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Cautious Urgency Can Resuscitate GFANZ 'Transition-Informed' Indexes

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Key Findings

The rise of passive investing underscores the growing need for benchmarks that match investors' net-zero ambitions. Demand for alternative approaches means the market for net-zero-aligned indexes is set to expand.

GFANZ's "transition-informed" indexes perhaps stand the best chance of displacing climate-agnostic indexes, but they come with elevated greenwashing risk that could put off many investors.

A pause in the GFANZ consultation process should be used to shore up guidance by introducing red lines for fossil fuel developers, shifting focus to "transition-engaged" variants, emphasising guardrails such as mandatory transition plans and factoring in lobbying transparency.

Additional measures would likely limit indexes by more than is currently implied, but they would help provide the assurances needed to solidify broad investor support.

Executive Summary

Despite growing diffidence towards collaborative action, financial institutions remain committed to their net-zero pledges. Combined with the fact that passive investing continues to dominate asset flows, the critical importance of benchmarks that can align assets with an orderly transition is both clear and growing by the year.

Recognising that traditional lower-carbon indexes, including ex-fossil fuel variants, do not equate to the emissions reductions required to achieve net zero by 2050 (or sooner), the EU formalised two methodologies that now underpin Paris-Aligned Benchmarks and Climate Transition Benchmarks. Assets managed against these indexes, collectively referred to as EU Climate Benchmarks, have grown considerably since their 2020 inception, but flows stagnated in 2024. This reflects concerns over divergence from parent indexes, unintended systematic biases and potentially counterproductive real-economy outcomes. Some doubts seem overblown, yet there is legitimate pause for thought as to whether EU Climate Benchmarks can support companies on non-linear (or nascent) decarbonisation trajectories. Demand for alternative approaches has grown. In the coming years, we might expect to see the establishment of transition-informed indexes (TIIs, proposed by the Glasgow Financial Alliance for Net Zero, GFANZ) and taxonomy-led offerings such as Investing for Transition Benchmarks (as proposed by the EU Platform on Sustainable Finance, EUPSF).

During Q4 2024, GFANZ held a consultation period for its voluntary guidance on the development of TIIs.[1] They represent a departure from incumbent climate-aware benchmark offerings, which largely seek reduced exposure to outsized carbon emitters. GFANZ proposes a more inclusive approach to benchmark construction, one that is based not on historical emissions profiles or sectoral exclusions but on the assessment of each individual entity's forward-looking net-zero alignment credentials. In doing so, TIIs overcome some of the criticisms levelled at existing climate benchmarks. But without well-defined guardrails, TIIs carry significantly elevated greenwashing risk.

Notably, less than a month after the consultation deadline, GFANZ put TII development on pause while the alliance undergoes its own period of transition. It would be surprising, however, for TIIs not to resurface in a similar guise given their clear alignment with GFANZ's new strategic direction. Assuming this pause is temporary, the restructure gives GFANZ much-needed breathing room to shore up its TII guidance, which in IEEFA's view lacked the requisite urgency and emphasis on guardrails to garner broad investor support.

As it stands, TII guidance builds on GFANZ's past efforts to define transition finance in sector-agnostic terms. At the time, IEEFA encouraged financial institutions to adopt more nuanced assessment frameworks than high-level guidance had provided.[2] Those recommendations remain

[1] GFANZ. Glasgow Financial Alliance for Net Zero Launches Consultation on Index Guidance to Support Real-Economy Decarbonisation. 9 October 2024.
[2] IEEFA. Beyond COP28: Financial institutions should adopt nuanced transition finance frameworks to support net zero. 13 February 2024.

valid in the context of index construction. Stakeholders can look to guidance from the likes of the Assessing Transition Plans Collective, Climate Bonds Initiative or the EU Platform on Sustainable Finance in that regard.[3,4,5] However, IEEFA would add some key considerations for future iterations of voluntary guidance that might reduce the risk of greenwashing and prevent carbon lock-in:

- **Red lines for fossil fuel developers:** To prevent transition-intended capital from being channelled into incompatible economic activity, fossil fuel developers should be removed from all fixed-income indexes. Short, time-bound expectations should be placed on equity indexes, with exceptions made only for companies with demonstrable commitment to the drastic overhaul of core business models.
- **Skip to "transition-engaged" index variants:** Leniency is implied in existing guidance through to 2030, significantly raising the risk of carbon lock-in by prolonging support for entities with no clear or credible timeline for net-zero alignment. Greater urgency is required given likely lead times before TIIs become commercially available.
- **Stronger guardrails including mandatory transition plans:** Any investable company credibly committed to net-zero alignment should have a transition plan by the time TIIs are expected to gain wider momentum. Transition plans should be a minimum requirement (with concessions based on regional considerations) and accompany greater emphasis on the need for guardrails.
- **Transparency on lobbying:** Discussion of corporate lobbying is entirely absent from voluntary guidance, despite its insidious and unquestionable impact on climate. This topic should be on the agenda.

