From commitment to action: how banks in Luxembourg are implementing transition plans

ABBL

EY

Shape the future with confidence

Contents

Foreword

We are pleased to present the **ABBL EY Discussion Paper on Climate Transition Plans** (the "Paper"). This research offers insights into how Luxembourg's banks are assessing climate-related risks and the financial impacts of the transition, analyzing their exposure to climate change and evaluating the resilience of their business models and portfolios. Based on in-depth interviews with nine institutions conducted between September and November 2025, and enriched by an assessment of leading European practices, the Paper provides a view of where the industry stands today and what it will take to move forward.

Anchored in the evolving European regulatory landscape, the analysis gives insights across governance and strategy, scenario analysis, targets and metrics, data and disclosure, and client engagement. The findings reveal both meaningful progress and the challenges that remain. Banks are increasingly turning ambition into structured transition plans, yet delivering on these plans will demand sustained investment in data, internal processes, monitoring and systems.

Our objective with this paper is to support informed dialogue and decisive action. By sharing evidence from market practice and benchmarking it against evolving expectations, we aim to help institutions embed credible, time-bound transition plans that create value while advancing the sector's contribution to Europe's climate objectives.

We extend our sincere thanks to the Luxembourg banking community for their openness, collaboration, and commitment to driving progress on the transition journey.

Executive summary

About the research

The Paper, developed collaboratively by Ernst & Young (EY) and the *Association des Banques et Banquiers, Luxembourg* (ABBL), provides a comprehensive overview of transition planning practices, challenges and opportunities for banks operating in Luxembourg. The report outlines the evolving regulatory landscape, shaped by international agreements such as the Paris Agreement and European legislation including the Corporate Sustainability Reporting Directive and Capital Requirements Directive and Regulation. It highlights the key role of transition plans as actionable, time-bound strategies for aligning business models, portfolios, and risk frameworks with the goals of the Paris Agreement and the European Climate Law.

Drawing on in-depth interviews and discussions with nine major banks in Luxembourg representing a diverse mix of sizes, business models, and market activities, the paper identifies five key pillars of credible transition planning:

1. Governance
2. Measurement and targets
3. Alignment with business
4. Decarbonization levers and risk management
5. Monitoring and verification

Key takeaways

Annual credit losses projected to rise

As climate-related financial risks intensify, banks across the EU are already facing substantial and immediate challenges. The latest European Central Bank (ECB) climate stress tests[1] highlight an urgent reality: even under optimistic assumptions, **annual credit losses are projected to rise by 25% by 2030 compared to 2022,** driven directly by climate-related factors. This is not just a matter of regulatory expectations: failure to act will result in significant financial impacts for banks.

It's therefore an important moment for Luxembourg's banking sector. These projections call for an urgent alignment with the EU's climate objectives to safeguard their financial stability and future profitability, all while operating in an increasingly complex and unpredictable regulatory landscape. The message is clear: **inaction is no longer an option.**

Two key challenges remain: data management and integration of environmental risks

While Luxembourg banks are making significant progress (particularly in governance, scenario analysis and sustainable product innovation) persistent challenges remain, especially in **data management** and in the **integration of environmental risks into risk frameworks.**

Clear actions to be taken for alignment to be achieved

The report concludes with actionable recommendations for banks: invest in robust data management, strengthen internal ESG expertise and capacity and set ambitious, science-based targets supported by concrete implementation strategies and client engagement. By focusing on these priorities, Luxembourg's financial institutions can enhance the credibility of their transition plans, build stakeholder trust, and control risks and financial exposure.

25% Annual credit losses driven by climate factors are projected to rise by 25% by 2030

1 Fahr, S., Giuzio, M., Mc Sweeny Pourtalet, C., Spaggiari, M. and Vendrell Simón, J.M. (2023) Climate change and sovereign risk. European Central Bank.

