

TRANSITION AND THE ENABLING ROLE OF TAXONOMIES AND FRAMEWORKS

The Investor Leadership Network



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INTRODUCTION

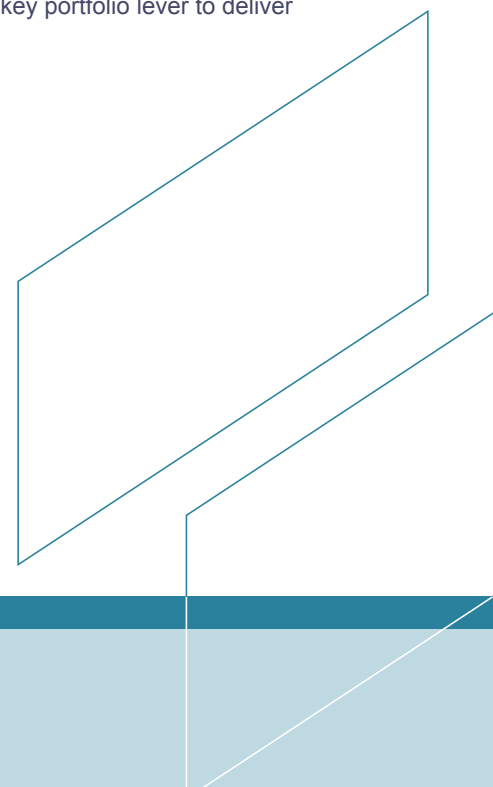
As the world mobilises towards achieving net zero emissions by 2050, the investor community can play a pivotal role in scaling capital flows at pace to deliver real-world decarbonisation and have a measurable impact on climate change. A critical part of achieving net zero is helping high-emitting sectors transition.

This paper seeks to provide asset managers and owners with perspectives on how the dynamic nature of the transition can be reflected in their investment strategies. These views are based on the practical insights gathered from ILN Members. By developing transition frameworks, investors can outline the tools, capabilities and principles for credible in-house transition approaches that support the decarbonisation of carbon-intensive sectors and achieve their climate commitments and ambitions. Approaches include exploring how to quantify and progress assets' transition readiness, capability, and trajectories and how to communicate this investment approach transparently.

While public and market actors continue to develop industry taxonomies and standards for transition financing, the investor community is developing proprietary solutions that can enable their portfolios to achieve decarbonisation goals, with a focus on decarbonising the real economy. To facilitate this, the ILN Members are together leading the industry thinking on transition finance. With a membership spanning geographies, asset classes and investment strategies, members are leveraging cross-network insights and experience to develop innovative proprietary approaches for their respective organisations.

How to read this paper

This paper aims to drive awareness among the broader investor community of how transition finance frameworks and taxonomies can be developed and applied to support decarbonisation goals. It builds on existing ILN Thought Leadership, including our recent whitepaper '[Investing for the low-carbon transition – Turning Portfolio Targets into Action](#)', which provided a behind-the-scenes look at leading asset owners' and asset managers' early experiences and innovative approaches in delivering portfolio decarbonisation goals alongside real-world decarbonisation. This paper identified capital allocation toward decarbonising assets or those in sectors with high transition impact as a key portfolio lever to deliver portfolio alignment.



ABOUT THE ILN

Launched at the 2018 G7, the Investor Leadership Network (ILN) champions initiatives and facilitates collaboration across leading global investors who are committed to accelerating the transition to a more inclusive and sustainable economy. The ILN's membership is comprised of 13 global institutional investors across six countries, with over US\$10tn in assets under management. This platform encourages members to share resources, expertise and networks to develop, promote and deliver scalable initiatives and solutions on climate change, diversity and inclusion, and sustainable infrastructure. The ILN established its Climate Change Advisory Committee (CCAC) to facilitate collaboration

among global investors, build on existing guidance and best practices, and promote and operationalise net zero commitments. The ILN's CCAC is dedicated to providing investors and other industry stakeholders with resources and guidance to assess, manage and mitigate the impacts of climate change. The initiative's previously published reports have supported investors in integrating some of the most pertinent climate-related initiatives and practices. Each publication has advanced the industry's understanding of climate change impacts and the urgency of investor's involvement in supporting mitigation and adaptation.



PART 1

THE DEVELOPMENT OF TRANSITION FINANCE APPROACHES

BASELINING UNDERSTANDING OF TRANSITION FRAMEWORKS

A transition framework is a set of methods embedded to assess a transition 'claim' over time and for different asset classes. Frameworks may include a taxonomy, a standardised classification approach via screening criteria that allows investors and organisations to consistently evaluate the eligibility of economic activities at the asset and sector level. However, frameworks may also include tools suitable for assessing those claims at a corporate level such as a credible transition plan assessment.

Transition finance frameworks and taxonomies help move the transition conversation away from subjective viewpoints and definition-based qualitative discussion, towards data-driven decision-making. They do this by providing definitional clarity and enabling financial institutions to measure, manage and benchmark the rate of progress towards company and sector-based net zero targets. Transition frameworks and taxonomies can also facilitate coordinated capital allocation towards technologies, activities or organisations that are aligned with credible, science-based transition pathways, or to engage those that need to accelerate their transition pathway.

The IIGCC guidance¹ is one example of a maturity scale for transitioning assets that provides a useful benchmark for asset classification:

- **Achieving net zero:** If an asset is achieving the listed criteria and already has an emissions intensity of the 'net zero' level required for its sector in 2050.
- **Aligned:** An asset achieving all listed criteria, but not yet achieving the required emissions intensity.
- **Aligning:** Where an asset has initial criteria (ambition, targets, emissions performance and governance) in place, it can be considered 'aligning' to a net zero pathway. Alternatively, where an asset compiles and discloses its emissions performance level relative to the relevant science-based net zero decarbonisation pathway for the sector, it can also be considered 'aligning'.
- **Committed to Aligning:** An asset that has defined its net zero ambition by setting a clear goal to achieve net zero emissions by 2050.
- **Not aligned:** All other assets.

NAVIGATING THE PROLIFERATION OF INDUSTRY FRAMEWORKS AND TAXONOMIES

Current transition frameworks are designed by a variety of market actors, including regulators, and there are notable divergences on interpretation and principles of transition alignment. Some frameworks adopt a principles-based approach while others use prescriptive criteria and time-bound thresholds, some are Paris-aligned and not all use recognised pathways.