The importance of exercising "cautious urgency" in this manner cannot be overstated. In IEEFA's view, TIIs will only gain broad support if investors trust they capture an opportunity set of entities making timely and credible attempts to decarbonise. To do so will likely limit the opportunity set by a little more than GFANZ's might have initially envisaged, but the bar is better set high than low to maintain index integrity and ensure broad investor support. Ultimately, there is no singularly correct net-zero-aligned benchmark approach, and choice will be key to continued uptake. Existing offerings and those in development each offer alternative theories of change, meaning TIIs (and in future, Investing for Transition Benchmarks) should not cannibalise existing assets. In fact, an approach that is more inclusive by design should hold wider appeal for investors, giving net-zero-aligned benchmarks a better chance of displacing traditional (climate-agnostic) indexes in core investment processes. Should this come to pass, the environmental benefits *could* be substantial. IEEFA would encourage sophisticated investors to implement elements of different methodologies, including low (and diminishing) carbon exposure, transition plan assessments, engagement progress indicators and sustainable capex considerations, to suit their own beliefs and preferences.

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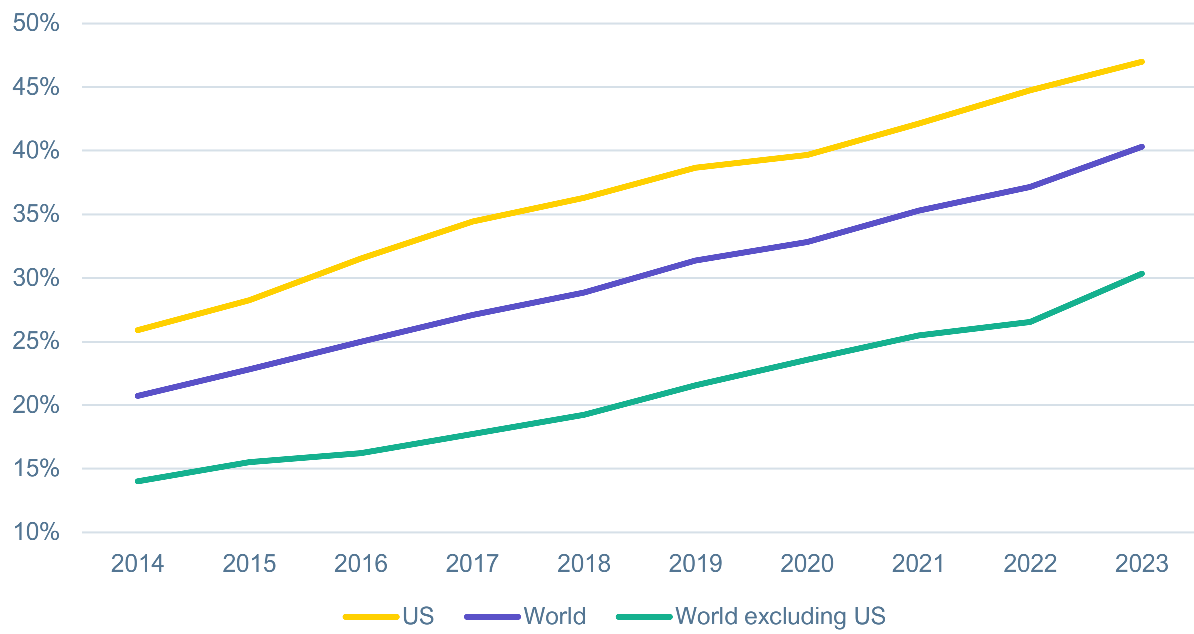
[3] World Benchmarking Alliance. Assessing the credibility of a company's transition plan: framework and guidance. September 2024.
[4] Climate Bonds Initiative. Navigating Corporate Transitions: A tool for financial institutions to assess and categorise corporates by their transition credibility and maturity. May 2024.
[5] European Commission. Platform on Sustainable Finance report on Building trust in transition: core elements for assessing corporate transition plans. 23 January 2025.

Net-Zero Indexes: Growing Diversity To Match Growing Importance

Despite the diluted aspirations of financial alliances and growing diffidence towards collaborative action, industry assets remain largely controlled by fund managers and asset owners still committed to net zero pledges. Separately, industry assets continue their march into index-tracking funds at the expense of actively invested counterparts.

Figure 1: Passive Investment Assets Under Management as % of Total



Source: PWL Capital.6 Based on data from Morningstar.
Note: Morningstar data reflects only a universe of publicly available, listed funds, and best reflects retail ownership preferences.

It is not only passives that require indexes to match climate goals. But unlike their active counterparts, passive managers cannot meaningfully deviate from underlying benchmarks in pursuit of Paris alignment (or other) goals. Lacking the threat of divestment, passive managers must rely on one of two primary avenues to affect behavioural change. The first is engagement, yet as collaborative initiatives such as Climate Action 100+ erode in the face of anti-trust challenges, engagement will perhaps become an increasingly solitary and ineffective pursuit. Even before the political weaponisation of anti-trust, passive managers were already hamstrung in this space given the threat of capital reallocation is largely absent. The second and perhaps most obvious method for a passive owner to achieve net-zero goals is through benchmark selection. With passive investing in the ascendancy, the need for net-zero-aligned benchmarks grows ever more crucial.

[6] PWL Capital. The Passive vs. Active Fund Monitor. 2024.

> **The most obvious method for a passive owner to achieve net-zero goals is through benchmark selection.**

The market for climate-aware indexes is dominated by lower-carbon offerings such as ex-fossil fuel variants of standard, market capitalisation indexes and EU Climate Benchmarks (EUCBs). IEEFA expects new benchmark types to proliferate, servicing different theories of change. Greater choice will be key to the continued uptake of climate benchmarks, but complexity is growing. Below, we briefly summarise this increasingly complex landscape.