1. The role of transition plans in banking: definition, purpose and importance

Recent years have illustrated the real-world impact of climate-related risks on banks and the broader economy. In **Germany**, for example, the 2021 Ahr Valley floods, the costliest flooding disaster ever recorded in the country, caused over $42 billion in damages, leading to significant loan defaults and insurance claims.[2]

Without decisive action, climate-related financial losses are projected to accelerate dramatically. Research suggests that indirect economic disruptions to global supply chains alone could result in **cumulative net losses of up to $25 trillion by 2060.**[3] **In 2024, natural disasters caused $417 billion** in direct economic damage globally, with 63% of these losses uninsured,[4] highlighting the significant physical risk exposure that banks now need to factor into credit assessments and capital planning. At the same time, transition risks are mounting. An ECB analysis from 2024 shows that most euro area banks' portfolios are still misaligned with Paris targets, particularly in high-emission sectors like power generation and automotive, signaling elevated credit risk as climate policies tighten and market dynamics shift.[5]

$ 417 billion

The cost of direct economic damage globally for natural disasters in 2024

Against this background, the growing recognition of the material financial impact of climate-related risks is driving banks to align their portfolios with the EU's climate objectives and to develop credible transition plans that address both regulatory requirements and the tangible financial impacts associated with both physical and transition challenges.

What is a transition plan?

A **credible transition plan** is a time-bound action plan, resulting from an institution's transition planning process, that outlines how it will realign its assets, operations, and business model with a trajectory consistent with the latest climate science.[6] A **credible plan** sets measurable and science-based targets and establishes mechanisms for monitoring progress (e.g., through regular measurement of GHG emissions, use of dashboards, and board-level oversight). It outlines the approach to climate-related engagement with portfolio counterparties and includes expectations of companies, an escalation strategy, and progress on engagement-related outcomes.

It ensures transparency and accountability across all levels of the institution. Beyond serving as a strategic roadmap, a transition plan is an essential tool for managing climate-related risks and controlling financial consequences.

As outlined in Section 2, the Corporate Sustainability Reporting Directive and its related European Sustainability Reporting Standards (ESRS), together with the prudential requirements introduced under the Capital Requirements Directive VI, establish transition plans as a central element of climate risk management. These plans serve as roadmaps for financial institutions to align their business models, portfolios and risk frameworks with the goals of the Paris Agreement[7] and the European Climate Law,[8] while also supporting the identification, assessment and management of ESG risks.

2 Munich Re. (2025). How catastrophes limit prosperity – Weather disasters are a growing burden, also for many industrialized countries.
3 Sun, Y., Zhu, S., Wang, D., et al. (2024). Global supply chains amplify economic costs of future extreme heat risk. Nature, 627, 797–804.
4 Gallagher Re. (2025). Natural catastrophe and climate report: 2024.
5 European Central Bank. (2024). Risks from misalignment of banks' financing with the EU climate objectives: Assessment of the alignment of the European banking sector. European Central Bank.
6 Network for Greening the Financial System. (2024). Credible Transition Plans: The micro-prudential perspective.
7 Paris Agreement. (2015). United Nations Framework Convention on Climate Change (UNFCCC).
8 Regulation (EU) 2021/1119. (2021). European Climate Law. Official Journal of the European Union.

Climate-related risks

Transition planning requires the identification and management of both climate-related physical and transition risks, as defined by the ECB:

CLIMATE RISK
Financial risks from climate change

Transition risk

Risk of financial loss from the shift to a low-carbon economy.

- **Policy and regulation**
- **Technology**
- **Market dynamics**
- **Consumer preferences**

Impacts asset values, business models, cost structures.

Physical risk

Financial impact from climate events and environmental degradation.

1) Acute risks

Event-driven: floods, storms, heatwaves

2) Chronic risks

Long-term shifts: rising temperatures, sea-level rise, water scarcity, biodiversity loss, resource

Can damage assets, disrupt operations, and indirectly affect supply chains, productivity, market access.

Use in risk identification, stress testing, and transition plan governance.

Implications for financial institutions in Luxembourg

In Luxembourg, where the financial sector plays an important role in directing capital flows, transition planning is essential for banks to effectively mitigate climate-related risks and safeguard financial stability.

Research from the *Banque Centrale du Luxembourg* (BCL) shows that while physical climate risks for banks in Luxembourg remain relatively low due to their European-focused portfolios, exposure to extreme precipitation and water stress is increasing. At the same time, transition risks are significant, with over 42% of loans to non-financial corporations concentrated in carbon-intensive sectors and stress tests indicating that an orderly transition (Net Zero 2050) would strengthen banks' Tier 1 capital ratios by 2% compared to a no-action scenario, whereas delayed policies would sharply increase credit risk after 2030.[9]