This fragmented landscape makes navigating and translating industry frameworks a complex activity, particularly for investors operating across multiple jurisdictions. It impacts investors' ability to assess and compare the economic and environmental credibility of portfolio companies' business models in the context of transition to a low-carbon economy.

The eligibility of 'transition enabling' sectors and activities, such as nuclear, often varies from jurisdiction to jurisdiction, and over different time horizons. Some of this divergence is a result of different regional decarbonisation pathways under a 1.5°C scenario (it is generally expected that developed economies will decarbonise more quickly in transition scenarios), while some of it is a result of taxonomies that are designed to promote domestic policy objectives. While government-led transition taxonomies are under development (focussing on attracting capital to specific activities in their countries), they will not be the subject of this paper.

“There is no one optimal or globally accepted framework for investors to quantitatively assess the “shades of green” across an investment portfolio...or to measure transition readiness across investment strategies, regions, and industries... it remains challenging for investors with globally diversified portfolios to make informed decisions when looking at multiple asset classes and sectors at the same time. Importantly, without a holistic framework at their disposal, investors may fail to correctly price or value financial assets in the context of climate change risks, which can potentially lead to a misallocation of capital and to stranded assets” –

PSP Investments, Green Asset Taxonomy

The immediacy of the transition financing need and the commercial drive to capture the size of the opportunity and manage the potential risks, has meant that ILN Members are navigating this landscape by developing their own innovative solutions. Members are applying a broad range of different market and public actor efforts as a basis while allowing for these approaches to mature. This includes leveraging guidance such as *ICMA Green Bonds Principles*², *the EU Taxonomy*, *Science-Based Targets Initiative pathways*³, *the Climate Bonds Initiative (CBI)*⁴, *CA100+*⁵, *TPI*⁶, *CDP*⁷ and *ACT*⁸ amongst others. Members take the view that these solutions will dovetail and plan to adopt industry standards as they develop.

ILN Members, such as Ninety One, are additionally using their insights to play a leading role in the continued design and development of industry frameworks, such as the [Sustainable Markets Initiative \(SMI\) Asset Manager and Asset Owner \(AMAO\) Transition Categorisation Framework](#) that is consistent with industry ambitions to achieve net zero.



Case Study: Ninety One

Providing thought leadership, developing innovative investment tools, and advocating for real-world impact are central to Ninety One's approach to net zero.

Member profile: Ninety One is a global asset manager with emerging market origins. This provides a different perspective, which is evident in how the investment firm pursues sustainability with substance. Ninety One manages GBP124.6bn on behalf of a global client base across equities, fixed income and alternatives. It is recognised as an expert investor in emerging markets.

Transition Framework description and objective: Ninety One led the design of the categorisation framework, with support from the SMI Transition Finance working group. Over a period of six months, the framework was stress tested and honed with ~40 asset owners, investors, managers, and technical experts. Other frameworks and taxonomies were referenced for consistency including GFANZ Transition Plan recommendations and IIGCC guidance.

The framework has been designed to establish clear criteria for assigning a net-zero transition pathway to companies and projects. The intention is to enhance confidence in the suitability of transition plans and provide investors greater clarity when investing in the harder-to-abate sectors, especially in emerging economies where real-world impact can be greatest.

The framework relies on a decision tree to categorise assets into five transition categories and one stranded asset category. Four of these categories align with the goals of the Paris-climate agreement.

Investing with confidence in transition plans that are deemed credible is increasingly recognised as an essential component of constructing portfolios that are aligned with net-zero objectives. To ensure the framework's effectiveness, the SMI AMAO Task Force is collaborating with climate specialist organisations, specifically Climate Arc and Climate Bonds Initiative. This collaboration aims to facilitate the development of appropriate metrics, thresholds, and timelines that companies or projects must meet to qualify for each category within the framework.

How this informed Ninety One's investment approach: Ninety One's Emerging Market Transition Debt (EMTD) strategy aims to achieve positive investment returns by actively participating in public and private lending activities that drive a just transition towards net-zero carbon emissions in emerging markets. Ninety One relies on the SMI Transition Assessment framework as the basis for evaluating and categorising companies within the strategy.

As part of its analysis, Ninety One assesses several factors. This includes examining the carbon commitments made by companies, evaluating the credibility of their investment plans, and assessing the pace at which they are implementing changes in comparison to country and sector benchmarks.

Based on these assessments, companies are placed into one of the transition buckets, reflecting their level of alignment with the transition towards net-zero carbon emissions.

	Transitioning/ Mitigating	Committed to Transition	Transition Enabler	Aiming to Transition
Aligned Transition	<p>Asset:</p> <ul style="list-style-type: none"> Has a Paris-aligned pathway OR Contributes significantly to carbon mitigation OR Emission intensity may be close to, or near net zero Is generating ~85% green revenue 	<p>Asset:</p> <ul style="list-style-type: none"> Is committed to net zero and contributes to carbon mitigation UT requires significant transition investment to achieve a Paris-aligned pathway 	<p>Asset:</p> <ul style="list-style-type: none"> Is required to enable the transition to net zero for other sectors May not have a Paris-aligned pathway Is committed to net zero 	<p>Asset:</p> <ul style="list-style-type: none"> Is committed to net zero and is taking action to reduce emissions AND Is ahead of its peer group <p>BUT</p> <ul style="list-style-type: none"> Has no clear pathway to net zero

In the EMTD strategy, all investments are required to fall into one of the first three Paris-aligned categories at either the corporate or use-of-proceeds level. Once a potential investment reaches this stage, analysts will proceed with carbon underwriting. Carbon underwriting involves estimating the annual quantity, measured in tons of carbon dioxide, that the company or project can reduce on a gross cumulative basis up until the year 2030. This process enables Ninety One to evaluate the potential real-world impact and contribution of the investment to the net-zero transition within the given time frame.