Table 1: The Climate Benchmark Landscape

	Currently available			Proposed/in consultation			
Type	**Lower-Carbon Benchmarks**	**EU Climate Benchmarks (EUCBs)**		**Transition-Informed Indexes (TIIs)**		**Investing for Transition Benchmarks (ITBs)**	
Subcategory	Various (e.g. fossil fuel screened, tilted carbon exposure)	Paris Aligned (PAB)	Climate Transition (CTB)	Transition Engaged	Transition Potential	ITB	ITBex (with exclusions)
Aligned with goals of the Paris agreement?	No	Yes	Yes (but with limited overshoot)	Yes	Yes	Yes (but with potentially significant overshoot)	
Brief description	Excludes or reduces weight to carbon-intensive assets or sectors compared to standard parent benchmarks. Often employed as a method for immediately reducing climate risk exposure	Applies industry exclusions plus strict decarbonisation objectives (immediate and ongoing), to build an opportunity set of companies that in aggregate adhere to Paris agreement emissions reduction goals	Applies intermediate decarbonisation objectives (immediate and ongoing), to build an opportunity set of companies that in aggregate adhere to Paris agreement emissions reduction goals (with limited overshoot)	Applies asset-level assessments of net-zero alignment credibility and expects companies to adhere to transition promises (or face time-bound index weight reductions)	More inclusive universe of companies that qualify as "transition engaged" OR demonstrate the time-bound "potential" to become so	Applies an annual decarbonisation objective that can be reduced should constituents demonstrate significant and/or growing sustainably aligned capex	As per ITBs but with additional exclusions for fossil fuel companies
Immediate exclusions	Yes (sectoral and/or asset level)	Yes (sectoral and potentially additional emissions based)	Likely yes (emissions based)	No	No	No	Yes (fossil fuel-based revenue and/or capex limits)

Table 1: The Climate Benchmark Landscape (continued)

	Currently available			Proposed/in consultation			
Type	**Lower-Carbon Benchmarks**	**EU Climate Benchmarks (EUCBs)**		**Transition-Informed Indexes (TIIs)**		**Investing for Transition Benchmarks (ITBs)**	
Subcategory	Various (e.g. fossil fuel screened, tilted carbon exposure)	Paris Aligned (PAB)	Climate Transition (CTB)	Transition Engaged	Transition Potential	ITB	ITBex (with exclusions)
Immediate aggregate decarbonisation objective	Yes (although not always explicit)	Yes (50%)	Yes (30%)	No	No	No (but must not exceed parent benchmark)	
Annual decarbonisation requirement	No	Yes (7%)	Yes (7%)	No, but companies must adhere to their individual Paris-aligned transition plans, which may include decarbonisation milestones	No (companies must only demonstrate the potential to become "transition engaged")	Yes (7%), but with potential reductions based on sustainable capex profile of benchmark holdings	
Other guardrails?	Index provider discretion	Index provider discretion	Index provider discretion	Index provider discretion	Index provider discretion	Companies with capex to price ratio of >1% to receive at least equal weight compared to standard indexes. Annual increases in taxonomy-aligned capex (5% in developed Europe; 1.5% in the rest of the world)	

Sources: IEEFA, GFANZ, EU Platform on Sustainable Finance, European Commission.