42%

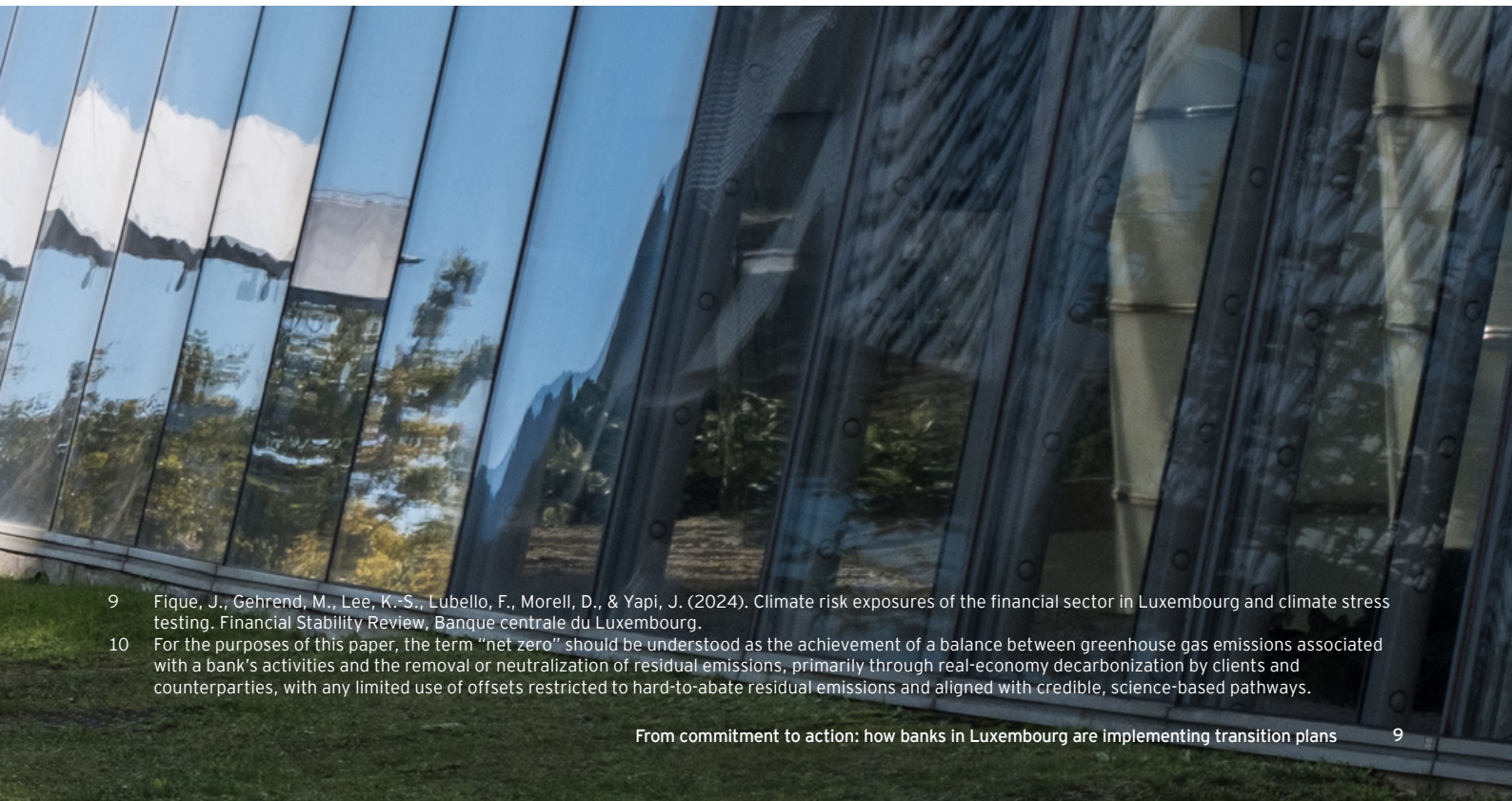
Of loans to non-financial corporations are concentrated in carbon-intensive sectors

2%

An orderly transition to Net Zero 2050 would strengthen banks' Tier 1 capital ratios by 2%

Recommendations

Transition plans provide the structure and accountability needed to guide decarbonization, ensuring that financial institutions can manage climate-related risks while contributing to a sustainable economic future. Collaboration across the financial sector and with external stakeholders is therefore necessary. Financial institutions can amplify their impact by participating in industry alliances, engaging with regulators and being involved in key consultations on the development of climate-related standards and taxonomies. As an endorser of high-level initiatives such as the United Nations Principles for Responsible Banking and the former Net Zero[10] Banking Alliance, the ABBL helps its members to shape a more transparent and consistent approach to sustainable finance and mitigate climate-related systemic risks.