Summary – the driving principles and goals of transition frameworks and Taxonomies:

- **Promoting transparency** between investors and organisations facilitating collaboration on transition planning and financing of decarbonisation
- Encouraging the **development and evolution of credible transition plans**
- Supporting **identification of transition opportunities and risks**
- **Driving decarbonisation of sectors with material Scope 1 and 2 emissions** where economic activity will likely remain stable or grow in a low-carbon economy.
- **Accelerating decarbonisation and phasing out of sectors with material scope 3 emissions** that will face decreasing demand in a low-carbon economy, for example Oil & Gas, Internal-combustion-engine vehicles and Coal.
- **Financing activities that have an increasing demand-side opportunity** in a low-carbon economy including those that facilitate transition of other sectors.



PART 2

THE ENABLING ROLE OF TRANSITION TAXONOMIES AND FRAMEWORKS

HOW DO TRANSITION FRAMEWORKS ENABLE CAPITAL ALLOCATION DECISIONS AND SUPPORT INVESTORS IN ALPHA GENERATION?

ILN Members are looking to enhance risk-return profiles by leveraging their proprietary transition frameworks to support portfolio construction and investment decisions. Identifying alpha opportunities will rely on investors knowing when and where to invest through analysis of the impact of transition on cost and revenue drivers and the rate and extent of sectoral pathways and market changes.

While financing decisions are inherently forward-looking, the climate-related data and tooling that have historically informed decisions has tended to be top-down and backward-looking, focussing on a static evaluation of companies' greenhouse gas emissions. Overlaying transition framework methodologies allow investors to consider a range of dynamic bottom-up and company-level factors, anchoring on the capital expenditure and emissions assumptions set out within the

house-view of production and warming scenarios, as well as the transition commitments or ambitions associated with pledges to reach net zero. Assets are evaluated both in their current state by emissions intensity analysis and across their future pathway by making an assessment on transition readiness. For specific sectors, such as Oil & Gas and Utilities, investors can apply additional lenses such as planned capacity additions.

Portfolios can be constructed to reach a number of different objectives. In some cases, this can be real economy decarbonisation and long-term asset performance, without impacting the risk-adjusted return profile. ILN Members, such as CDPQ, have used this approach to develop specific funds aimed at identifying opportunities that are adjacent to or a facilitator of the transition and committed to aligning.



Case Study: CDPQ

CDPQ have developed a Transition Envelope to facilitate the financing of companies in carbon-intensive industries that are required for low-carbon transition.

Member profile: CDPQ is a Canadian global investment group present in all major markets with CAD 424bn in assets and offices in ten countries. It invests constructive capital in a large range of asset classes, including private equity, equity markets, private credit, infrastructure and real estate – to create opportunities and position enterprises to succeed.

Transition Framework description and objective: CDPQ's \$10bn [Transition Envelope](#) is capital made available to companies for constructive and innovation-based support to assist them on their decarbonation journey. It targets four of the highest-emitting sectors – raw materials production, transportation, power generation and agriculture.

Process to design and implement: Within carbon-intensive industries, to determine if an investment can be included in the Transition Envelope, companies must meet specific standards set by the Climate Bonds Initiative (CBI) or the Science-Based Target Initiative (SBTi). CDPQ made the decision to have very specific screening criteria for their Transition Envelope to ensure the credibility of the assets' decarbonisation trajectory.

To identify and evaluate credible opportunities, CDPQ focuses on the education of its investment teams to facilitate enhanced research. In addition, investments are reviewed by independent external experts to validate the rigour of their respective decarbonisation plans and to ensure alignment with the Paris Agreement.

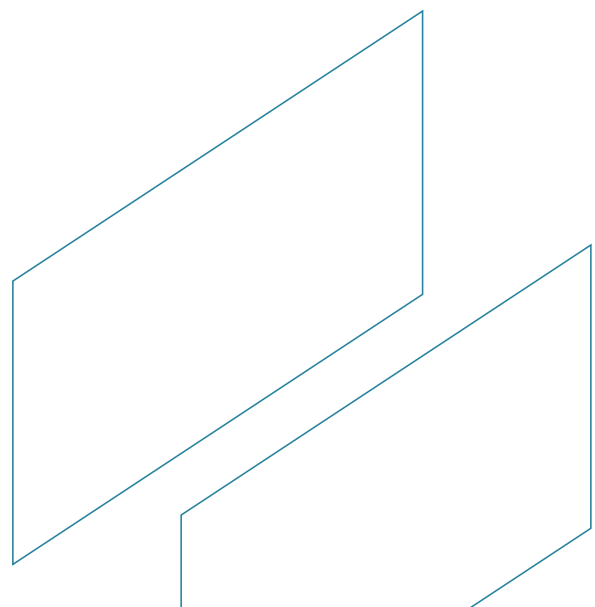
Outcome: Three transactions have been completed to date, each that drive decarbonisation within the real economy, in particular accelerating [renewable energy strategies](#).

As frameworks mature, ILN Members are mindful that transition taxonomies, where used, must be agile to allow for the dynamic nature of the transition and therefore changing portfolio exposures. This will be impacted by external factors such as technology developments, consumer and corporate behaviour changes, government regulation and carbon markets, among other factors. Ultimately, if designed to be agile, frameworks can support better opportunity identification and allow investors to measure, manage and de-risk the financing need in emerging solutions and markets⁹.

Supporting laggard assets

ILN Members are using transition frameworks to identify highly exposed assets in sectors with market constraints associated with their decarbonisation such as heavy industrials and transportation. These assets are often found to have low preparedness levels and limited emissions data. By constructing frameworks to identify these types of assets, rather than automatically exclude them from categorisation on the basis of limited data, investors can better understand their risk profile and support companies in developing mature decarbonisation roadmaps.

For example NAM have developed specific funds focused on identifying under-appreciated assets with limited climate disclosures and supporting these organisations in improved transition planning and associated disclosures to bring them from laggards to leaders.



HOW CAN FRAMEWORKS SUPPORT CREDIBLE STAKEHOLDER ENGAGEMENT AND COMMUNICATION OF INVESTMENT STRATEGIES?