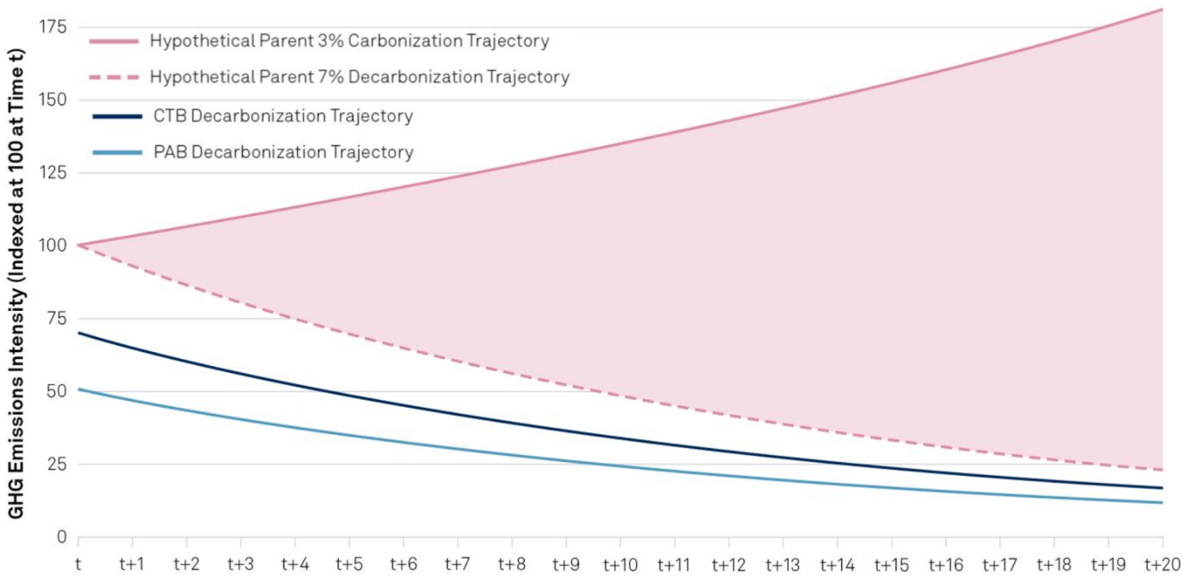
Lower-Carbon and EU Climate Benchmarks

Spurred by demand for lower exposure to carbon emissions and climate risk, the first wave of commercially available, climate-conscious indexes came in 2014, with a focus on reduced fossil fuel exposure. FTSE and MSCI both introduced ex-fossil fuel variants of popular indexes, with S&P following suit in 2015.[7,8,9] The market for ex-fossil fuel indexes quickly expanded to cover most regions. Alternative variations of lower-carbon offerings have since emerged to cover a broad range of investor preferences. These include the use of non-sectoral exit lists (such as Carbon Underground 200 and Urgewald's Global Coal/Oil & Gas Exit Lists)[10,11,12] as well as offerings with construction based on tilts (rather than exclusions), that target different parts of the fossil fuel value chain, that expand scope to other carbon-intensive industry, or that focus more squarely on asset-level metrics (such as "leaders" indexes). The common thread being the immediate reduction of carbon intensity and climate risk, either by design or by default, compared with parent benchmarks.

Lower carbon exposure does not, however, equate to alignment with the emissions reductions required to achieve net zero by 2050. Recognising this, the European Commission introduced legislation in 2020 detailing minimum criteria that now underpin Climate Transition Benchmarks (CTBs) and Paris-Aligned Benchmarks (PABs), ensuring alignment with the warming goal of the Paris agreement (with limited overshoot in the case of CTBs). The legislation requires not only sizeable and immediate emission reductions versus parent indexes (30% in the case of CTBs; 50% for PABs), but also subsequent carbon intensity reductions of 7% a year. In this way, EUCBs approximate the minimum emissions reductions needed to achieve an orderly transition, by carving out two separate pathways.

[7] Natural Resources Defense Council. NRDC, BlackRock and FTSE Jumpstart Mainstream Climate-Conscious Investing. April 2014.
[8] MSCI. MSCI Launches Global Fossil Fuels Exclusion Indexes. 16 October 2024.
[9] S&P. Three New Climate Change Index Series Launched by S&P Dow Jones Indices. 17 September 2015.
[10] FFI Solutions. The Carbon Underground 200.
[11] Urgewald. Global Coal Exit List 2024.
[12] Urgewald. Global Oil & Gas Exit List.

Figure 2: Planned Net-Zero Trajectories Under PAB and CTB Methodologies



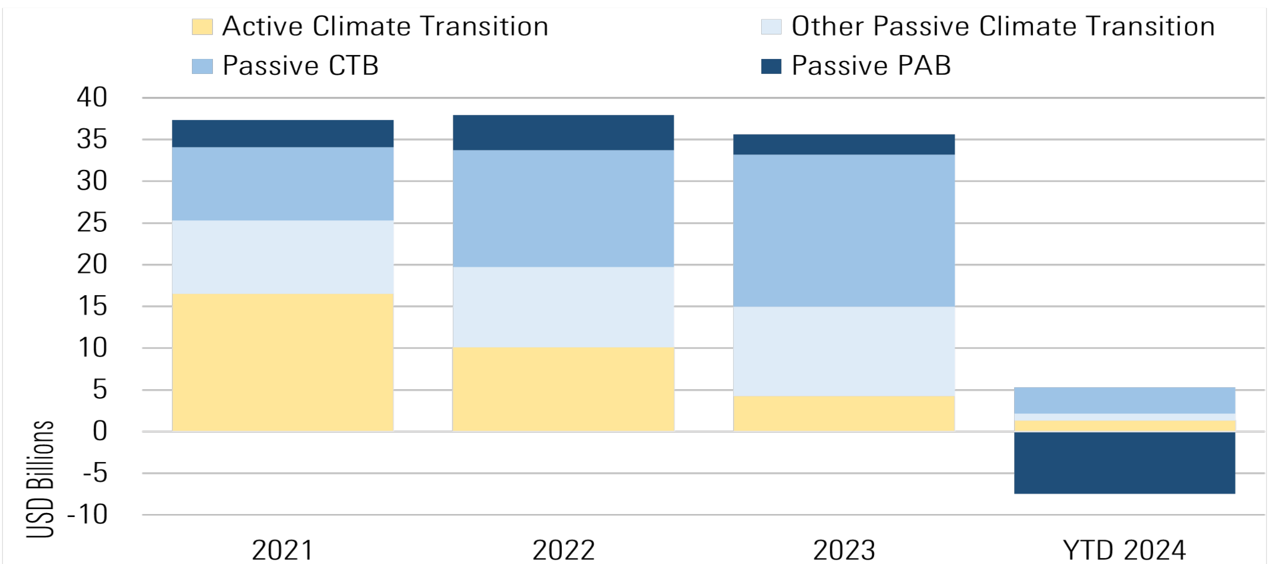
Source: S&P Global.