9 Fique, J., Gehrend, M., Lee, K.-S., Lubello, F., Morell, D., & Yapi, J. (2024). Climate risk exposures of the financial sector in Luxembourg and climate stress testing. Financial Stability Review, Banque centrale du Luxembourg.

10 For the purposes of this paper, the term "net zero" should be understood as the achievement of a balance between greenhouse gas emissions associated with a bank's activities and the removal or neutralization of residual emissions, primarily through real-economy decarbonization by clients and counterparties, with any limited use of offsets restricted to hard-to-abate residual emissions and aligned with credible, science-based pathways.

2. Regulatory requirements and overview of market developments

EU Climate Transition Planning: Regulatory Timeline

The regulatory landscape for climate transition planning in the EU is rapidly evolving, driven by EU legislation and underpinned by foundational instruments such as:

EU regulatory and prudential landscape

Corporate Sustainability Reporting Directive (CSRD)

In this context of political ambitions to achieve climate-neutral economies, climate transition planning has emerged as a central regulatory expectation for financial institutions. **The Corporate Sustainability Reporting Directive (CSRD)** is fundamental to the EU's climate transition planning framework, shifting from voluntary to mandatory, standardized sustainability reporting. Companies must disclose whether they have a climate transition plan; if not, they need to state this and indicate whether they plan to adopt one. Transition plans should describe concrete actions, intermediate and long-term targets, implementation timelines, and mechanisms for tracking progress. While CSRD currently applies to large public-interest undertakings, its scope of application will narrow down as from financial years starting on or after 1 January 2027 to certain EU companies and groups with more than 1,000 employees and over EUR 450 million turnover in the EU. These thresholds reflect the latest EU legislative developments[11] and may still evolve during the legislative process and national implementation.[12]

Capital Requirements Directive (CRD VI)

Climate transition planning has also entered the banking prudential supervision framework. The amended **Capital Requirements Directive (CRD)** requires management bodies to develop and monitor the implementation of specific plans to address the financial risks arising, in the short, medium and long term, from ESG factors, including from transition trends.[13] Banks must also include climate scenarios in stress testing and incorporate climate-adjusted capital adequacy measures. Meanwhile, the **Capital Requirements Regulation (CRR)** obligates banks to report their risk exposures, governance and strategies, including ESG and climate-related risks, as part of their **Pillar 3 disclosures.**

The **ECB** expects institutions to treat climate risks as material financial risks, progressively subjected to a similar level of scrutiny as traditional credit, market and operational risks. The supervisor also expects them to be fully integrated into stress testing, the Internal Capital Adequacy Assessment Process (ICAAP), and risks frameworks over time, proportionate to the size, complexity and data capabilities of institutions. Governance arrangements must ensure accountability at board and senior management levels for climate risk oversight and transition plan execution.

11 Directive (EU) 2026/470 of the European Parliament and of the Council of 24 February 2026 amending Directives 2006/43/EC, 2013/34/EU, (EU) 2022/2464 and (EU) 2024/1760 as regards certain corporate sustainability reporting requirements and certain corporate sustainability due diligence requirements.
12 EFRAG. (2025, November). Draft revised European Sustainability Reporting Standards (ESRS), specifically ESRS E1 on climate.
13 Capital Requirements Directive VI | Directive (EU) 2024/1619.

	Application	Purpose	Scope & Audience	Key Components
CRD VI	Applies to all credit institutions and investment firms in the EU	Aims at protecting the bank by ensuring financial stability and resilience to material ESG risks Mandatory for institutions under CRD VI, embedded in Supervisory Review and Evaluation Process (SREP) and ICAAP Focuses on material ESG risks, especially climate and environmental risks	Confidential submission to supervisors (ECB/ DNB), part of SREP Audience: prudential supervisors and risk authorities Focuses on long-term (≥10 years) with explicit short-, medium-, and long-term risk outlooks	ESG risk materiality assessment Capital adequacy impact, ESG risk appetite, scenario analysis Integration in risk management processes, ICAAP and Pillar 3 Counterparty engagement strategy and supervisory-aligned metrics
CSRD	For FY27 reporting, it applies to: All large EU companies who meet the following 2 criteria: ▪ >1,000 employees ▪ >€450 million turnover (revenue) All large non-EU companies* who meet the following 2 criteria: ▪ >€450 million turnover generated in the EU Subsidiaries or branches in the EU if: ▪ >€200 million EU turnover	It aims at transforming the bank's impact toward a sustainable economy It is mandatory for large companies and financial institutions to disclose whether they have a transition plan Covers all sustainability matters: climate, biodiversity, social, human rights, governance	Public disclosure in the annual sustainability report Audience: investors, clients, NGOs, public stakeholders Focuses on long-term, typically beyond five years (aligned with climate commitments such as 2030 or 2050)	Double materiality assessment Climate & sustainability targets, pathways Transparency on dependencies, impacts, and decarbonization levers KPIs, financed emissions, transition financing