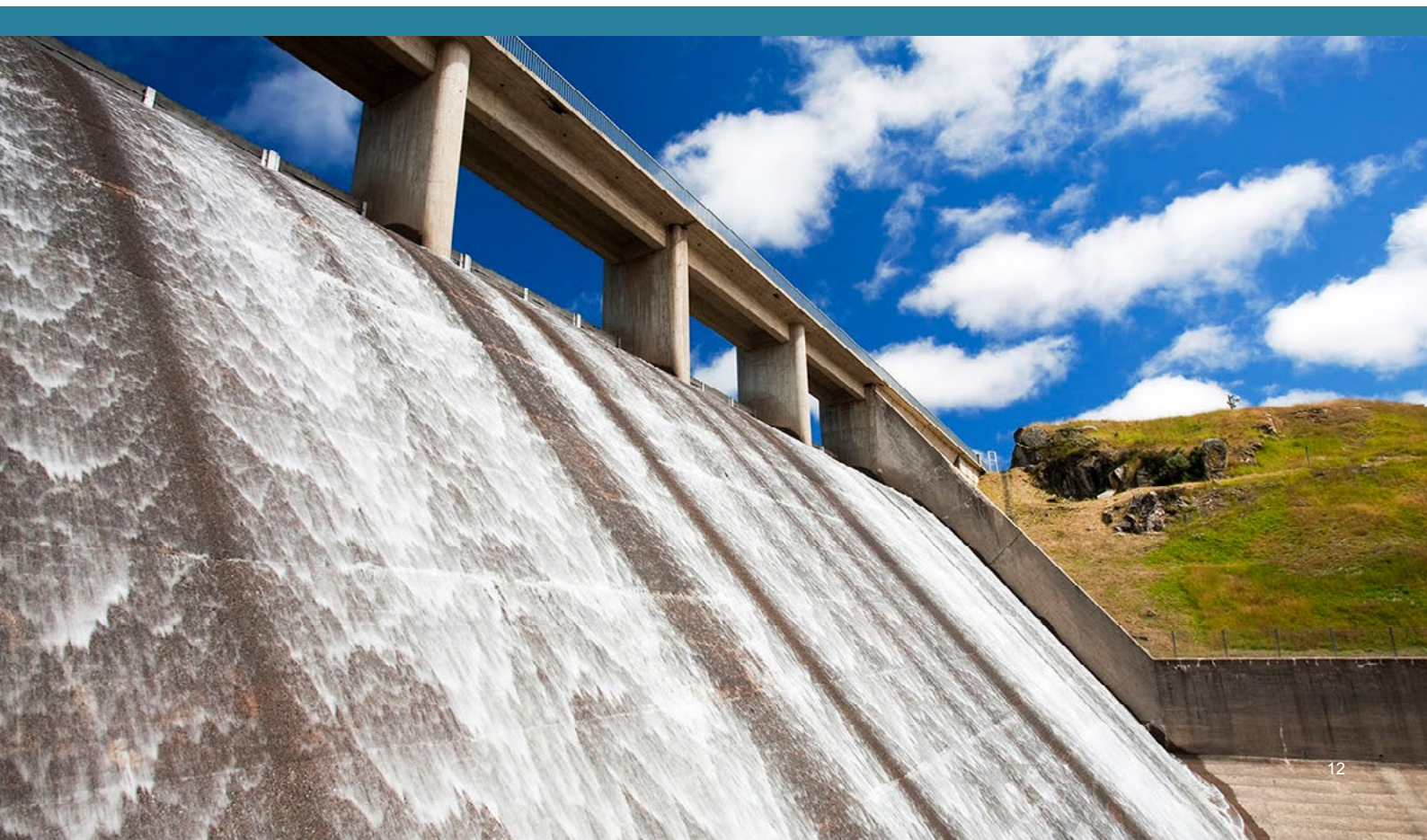
Asset managers and asset owners who invest in new technologies or carbon-intensive sectors and companies in the short to medium-term are facing increased scrutiny to transparently communicate the rationale for this approach. Transition finance is a rapidly evolving asset class and is highly complex and nuanced across markets; approaches are often based on ambiguous definitions, dynamic thresholds and reliant on incomplete data on company emissions.

Stakeholders often hold a range of perspectives on the transition and vary in their level of technical knowledge. Some embrace the shared objective of real-world decarbonisation, while others are binary about inclusion of fossil fuels in portfolios. These characteristics, combined with the size of the commercial opportunity, increases the reputational risk of greenwashing allegations where an investment approach is not easily understood

by stakeholders and looks inconsistent with climate commitments. Investors managing Transition Sleeves, where investments are excluded from total portfolio intensity calculations, for example, must dispel perceptions that transition sleeves are a 'catch-all' for high-emitting assets rather than being strictly for assets that have demonstrable transition potential.

Taxonomies help investors to communicate effectively, providing a common understanding of the asset owner's or asset manager's definition of transition in a format that is easy to apply, disclose and interpret. Where investors are adopting a proprietary approach, ILN Members have found it helpful to integrate alignment to established industry standards, screening criteria and pre-determined metrics to provide credibility and mitigate greenwashing risk.

SSGA conducted a series of engagements with key stakeholders – portfolio companies in carbon-intensive sectors, asset owners, investor advocates and coalitions, and internal cross-functional subject matter experts – to collect feedback on their transition plan disclosure expectations. Through these, SSGA identified disclosure areas that were realistic and others where the market may need more time to coalesce around methodologies.



In addition to helping with external communication, transition frameworks facilitate education and communication with internal stakeholders. Through categorising existing assets and having the capability to articulate their trajectories, ILN Members have identified taxonomies and frameworks as educational tools internally.

If designed so that the outputs are decision-useful, frameworks facilitate conversations around potential assets at Investment Committees and other business strategy governance fora. This process can result in increased engagement internally and appetite to further support real economy decarbonisation.



How ILN Members have used taxonomies to engage internal stakeholders

Since launching their Green Asset Taxonomy, which categorises assets based on carbon intensity and transition plan readiness, PSP Investments have found it to be an important tool in facilitating the discussion around climate investing internally. As a result, asset class teams have become better versed on the topic of low-carbon transition. Conversations are increasingly more focused on what investors need and want from portfolio companies.

Other Members have found benefit in transition frameworks aligning their organisations on house-definitions of 'green', 'transition' and 'hard to abate' and embedding a common language throughout the business.

"Our Transition Envelope grows with our investment teams. We have had extensive conversations on what makes a good and Paris-aligned decarbonisation plan and which sectors need to be decarbonised in priority to then enable further decarbonisation in the real economy. It has been a great opportunity to share information and knowledge on this topic, which then helps our investment teams to identify investment opportunities that could be a good fit for the Transition Envelope, and overall, just give them a better understanding of the low-carbon transition and what it entails" – Charly Bastard, CDPQ

Transition frameworks additionally generate insights that inform engagement with portfolio companies to understand and develop transition ambitions and readiness. ILN Members have integrated transition plan credibility assessments within their frameworks to understand progress beyond publicly reported commitments, management incentives and levels of CapEx and OpEx committed.