Adhering to annual emissions intensity reductions means one of two things needs to happen: Constituents must decarbonise in line with the reductions set out by the pathway (7% a year on average), or index providers must reweight and/or exclude constituents that do not contribute to meeting emissions reductions criteria. It is worth highlighting that EUCB methodology does not require this of all constituents, but that benchmark construction must achieve these targets in aggregate while maintaining the same (parent-level) exposures to high climate impact industries such as energy, agriculture and transport.

Support for EUCBs Falters

Since their introduction in 2020, net-zero-aligned EUCBs have grown rapidly to become the dominant force in the climate transition space. Yet, despite being seen as a success, assets referring to EUCBs remain measured in billions rather than trillions. Furthermore, inflows to funds that might typically be measured against EUCBs dropped off sharply in 2024 (Figure 3). Passive PABs suffered in particular, with outflows eclipsing all cumulative inflows over the three preceding years.

Figure 3: Annual Flows Into Climate Transition Funds by Subcategory



Source: Morningstar.[13] Note: 2024 data is up to 21 November.

Exogenous economic, political and social factors will have played their part in this abrupt reversal. Yet demand remained remarkably stout following Russia's full-scale war against Ukraine in 2022, and underlying assets are almost entirely European domiciled, to some extent shielding flows from US political headwinds.

Fears of EUCB Divergence From Standard Benchmark Offerings

The faltering support stems from maturing concerns over EUCBs becoming too far removed from standard benchmarks for core investors. Such concerns have become increasingly acute as the world (excluding Europe) shows little sign of decarbonising in line with the 7% necessitated by EUCB methodology. Divergence certainly seems to have eroded their broad appeal, with commentators citing tracking error (TE) versus standard benchmarks as a sticking point. MSCI Germany's

[13] Morningstar. Investing in Times of Climate Change. 22 November 2022.

executive director Alexander Dorbrinevski, for example, highlighted investors' increasing insistence on explicit TE minimisation objectives at a recent European Commission workshop.[14]

While it is true strict decarbonisation targets result in a shrinking opportunity set, and *could* give rise to TE creep versus standard benchmarks, this may not be an entirely negative outcome. Market-cap-weighted indexes are not themselves risk optimised, and traditional absolute measures of risk (such as value at risk) reportedly improve under EUCB methodology – even for more immediately strict PABs.[15]

Certainly though, to minimise traditional measures of divergence while adhering to decarbonisation objectives, something has to give. Index providers may, for example, be required to reduce exposure to emerging markets, where large emissions savings can be made in exchange for only modest active share increases. Even where TE is not specifically controlled, analysis suggests significant unintended regional and style tilts await.[16]

Real Economy Decarbonisation

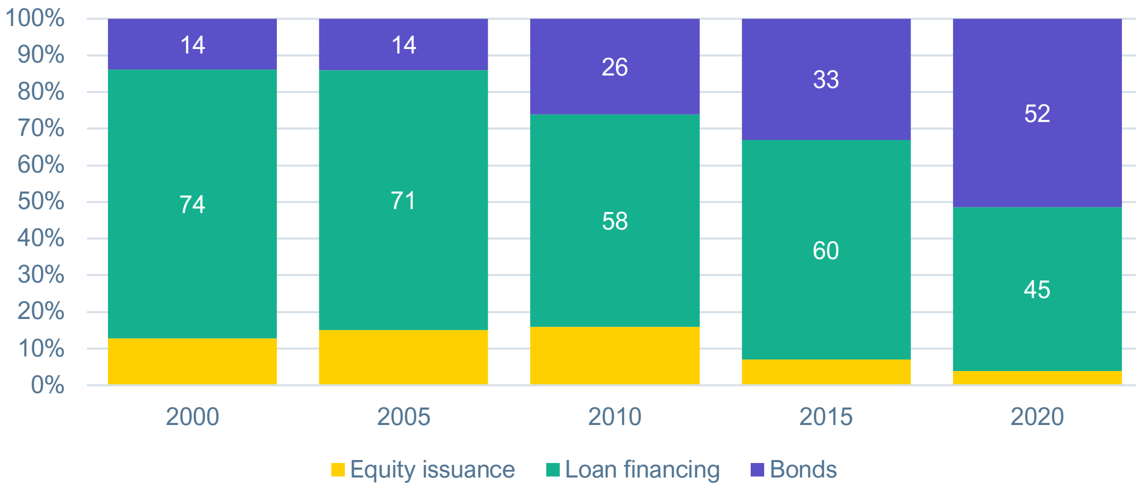
Perhaps more importantly, investors have also begun to question whether an EUCB approach actually encourages real-world emissions reductions. Indeed, this seems to be the core motivator behind the Glasgow Financial Alliance for Net Zero's (GFANZ) Q4 2024 consultation, which fleshed out guidance for "transition-informed" indexes (TIIs).[17] The consultation paper characterised EUCBs as effecting portfolio-level decarbonisation *only*, presenting this as a statement of fact. Inevitably, EUCB methodology *will* direct capital away from companies with comparatively high carbon emissions profiles and likely remove support for companies on non-linear (or nascent) decarbonisation trajectories. In defence of EUCBs, IEEFA contends that emissions-based reallocation is far from a simple exercise in "paper decarbonisation". Exclusion and tilting could bring indirect, system-wide benefits through a variety of channels, including the role played in market shaping, the delegitimisation of carbon-intensive activity, signalling to policymakers and share price incentivisation of company management. What is more, although EUCBs mandate relatively strict and immediate exclusions (most obviously in the case of PABs), they still require significant exposure to carbon-intensive sectors and can thus provide an incentive for companies to attain "best-in-class" status. Swift reinclusion can incentivise behavioural shifts at emissions laggards.

