”15.

- **The analysis should be supported by quantitative financial estimations** where possible, such as the costs of carbon emissions or emission allowances, or the growth of the market for sustainable products or services.

From these points above, for Michael Schmidt, Chief Investment Officer at Lloyd Fonds AG, sustainable corporate governance is of major importance in order to turn risk into opportunity management: “It is all about resilient and robust climate transition plans. Those can only be achieved when sustainability-related risk and opportunity management is clearly linked to a companies’ governance. Only thus, climate-related factors become material”16. Katarin Wagner, Head of Corporate Sustainability, HSBC, underlines this by stating that “companies following their climate-neutral transition plans, are more resilient and successful than those without”17.

Clear EU climate reporting standards are of critical importance to help navigate companies through their transition. And as concluded by the European Project Task Force on Non-Financial Reporting Standards under the European Financial Reporting Advisory Group (EFRAG) in its final advice to the European Commission, standards on climate change should be one of the early priorities of the future EU corporate sustainability reporting framework.

What is still missing in the current CSRD proposal?

1. **Baseline climate scenarios and tools for scenario analysis.** Clarification on which scenarios companies should use, and guidance on how to implement the analysis. Using scenario analysis to identify long-term risks and opportunities is extremely challenging for companies. The role of the standards should not be to merely copy from the far-reaching, yet vague requirements of existing international standards, but rather to help companies to assess the opportunities and risks.

2. **Metrics for risks and opportunities.** Clarification on what to disclose on risks and opportunities. EU standards can provide more specific indications for companies to follow, especially with respect to key sector-sensitive quantitative indicators.
This article is part of our series “Full Disclosure: Monthly Briefing on EU Corporate Transparency Regulation”, in which we aim to shed light on the need for and benefits of forward-looking reporting requirements in a changing EU regulatory environment. The series includes to date:

- **The EU Sustainable Finance April package and how EU sustainability reporting standards fit in** (May Issue): [https://www.germanwatch.org/de/20152](https://www.germanwatch.org/de/20152)
- **What needs to be reported on sustainability-related governance?** (April Issue): [https://germanwatch.org/en/2081](https://germanwatch.org/en/2081)

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