Often what has been found, are material differences between level of decarbonisation ambition and the actual likelihood of realisation, affecting future value estimations and real-world impact. Through this approach, asset owners such as CPP Investments have been able to support companies in developing and maturing their approach.

Case Study: CPP Investments

Through its decarbonisation investment approach (DIA), CPP Investments has partnered with management teams at portfolio companies to support them either to define their climate ambitions or confirm and progress existing plans.

Member profile: CPP Investments is a global investment management organisation that manages investments on behalf of the Canada Pension Plan (CPP). CPP Investments has over CAD 500bn in assets under management and invests in a range of asset classes, including public and private equities, real estate, infrastructure and fixed income.

Transition Framework design and objectives: A key component of CPP Investments' net zero commitment is its decarbonisation investment approach, which was introduced in December 2021 to identify, fund and support the decarbonisation efforts of high-emitting companies and capture the value of the whole economy transition. In 2023, CPP Investments applied its DIA on more than 10 existing and new assets spanning the real estate, infrastructure, agriculture, energy and tourism sectors¹⁰. As part of this process, it partnered with management teams at portfolio companies to:

- 1) Establish the company's emissions baseline and trajectory according to its emissions profile today, and a business-as-usual (BAU) projection based on current business plans.
- 2) Assess current and projected abatement capacity using CPP Investments Abatement Capacity Assessment Framework. The framework provides a step-by-step guide to explore the economic viability and emissions reduction potential of individual decarbonisation options.
- 3) Define decarbonisation ambition and action plan. This pathway prioritises economic (proven) abatement actions that will have the highest impact, per dollar spent. Companies also plan for and sequence actions to be taken over time that require higher capital expenditures, based on the company's climate ambition.

This process required close collaboration between CPP Investments and the portfolio companies. Senior management and the board's, willingness to participate in the multi-month program was critical as was a commitment to incorporate the findings into their long-term planning. A decarbonisation assessment is not a sustainability initiative in isolation, but rather a full-company transformation. It requires both top-down engagement from the board and C-suite, as well as involvement across multiple departments such as finance, procurement, operations and facilities. To build a robust decarbonisation roadmap is not an easy task, and requires adequate resourcing, budgeting, and planning.

Outcomes: The detailed bottom-up DIA helped portfolio companies either define their climate ambitions or confirm existing plans. They helped determine where cost-effective actions can be taken immediately to meet near term targets, and enabled CPP Investments and the companies to monitor other decarbonisation options that will help inform later decisions.

Future development: Over time, CPP Investments hopes to utilise key learnings from this experience to scale the DIA across its portfolio and help portfolio companies develop transition plans that increase their value.

Read more about CPP Investments innovative approach [here](#).

PART 3

HOW ARE ILN MEMBERS DEVELOPING PROPRIETARY TAXONOMIES?





Recognising the urgent need for transition financing, ILN Members have been developing industry-leading proprietary solutions to lay the groundwork whilst industry taxonomies mature. In doing so, members have defined what transition means, the impact on their material sector exposures and how they engage with real economy decarbonisation. This has had additive benefits of expediting cross-asset class learning internally, aligning teams on a consistent approach to portfolio transition.

The Case Studies below explore the design and implementation considerations ILN Members addressed in developing and maintaining proprietary transition approaches. Detailed design steps and decisions can be found in the Appendix. ILN member approaches coalesce around the following key areas to consider:

- **‘Dynamic by design’** – frameworks should reflect the dynamic nature of the transition. Investors should be able to articulate changes in thresholds and have the mechanisms in place for its periodic review and updating.

- **Permissive versus prescriptive approaches** – the balance of integrating objective and science-based criteria, whilst not designing overly prescriptive guidelines that limit the investible universe to such an extent that the flow of capital to transition-enabling activities is severely reduced.
- **Data and tooling** – there are challenges and opportunities in accessing robust data and tooling required for multi-faceted analysis that includes credible transition plan assessment to inform engagement activity and value estimations.
- **Resourcing** – the technical skillset and intensity of resource required to perform quantitative transition modelling and translate complex results.
- **Stakeholder communication** – how to engage with internal stakeholders to socialise proprietary approaches, educate and facilitate investment decision-making.





Case Study: Nordea Asset Management (NAM)

NAM has developed a transition framework including an in-house alignment assessment tool that leverages the NZIF maturity scale to provide indicative alignment status across their entire investment universe. This view informs their portfolio analytics and engagement activity.

Member profile: NAM is a global asset manager serving more than 500 institutional clients around the world, including some of the world's largest pension plans, and has been committed to the North American market for over 25 years. NAM offers a broad range of equity and fixed income ESG-Enhanced and RI thematic solutions, stemming from 30 years of commitment to ESG. For many of these asset classes, the investment community is still working on methodologies for measuring contribution to financed emissions, fair share emission reduction pathways and net zero alignment. In pursuit of NAM's own net zero commitment, efforts have been focused on driving [Paris alignment](#) among investee companies.

Transition Framework description and objective: To gain a holistic understanding of the trajectory of portfolio companies, NAM assesses individual issuers using NZIF's maturity scale approach. NZIF introduces ten current and forward-looking criteria with a binary yes/no outcome, which can be combined to place companies into one of four categories; *Aligned, Aligning, Committed to aligning or Not aligning*. As an example of the comprehensiveness of this approach, having a science-based target is one of the six core alignment indicators, but on its own it is not sufficient for an issuer to be categorised as 'Aligning'. For that, NAM also expects to see adequate GHG emissions disclosure and a decarbonisation strategy.

Process to design and implement: NAM has built an in-house alignment assessment tool, drawing data from credible third parties such as Transition Pathway Initiative, Science-Based Targets Initiative (SBTi) and CA100+, which is complemented with proprietary data to indicate if one of six criteria is met. In total, the tool uses 139 different indicators across six data providers. The quantitative assessment is indicative of alignment and is further enhanced by individual research into, and engagement with, companies to firmly establish alignment status. This individual research is then fed into the tool to increase accuracy.