Much of this discourse will be familiar because it re-treads the well-worn "engagement versus divestment" debate. IEEFA has highlighted the importance of incorporating both strategies into investor toolsets, and when viewed in these terms it is far more widely accepted that exclusion is a necessary escalation strategy.[18] IEEFA would argue that time-bound ratcheting of index criteria, such as EUCBs' 7% annual decarbonisation targets, simply formalise escalation and prevent companies

[14] European Commission. Workshop on EU Paris-aligned and EU Climate Transition benchmarks. 17 October 2024.
[15] Responsible Investor. EU climate benchmarks: Still in vogue? 5 November 2024.
[16] Schroders. Why there may be more to Paris-aligned benchmarks than meets the eye. September 2024.
[17] GFANZ. Index Guidance to Support Real-Economy Decarbonization. October 2024.
[18] IEEFA. Engagement and divestment: Shareholders transcend a false binary. 12 September 2024.

from ignoring their own climate pledges. Finally, it is worth noting that as bond issuance increasingly supplies new capital to carbon-intensive industry, many are now waking up to the fact that exclusion in primary markets can more directly incentivise behavioural change by cutting off funding avenues and potentially increasing the cost of capital.[19]

Figure 4: Proportion of Global Fossil Fuel Fundraising by Asset Class, %



Source: The Guardian.[20]

Admittedly though, much like their ex-fossil fuel antecedents, EUCBs' main attraction lies not with real-economy decarbonisation *per se*, but in the clear protections offered against transition-related climate risk. Negatively screened, low-carbon benchmarks do not, for example, incentivise capital flows into climate solutions. But they do immediately reduce exposure to increasingly speculative market segments facing structural decline. In IEEFA's view, this is a compelling argument, but it is assumed by some to represent an investment thesis, rather than a clear fiduciary imperative (despite undeniable evidence of long-term share price decline).[21]

[19] Ellen Quigley. Evidence-based climate impact: A financial product framework. Energy Research & Social Science. Volume 105. November 2023.
[20] The Guardian. Europe's banks helped fossil fuel firms raise more than €1tn from global bond markets. 26 September 2023.
[21] IEEFA. Another bad year – and decade – for fossil fuel stocks. 27 January 2025.

Transition-Informed Indexes

Looking to overcome some of the concerns associated with EUCBs while still targeting net-zero alignment, GFANZ has proposed TIIs, the consultation period for which was held during Q4 2024 in the form of a voluntary guidance document.[22] TIIs represent a departure from incumbent climate-aware benchmark offerings by adopting a more inclusive approach to construction, one that is based not on historical emissions profiles but assessment of an entity’s forward-looking net-zero alignment credentials. In doing so, TIIs overcome some of the criticisms levelled at incumbent low-carbon benchmarks but come with baggage in the form of significantly elevated greenwashing risks.

“ **Transition-informed indexes overcome some of the criticisms levelled at incumbent low-carbon benchmarks but come with baggage in the form of significantly elevated greenwashing risks.**

By emphasising the role of engagement, TIIs embody a more popular and direct theory of change when compared with EUCB counterparts. A clear benefit of a TII approach is that by assessing the individual credibility of a company’s proposed transition pathway, unintended systematic biases should be removed. TIIs also sidestep problems faced by EUCBs whereby “climate solutions” often appear carbon intensive, even if “avoided emissions” would clearly define them as a positive contributor to real-economy decarbonisation. Emissions-reliant EUCB methodology might unintuitively discourage support for climate solutions because index inclusion makes it difficult to balance carbon intensity goals with TE expectations. There are also clear benefits to designing benchmarks with one eye on broad investor appeal. With engagement still widely preferred to divestment, TIIs stand a far better chance of displacing standard, climate-agnostic indexes in core investment processes. If this feat can be achieved without benchmarks becoming so inclusive as to be meaningless, the long-term environmental benefits could be considerable.

Elevated Greenwashing Risks

Although likely to appeal to a broader range of investors, inclusive transition-informed approaches come with significantly elevated greenwashing risks that mirror wider difficulties in defining transition finance. EUCB rules are well defined, based on relatively easy-to-quantify metrics that are enshrined in regulation. Index providers are given parameters within which they are free to implement their own methodology but must ultimately adhere to aggregate emissions reductions guardrails. The same cannot be said of TIIs, which from inception will rely heavily on assumptions and often qualitative assessments at the asset level, without clear overarching guardrails. GFANZ guidance, for example, emphasises how assessments of transition plans and engagement should be a key component of

[22] GFANZ. Glasgow Financial Alliance for Net Zero Launches Consultation on Index Guidance to Support Real-Economy Decarbonisation. 9 October 2024.

index construction. Yet the real-world impact of engagement remains questionable, and in all likelihood, transition plans, much like climate pledges before them, will be subject to revision, dilution and deletion. Even ostensibly credible plans might depend on highly uncertain technological progress, decades-forward predictions of market dynamics or policymakers providing an enabling environment (among other factors mostly outside an entity's control). An over-reliance on any of these highly uncertain factors, and a lack of flexibility built into plans, could betray credibility issues. But where to draw the line is far from obvious.