EBA Guidelines

As part of its enhanced supervisory focus on climate and environmental risks, the **European Banking Authority (EBA)** has introduced requirements for transition plans under the EBA Guidelines on the management of ESG Risks (EBA GL/2025/01). These guidelines specify the principles institutions must observe and the minimum elements they must include to ensure they produce a **credible, coherent and forward-looking transition plan,** demonstrating how their strategy, governance, metrics, engagement and implementation actions support the management of ESG risks. Where relevant, the EBA specifies such plans must be consistent with the plans that institutions disclose pursuant to CSRD.

The EBA Guidelines' provisions on transition plans specify how institutions should comply with Article 76(2) CRD on the management of ESG risks. They are designed to apply to all EU credit institutions, with application dates phased in by size and complexity. For large institutions, the main obligations have been in application since 11 January 2026, subject to national implementation and supervisory practice. **In Luxembourg, CSSF Circular 26/905** implements these prudential expectations for Less Significant Institutions (LSIs) **from 1 April 2026** and **from 11 January 2027** for Small and Non-Complex Institutions (SNCIs). Supervisory expectations remain subject to ongoing implementation and may be further specified as the EBA framework and national practice evolve.

For a full overview of the core components of a compliant transition plan, as required under the EBA guidelines and adapted to institutions of different sizes, please refer to Annex I.

Furthermore, the EBA has introduced on 5 November 2025 a second set of guidelines on environmental scenario analysis (EBA GL/2025/04), addressing the point 8d) of the mandate and fulfil Article 177(2a) of CRR for IRB banks, on how climate-related risk factors must feed into credit-risk internal stress testing. They should apply no later than 1st January 2027. Still, at the date of the issuing of this report, they remain to be implemented in Luxembourg.

Alliances and initiatives

Voluntary **global alliances and investor coalitions** have emerged to bolster market practices on climate topics before regulations entered in force and have driven early commitments and accelerated the alignment of financial flows with net-zero objectives. Even if some are undergoing significant restructuring, both the Net-Zero Asset Managers initiative[14] and the Glasgow Financial Alliance for Net Zero[15] still have the objective to encourage financial institutions to set climate targets and disclose their progress. Initiatives, such as the Partnership for Carbon Accounting Financials[16], support financial institutions by providing methodologies, tools and databases for measuring and disclosing the GHG emissions associated with financial portfolios, enabling institutions to track progress toward decarbonization targets.

Overall, these regulatory and market developments are creating a robust ecosystem that supports and incentivizes the integration of climate transition planning into financial decision-making.

14 Net-Zero Asset Managers initiative.
15 Glasgow Financial Alliance for Net Zero.
16 Partnership for Carbon Accounting Financials.

3. Methodology

STUDY OVERVIEW: TRANSITION PLANNING IN LUXEMBOURG BANKING (EY & ABBL)

Scope, methodology, sample, and benchmarking

Collaboration & purpose

- Joint paper by EY and ABBL
- Overview of practices, challenges, and opportunities
- Focus: Luxembourg banking sector

Interview sample

- 9 banks with presence in Luxembourg
- Interviews: Sep–Nov 2025
- Varied size, HQ locations, business lines, and maturity

Topics covered

- Governance
- Business strategy
- Scenario analysis
- Targets
- Data
- Client engagement
- Risk management
- Disclosure
- Challenges & solutions

Benchmarking add-on

- Desk review of 3 major international players
- Public sustainability and regulatory disclosures
- Best practices integrated to strengthen benchmarking

Regulatory alignment

- Paris Agreement, EU Green Deal
- ESRS, CRD VI
- EBA and ECB guidelines

Outcome: showcase transition plan practices, highlight challenges and opportunities, inform policy and foster dialogue in Luxembourg.

4. Transition plan elements & case studies: from theory to market reality

Regulatory expectations have established benchmarks for what constitutes a credible transition plan. As mentioned in Section 2, supervisory authorities such as the ECB, EBA, and CSSF require financial institutions to embed climate and environmental risks into governance, risk management, and strategy, while disclosure directives like CSRD emphasize transparency.