Design considerations:

Increasing granularity to better distinguish between company maturity for each indicator: Currently the maturity scale is a binary Y/N for each indicator. As a next step, NAM is looking to ensure the assessment framework can provide a more nuanced view, for example by distinguishing between companies with no reduction target and companies with insufficient reduction targets, both of which are currently assessed as a fail.

Data challenges: Scope 3 data availability and quality remains a challenge, but is material for an effective transition in significant sectors such as Energy and Automotive. To manage the risk of companies underreporting, the NAM alignment assessment includes a rule that if estimated Scope 3 emissions > 40% of total Scope 1,2 and 3 emissions, then targets must encompass Scope 3. NAM has also created a methodology to manage conflicting inputs – for each indicator, there may be times where one data source passes a company, and another fails it. To navigate conflicting data inputs, NAM has created a **data hierarchy** that prioritises the assessment of the most robust sources (TPI, SBTi, CA100+).

Outcomes:

Portfolio and investee analytics. Alignment information is made available in the ESG Data platform for all issuers in the investment universe, as well as aggregate portfolio data. NAM sees an opportunity to maximise absolute GHG emission reductions within portfolios by supporting companies in emissions-intensive sectors that are aligning with the Paris Agreement as well as companies that present an engagement opportunity, allowing NAM to benefit from the potential valuation uplift in companies with improved transition plans as that gets priced in by the market.

Engagement activity. NAM has an [ambitious 2025 target](#) to ensure that 80% of the top 200 largest carbon footprint contributors are on a Paris aligned trajectory or else subject to engagement to become aligned. The maturity scale acts as a useful engagement framework, but it is sector-agnostic. This is why sector and geopolitical considerations are added to engagement dialogues with a view to identify and capitalise on company-specific climate risks and opportunities.

Case Study: PSP Investments

PSP Investments' have developed a data-driven two-dimensional climate alignment framework; the PSP Investments Green Asset Taxonomy designed to assess and screen investments through dynamic and forward-looking analysis related to the execution of climate transition plans.

Member profile: As an institutional investor with a long-term investment horizon, the overarching objective of PSP Investments' climate strategy is to support the global transition to net zero emissions by striving to proactively manage climate risks, unlock investment and carbon reduction opportunities associated with climate-aligned assets, strengthen carbon disclosure, and enhance collaboration with a wide range of stakeholders.

PSP Investments believe that investors have an important role to play in ensuring a smooth transition as long-term capital providers to industries and assets that need to decarbonise. Investing in transition assets is an important aspect of the [Climate Strategy Roadmap](#), as PSP Investments believe companies with credible transition plans in place will likely outperform their peers over time.

Transition Framework descriptions and objective: PSP Investments have designed two-dimensional climate alignment framework, called the [PSP Investments Green Asset Taxonomy](#). This taxonomy considers two of the key variables of climate investing: carbon intensity and the credibility of a company's transition plan. The framework allows for monitoring progress based on the like-for-like change of individual assets or portfolios from an emission intensity perspective, as well as a company's year-over-year progress in implementing transition plans.

Design considerations

Along the Greenhouse Gas Intensity axis, assets can be classified from high carbon (i.e., High Carbon and Hard to Abate Assets) to low-carbon (i.e., Dark Green, Light Green, Enablers). This axis measures the carbon intensity of a company's business model and allows for comparison of relative "carbon competitiveness" across asset classes and investment strategies. PSP Investments chose to normalise GHGs by revenues of the business instead of by investment size to better reflect the carbon intensity of the asset's business model, irrespective of PSP Investments' investment size.

On the transition readiness axis, assets are classified along a spectrum from no evidence of transition plans to mature transition plans. Mature transition plans are those assets that have short and long-term emissions reduction objectives aligned to Paris Agreement mitigation outcomes. At present, the PSP Investments Green Asset Taxonomy evaluates transition plan credibility based on public disclosures, namely targets and metrics disclosed in alignment with the TCFD recommendations. Going forward, PSP Investments intends to evolve the transition axis to integrate a rigorous credible transition plan assessment that considers other financial metrics, including allocation of capital expenditures where relevant.

PSP Investments employ strict thresholds and conditions for each of the categories on the basis of the portfolio weighted average carbon footprint and performance relative to their green bond framework.

Outcome

The taxonomy is not only a monitoring and screening tool, but also a method for enhancing investment in relevant sectors and contributing to the global net zero transition. The framework helps PSP Investments understand their baseline exposure to systemic climate risks and opportunities across the investment portfolio, and aids PSP Investments to prioritise engagement activities; identifying potential ways to steer their engagements with portfolio companies (where appropriate) toward more relevant decarbonisation opportunities.

By consolidating the results of the taxonomy at the asset class levels and using year-over-year GHG and transition plan data, PSP Investments can assess the rate of acceleration and relative progress of asset-level transformations. This can help inform climate investing decisions at the asset, asset class and portfolio level, and improve engagement.

Case Study: PSP Investments (continued)

PSP Investments' measurement of Transition Readiness over time:

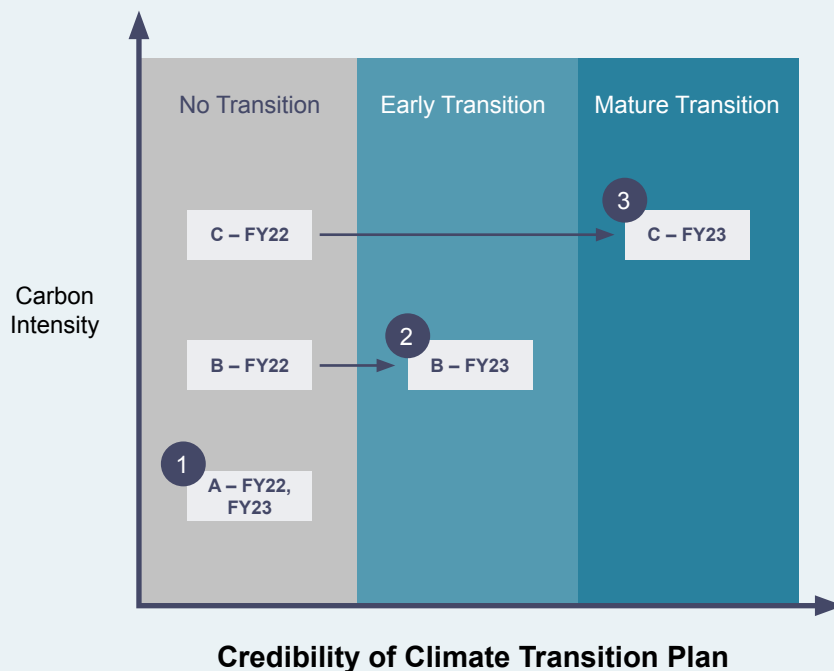


Figure 4: Transition Readiness Dimension along the X-Axis

Once again, we can use different examples of investments to demonstrate how PSP Investments can use the Green Asset Taxonomy to monitor progress at the asset or company level.