Pause in Proceedings Expected To Be Just That

Notably, less than a month on from its own consultation deadline, GFANZ announced that the development of its TII guidance was on pause while the alliance undergoes its own period of transition. Unless consultation responses were so overwhelmingly negative as to bury the fledgling concept, it would be surprising for TIIs not to resurface in a similar guise, especially given their alignment with GFANZ's new strategic direction (which seeks to "mobilize the capital needed for the transition, especially in emerging markets and developing countries").[23] Assuming this pause does indeed signal an intermission rather than a death knell, GFANZ's restructuring gives additional breathing room to shore up guidance, so that it might better protect against greenwashing risk and unnecessary carbon lock-in.

Recommendations for Revised Transition-Informed Index Guidance

As it stands, TII guidance builds on GFANZ's past efforts to define transition finance in sector-agnostic terms. At the time, IEEFA encouraged financial institutions to adopt more nuanced assessment frameworks than high-level guidance had provided.[24] Those recommendations remain valid in the context of index construction. Stakeholders can look to input from the likes of the Assessing Transition Plans Collective, Climate Bonds Initiative or the EU Platform on Sustainable Finance in that regard.[25,26,27] However, IEEFA would add some key considerations that should underpin future iterations of voluntary guidance. While recognising the need to allow index providers room for differentiation, such measures would provide the assurances needed to solidify broad investor support. At the very least, stakeholders looking to build or adopt TIIs should consider the following factors during implementation.

[23] GFANZ. 2025: New year update from GFANZ secretariat.
[24] IEEFA. Beyond COP28: Financial institutions should adopt nuanced transition finance frameworks to support net zero. 13 February 2024.
[25] World Benchmarking Alliance. Assessing the credibility of a company's transition plan: framework and guidance. 25 September 2024.
[26] Climate Bonds Initiative. Navigating Corporate Transitions: A tool for financial institutions to assess and categorise corporates by their transition credibility and maturity. May 2024.
[27] European Commission. Platform on Sustainable Finance report on Building trust in transition: core elements for assessing corporate transition plans. 23 January 2025.

Red Lines for Fossil Fuel Developers

In line with the International Energy Agency roadmap, the cessation of new fossil fuel financing should be the overarching guiding principle for transition finance.[28] The tone of GFANZ’s voluntary guidance is tentative on exclusion (even referring to it euphemistically as “non-inclusion”). Yet IEEFA believes that credible transition finance does not work without an exit strategy from fossil fuels within a defined timeframe. Companies seeking to expand reserves certainly cannot be considered as net-zero “aligned” without demonstrable commitment to the drastic overhaul of core business models. As such, entities with any expenditure or revenues derived from fossil fuel exploration should be excluded by default from “aligned” equity indexes. Similarly, they should receive significantly lower weightings in “aligning” equity indexes from the outset, with urgent time-bound requirements to halt exploration.

Perhaps most critically, any transition finance strategy (including the adoption of TIIs), should cautiously ring-fence capital so it cannot be used to facilitate fossil fuel expansion. To protect against misaligned use of proceeds, guidance should *strongly* recommend fossil fuel developers be excluded from all fixed-income TIIs, with the exception of green bond issuance where use of proceeds is clearly ring-fenced.

Skip to ‘Transition-Engaged’ Offerings

The OECD and others warn that transition finance bears a high risk of carbon lock-in by prolonging support for entities showing no clear or credible timeline for net-zero alignment.[29] Despite such concerns, voluntary guidance implies extreme leniency, necessitating as little as the intent to adopt net-zero commitments in the future. Consequently, it’s difficult to envisage any company failing to achieve GFANZ’s “transition-potential” status without purposefully doing so. Moreover, guidance clearly indicates that transition-potential indexes should be the flagship category for some time following launch, perhaps until 2030.

Time frames are ultimately down to index providers. But this apparent lack of guidance urgency is highly questionable, especially as regulatory frameworks such as the EU Corporate Sustainability Reporting Directive already require entities (including those with any meaningful footprint in the EU) to report the data needed to meet criteria for transition-engaged indexes. Given the lead times expected before TIIs become commercially available, IEEFA proposes that guidance focuses on fleshing out the case for transition-engaged indexes, bypassing the transition-potential category.

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[28] International Energy Agency. The path to limiting global warming to 1.5 °C has narrowed, but clean energy growth is keeping it open. 26 September 2023.
[29] OECD. Mechanisms to Prevent Carbon Lock-in in Transition Finance. 26 September 2023.

Mandatory Transition Plans and Stronger Emphasis on Guardrails

Transition plans will soon be a requirement under the EU Corporate Sustainability Due Diligence Directive. Even where transition planning is not mandatory, by the end of 2026 it should be expected that any investable company credibly committed to net-zero alignment will have a transition plan. Certainly by 2027, when transition-informed indexes might be expected to gain wider momentum, a transition plan should be the minimum bar for inclusion, with concessions made on regional considerations (such as in the case of emerging markets and developing countries).