To describe how interviewed banks operationalized these expectations, and to bridge supervisory expectations under CRD VI (prudential transition plans) with disclosure expectations under CSRD, we have grouped best practices into **five key pillars** that form the foundation of a transition plan, based on the EBA Guidelines on the management of ESG risks and the recommendations of the TCFD:

1. Governance
2. Measurement and targets
3. Alignment with business
4. Decarbonization levers and risk management
5. Monitoring and verification

Best Practice 1 – Governance: transition plan oversight and management

EBA/GL/2025/01 ¶88

Institutions should clearly identify and allocate responsibilities for the development validation, implementation and monitoring of the plans.

Governance on transition planning should be an organization-wide process embedded in strategy, risk management and decision-making. Setting the tone from the top, boards of directors should approve and periodically review transition plans, while executive management should oversee their implementation and progress against targets, and take corrective action where deviations arise.

Banks should allocate **clear responsibilities** with regard to transition targets across all three lines of defense (i.e., business lines, risk management, control functions). **Adequate internal capacity** is needed, including sufficient resources and targeted training, so that relevant staff understand climate risks, transition pathways and their roles in achieving the bank's targets. **Remuneration and incentive** frameworks for executive management may promote the execution of the transition plan by linking variable pay to climate-related objectives and risk indicators, in line with the bank's risk appetite.

A. Governance arrangements

EBA/GL/2025/01 ¶89

The management body should be responsible for the approval of the plans and should oversee their implementation, including being regularly informed of relevant developments and progress achieved in relation to the institution's targets and taking decisions on remedial actions in case of significant deviations.

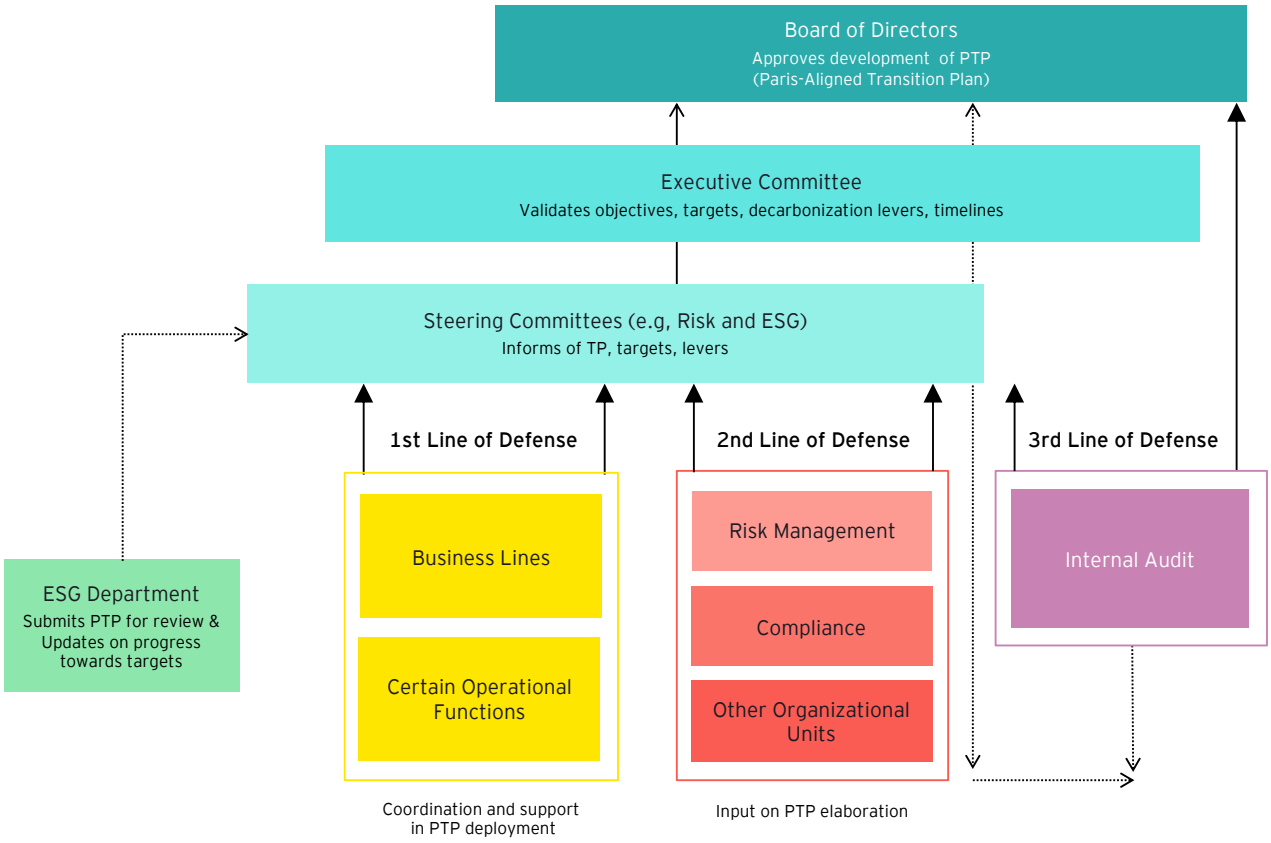
Banks' transition planning should be clearly structured **across the three lines of defense**, with well-defined roles, escalation mechanisms and oversight by the management body and supported by clear accountability. Boards of directors approve transition plans and oversee their implementation, while senior management is responsible for their execution, coordination across functions, and timely remediation where targets or risk limits are breached.