1

Company A does not have a transition plan in place and is not yet disclosing any short-, medium- and long-term GHG targets. Because of this, the asset is considered as an asset with **no transition plan**.

2

Company B initially did not have a public climate change goal; however, it has graduated by announcing short- or long-term climate targets for GHG reductions, despite those targets having not been validated against a third-party decarbonisation pathway. The company is now considered an **early transition asset**.

3

Company C began its journey with some short- or long-term climate commitments in place. Over the period, it evolved its approach and has publicly disclosed short and long-term carbon reduction goals that are considered science-based by credible third party standard providers. The company is now considered a **mature transition asset**.

Future development: It may also become possible to use scenario analysis and stress-testing to evaluate the potential impacts of adopting various climate investing targets on a portfolio's future weighted average carbon intensity.

Case Study: State Street Global Advisors (SSGA)

SSGA's transition framework supports portfolio companies in setting disclosure expectations for effective climate transition plans.

Member profile: SSGA is one of the world's largest asset managers, responsible for over \$3.48 trillion in assets under management (as of 31 Dec, 2022). SSGA invests in a range of asset classes and offer investment solutions in index, active, and ESG investing. SSGA is a signatory to the Net Zero Asset Managers Initiative.

Transition Framework description and objective: Companies in portfolios managed by SSGA on behalf of its clients are adopting long-term climate ambitions in increasing numbers.

However, few have provided a clear roadmap to achieving these goals — and fewer asset managers have provided detail on what companies are expected to disclose as they prepare for a transition to a low-carbon economy.

SSGA encourage companies in relevant sectors¹¹ to develop robust climate transition plans that take into account the risks and opportunities associated with a transition to a lower carbon economy. To that end, they believe that portfolio companies can benefit from clarity on disclosure expectations to ensure they – and the broader investor community – receive the information necessary to assess each company's preparedness.

Process to design and implement: The SSGA Asset Stewardship team conducted an in-depth assessment of existing ESG frameworks and standards for relevant climate-related disclosures. They considered several factors (e.g., market adoption, usefulness for decision-making, applicability across sectors, financial materiality) and selected a core set of useful disclosures for climate transition plans, leveraged existing frameworks and considered market practice to help reduce the reporting burden on companies while benefiting investors with more consistent and robust disclosure.

Their selected disclosures are organised into ten categories that closely align with those found in the IIGCC Net Zero Investment Framework¹². SSGA included two additional categories, "Physical Risk" and "Stakeholder Engagement", as they believe these are critical in understanding company performance and represent key disclosure improvement areas. SSGA recognise this is an emerging area of disclosure and they will continue to develop their expectations over time, including consideration of any mandated disclosure by regulators.

Outcomes: Through engagements, SSGA aim to better understand climate transition strategies and gain insight into each company's unique set of climate-related risks and opportunities. SSGA may consider taking voting action if companies fail to implement and communicate effective oversight of applicable climate transition risks.



Case Study: OMERS

OMERS has consolidated its work into a Climate Action Plan that includes commitments around growing investments in green and transition assets.

Member profile: OMERS (Ontario Municipal Employees Retirement System) is one of Canada's largest public sector pension plans. It invests globally and had CAD 124bn in assets under management as of December 31, 2022. Their [Climate Action Plan](#), launched in 2023, outlines their approach to achieving net zero by 2050 and n green assets and engage the highest carbon-intensive portfolio companies to align.

Transition Framework Description and Objective: OMERS defines green assets and transition assets as follows:

Green assets refer to investments in companies where a majority of economic activities are in alignment with the ICMA Green Bond Principles. The purpose of defining green assets is to understand OMERS, current exposure to these assets and measure the growth in this category. OMERS has a goal to grow green assets from CAD 19bn in 2022 to CAD 30bn by 2030.

Transition assets play a key role in the low-carbon transition but have high emissions in the near term and their emission trajectory may not align with the plan's interim carbon emission reduction goals. New investments that meet the right criteria will be held in a transition sleeve of up to CAD 3bn and will be excluded from carbon footprinting calculations. Existing investments cannot be reclassified into this sleeve.

To be included in the transition sleeve, the asset must a) be high carbon, b) enable decarbonisation, and c) be aligned to a net zero by 2050 pathway. The criteria for inclusion and the size of the transition sleeve will be reviewed after two years.

High carbon is defined as a company or asset:

- that meets OMERS, definition of high carbon, and/or
- whose addition to the portfolio would contribute to an increase in OMERS WACI which is the metric we used to set and monitor interim portfolio intensity reduction goals.

Enable decarbonisation means:

- be carrying out activities that contribute to reducing global GHG emissions, and/or
- are high carbon and harder to abate (e.g., steel) in the near term but have a credible decarbonisation pathway.

Aligned to a net zero 2050 pathway means the company or asset:

- has a net zero 2050 commitment, and
- has a credible decarbonisation plan, or OMERS can influence, support, and help develop and execute such a plan through asset management.