Additionally, guidance should strongly suggest quantitative guardrails to protect against over-inclusivity, minimise greenwashing risk and prevent carbon lock-in. From the latest EU Platform on Sustainable Finance briefing,[30] such guardrails could include:

- Maximum (X%) aggregate weight in entities without a transition plan
- Minimum (X%) asset-level taxonomy-aligned capex and/or revenue (particularly in the case of high-risk sectors)
- Sovereign debt inclusion based on nationally determined contributions, climate mitigation, adaptation, just transition and other national environmental objectives and performance
- Assets should not undermine wider transition objectives

Add Lobbying Transparency to Qualifying Criteria

GFANZ's voluntary guidance doesn't mention corporate lobbying on climate issues, despite wide acknowledgement of its insidious and significant impact on climate degradation. IEEFA would encourage this issue be put on the agenda. Even if damages associated with lobbying are difficult to quantify, the practice has proved a highly potent weapon in the arsenal of carbon-intensive industry stretching back decades. To give an idea of scale, US-based trade associations opposing climate policies reportedly spent US$3.4 billion on political activities from 2008 to 2018.[31] Direct lobbying, grants and political contributions made up US$1.4 billion of that (with the lion's share spent on advertising and promotion), dwarfing similar spends from climate-supporting groups by a ratio of 27:1.[32] Measurable activity is just the tip of the iceberg given the prevalence of backchanneling and that additional, untraceable expenditure is likely to be multiples higher. Targets are also no longer simply political; reports of an escalation in lobbying at the US Securities and Exchange Commission began to surface in 2021.[33] These efforts perhaps bore fruit in 2024, through watered-down corporate climate risk rules and Scope 3 emissions being removed from financial disclosure requirements.

[30] EU Platform on Sustainable Finance. Platform Briefing on product categorisation. December 2024.
[31] Robert Brulle and Christian Downie. Following the money: trade associations, political activity and climate change. Climatic Change. Volume 175:11. 2022.
[32] Ibid.
[33] Financial Times. Fossil fuel groups step up lobbying of SEC to dilute climate reporting rules. 2 August 2021.

Greater transparency is needed. IEEFA recommends that guidance adds corporate lobbying transparency to the qualifying criteria for any transition-engaged index, with subsequent assessment used to help determine sub-categorisation (aligned, aligning or otherwise). Should that be too immediately restrictive, transparency could be included as a time-bound requirement. At the very least, guidance should suggest index builders incorporate lobbying key performance indicators, such as those devised by InfluenceMap, to inform index construction.[34]

Future of Climate Indexes

IEEFA believes there is a case for alternative benchmark products that embody different approaches to net-zero alignment. TIIs will, however, need to demonstrate greater urgency and caution than GFANZ's guidance suggests if they are to prevent undue carbon lock-in and gain wider investor support. The pause in development offers GFANZ a chance to amend the tone of guidance and encourage stronger protections. To do so will likely reduce the opportunity set more than voluntary guidance might imply, but the bar is better set high than low if transition-informed indexes are to maintain their integrity. The importance of this cannot be overstated: With an elevated risk of failing to achieve net-zero alignment, TIIs will only gain popular support if investors trust they capture an opportunity set of entities making timely and credible attempts to decarbonise. Assuming guardrails are implemented and the methodology is appropriately time-bound, there is no reason such benchmarks cannot coexist with incumbent benchmark offerings.

Interested parties should also keep a close eye on the development of indexes using EU taxonomy-aligned capex ratios, which would combine historical emissions metrics *with* concrete evidence of commitments. Investing for Transition Benchmarks (ITBs, Table 1) might sit in the Goldilocks zone between strict, retrospective EUCBs and flexible but less certainly net-zero-aligned TIIs.[35] ITBs would, however, rely on data that is not yet broadly available to replace standard indexes.

Ultimately, there is no singularly correct net-zero-aligned benchmark approach and no true route to passive Paris alignment, given patently active decisions are made in benchmark selection. Existing climate benchmarks and those in development offer alternative theories of change but come with their own weaknesses. This means that TIIs (and in future, ITBs) should not cannibalise existing transition-aware assets. In fact, an approach that is more inclusive by design should hold wider appeal for investors, giving net-zero-aligned benchmarks a better chance of displacing traditional (climate-agnostic) indexes in core investment processes. Should this come to pass, the environmental benefits could be substantial. IEEFA would encourage sophisticated investors to implement elements of different methodologies, including low (and diminishing) carbon exposure, transition plan assessments, engagement indicators and sustainable capex considerations, to suit their own beliefs and preferences.

[34] InfluenceMap. The LobbyMap Methodology Portal.
[35] EU Platform on Sustainable Finance. Investing for Transition Benchmarks (ITBs) Report. 19 December 2024.

About IEEFA

The Institute for Energy Economics and Financial Analysis (IEEFA) examines issues related to energy markets, trends and policies. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

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Alasdair Docherty is the Sustainable Finance & Data Analyst for IEEFA's European team. His research predominantly covers asset management and equity markets in Europe. Alasdair has over fifteen years of experience working with equities management, earned during his time at Schroders, where he built a deep understanding of the regulatory environment and how sustainability considerations are integrated into both investment and operational processes. He further has a background in data analysis, having spent time earlier in his career at industry analytics provider FactSet Research Systems, and is qualified as a data analyst through BCS (UK). He graduated in 2004 with a bachelor's degree in Business Finance from the University of Durham.