Within this framework, as the first line of defense, business lines and client-facing functions assess the alignment of counterparties' climate transition strategies with the bank's risk appetite and embed climate targets into credit and investment decisions.

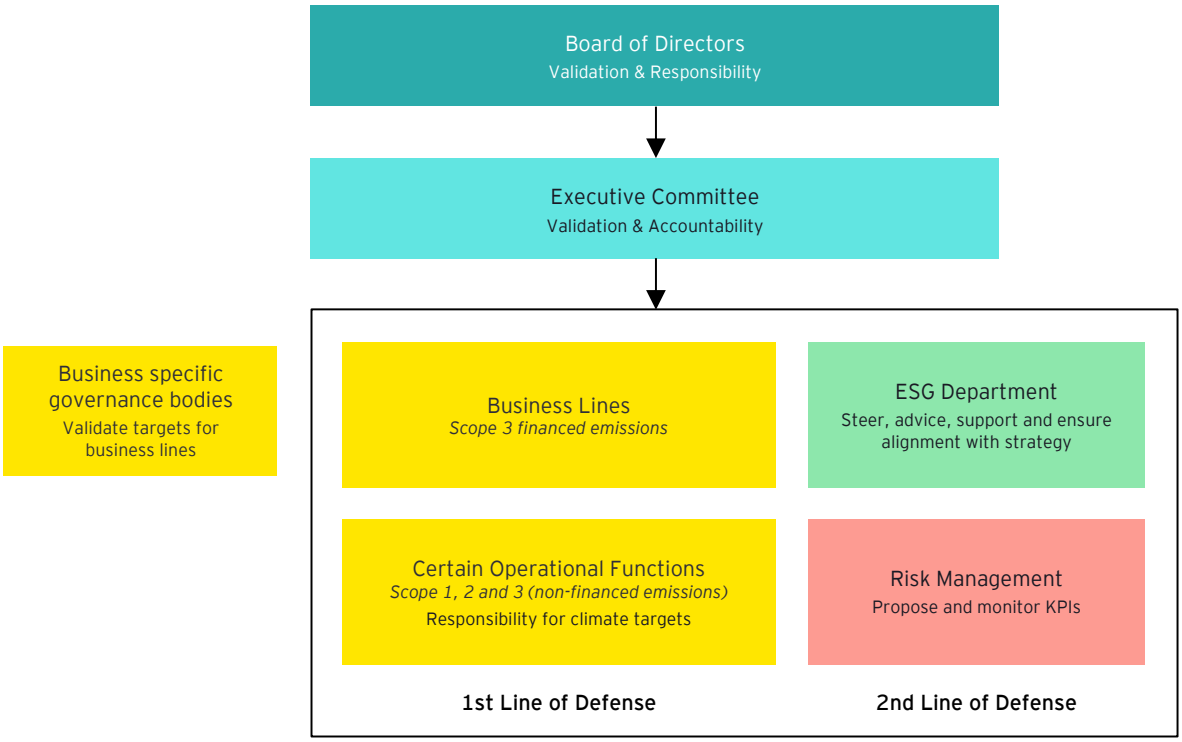
Risk management functions define institutions' methodologies and risk indicators under various scenarios and assumptions, ensuring consistency with the transition plan and its sector policies. The third line of defense, internal audit, needs to project reviews of the institution's transition plan to check its compliance with the applicable regulatory framework and alignment with the institution's risk appetite and internal policies.