Process to design and implement: OMERS reviewed several global taxonomies and peer practices to determine these criteria. They continue to advance their work as new taxonomies and approaches emerge. Key attributes that OMERS is looking for in a taxonomy are that it:

- Applies to both public and private investments, ideally with minimal manual effort
- Largely maps to other classification standards already used for assets, e.g., GICS
- Accurately captures the nature of the business and those with higher stranded asset risk
- Captures scope 3 emissions

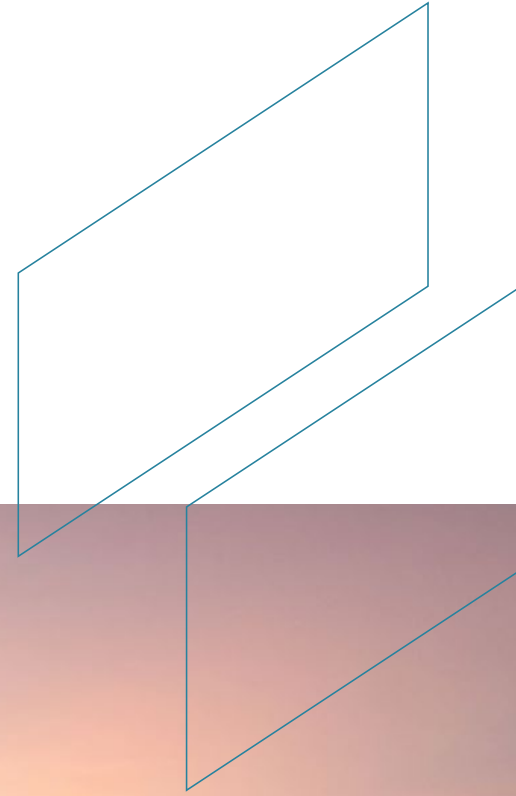


CONCLUSION

Transition frameworks are critical in unlocking private financing for solutions required to deliver net zero and steering the real economy toward an orderly transition that considers assets in harder-to-abate sectors that have longer decarbonisation timelines. Frameworks demonstrably provide forward-looking insights into the value accretion potential of transition assets and opportunities to balance portfolio exposure to transition and greenwashing risk.

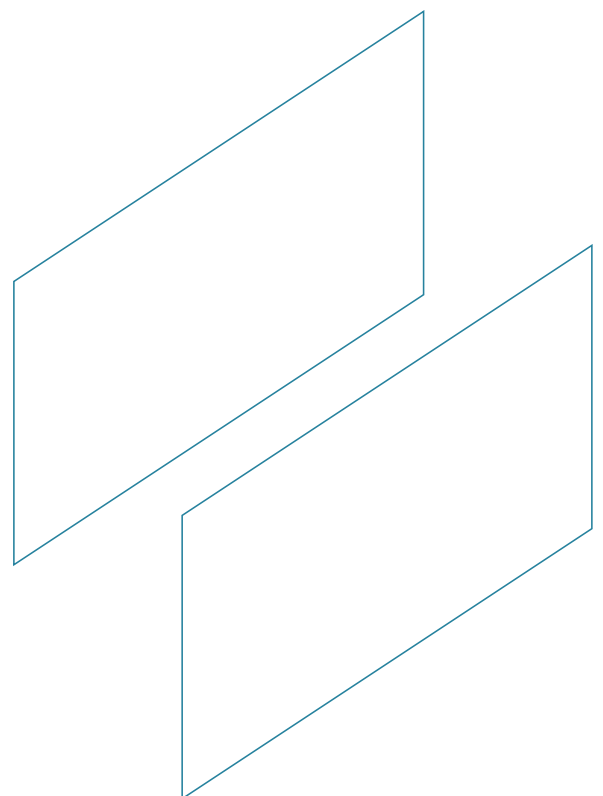
As seen throughout this paper, there is, as of yet, no universal standard classification for transition activities or singular approach. However, there is a strong commitment from long-term capital providers to embed transition finance frameworks to accompany the real-world towards transition at pace. Members continue to mature their approaches while industry standards evolve and are notably now focused on extending capabilities to measure the system-level impact attribution of their transition investments. The convening power of the ILN provides a unique network to drive this activity and bilateral exchange between members has been fundamental to progressing proprietary approaches.

This paper provides a practical view of the experience of our members; exploring drivers, enablers, and considerations in using transition finance frameworks. We hope that in doing so, the ILN has contributed to the shared knowledge base and will engage the broader investment community to develop approaches that accelerate the transition to a more inclusive and sustainable economy. The wider community of investors can collectively promote future progress by continuing to share best practice and lessons learned.



ENDNOTES

- 1 IIGC Net Zero Investment Framework, Implementation Guidance, 2021
https://www.parisalignedassetowners.org/media/2021/03/PAIL-Net-Zero-Investment-Framework_Implementation-Guide.pdf
- 2 ICMA Climate Transition Financing Handbook (2020): provides a high-level, principles-based guide that specifies the forms of financing and disclosure requirements for climate transition bonds to demonstrate the credibility of the transition.
- 3 The SBTi Pathways to Net Zero Technical Summary (2021) provides an approach to determining 1.5°C-aligned pathways for target-setting.
- 4 The Climate Bonds Initiative (CBI) Discussion Paper (2021), 'Transition Finance for Transforming Companies: Avoiding greenwashing during financing company decarbonisation': outlines five hallmarks of a credibly transitioning company. This builds on the CBI's 2020 white paper, 'Financing Credible Transitions: How to ensure the transition label has impact' which provides an initial framework and principles for identifying a credible transition label.
- 5 Climate Action 100+: Net Zero Company Benchmark assess alignment of company actions with the Paris Agreement goals.
- 6 The TPI's Carbon Performance assessment is based on the Sectoral Decarbonisation Approach (SDA). On an annual basis, TPI assesses how companies are preparing for the transition to a low-carbon economy in terms of their management quality and carbon performance.
- 7 The CDP Discussion paper (2021): illustrates six guiding principles of a Climate Transition Plan.
- 8 The Accessing Low-Carbon Transition (ACT) Initiative Assessment Framework (2019): consists of an assessment framework to outline a consistent path and a set of common rules for the development of the methodologies and an indicator framework to set the basis for identifying the most relevant indicators for assessing a business climate impact.
- 9 The IEA estimates that seven-fold surge in clean energy investment in emerging market and developing economies (outside of China) is needed by 2035 to align with the Paris Agreement and sustainable development goals.
- 10 CPP Investments' net-zero commitment is made on the basis and with the expectation that the global community will continue to advance towards the goal of achieving net-zero greenhouse gas emissions by 2050. For more details, see <https://www.cppinvestments.com/the-fund/sustainable-investing/>
- 11 As defined by the IIGCC Net Zero Investment Framework
- 12 SSGA referred to the IIGCC Net Zero Investment Framework which provides a list of alignment criteria for assessing transition plans for listed equity and fixed income.



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