Market overview: Banks are increasingly structuring transition planning through formalized governance frameworks that clarify decision-making roles from the board to senior management and operational functions, as illustrated in the following governance charts.

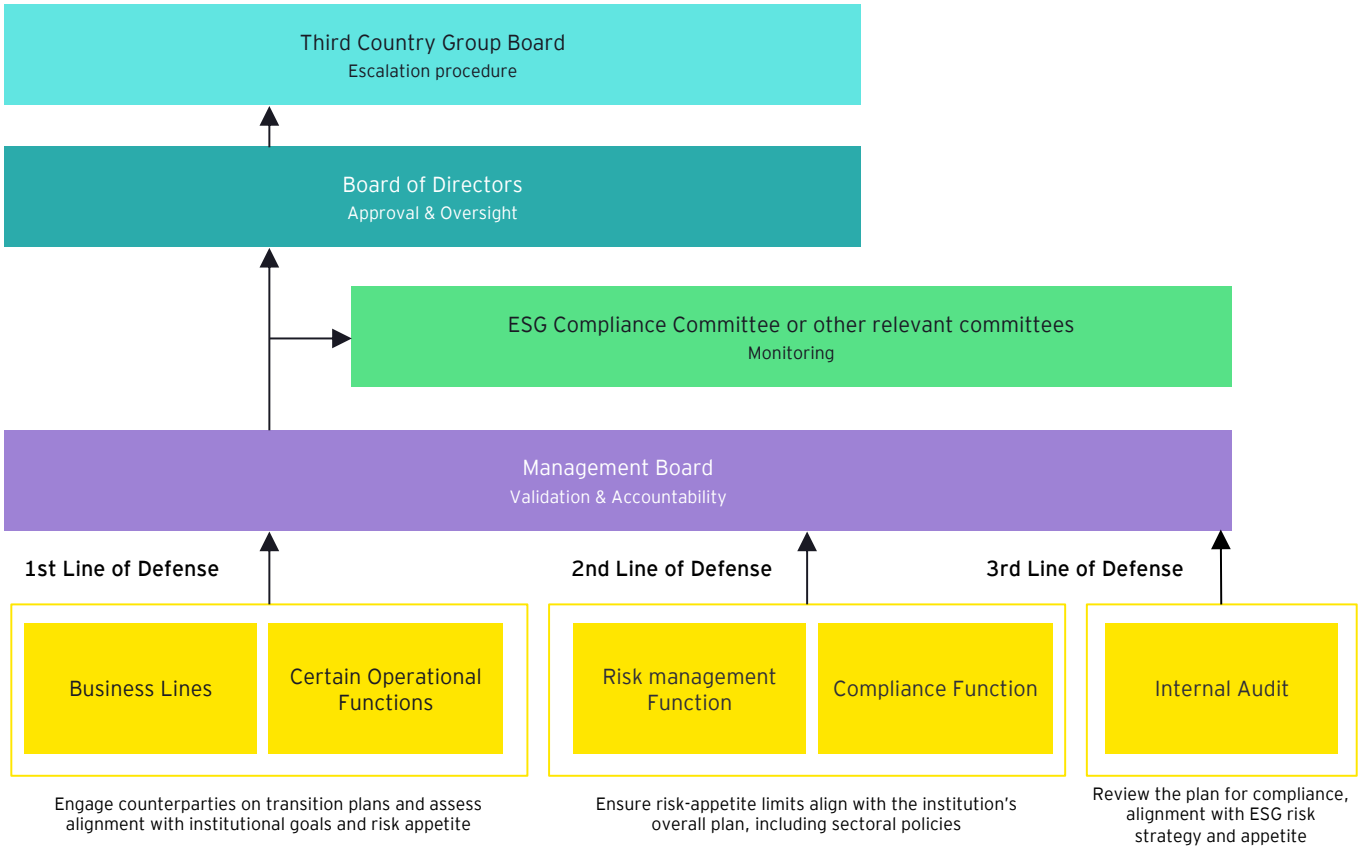
Example 1: Illustrative governance structure for a universal bank



Example 2: Illustrative governance structure for a private bank



Example 3: Illustrative governance structure for a non-EU bank



B. Training and internal capacity

EBA/GL/2025/01 ¶92 […]

Institutions should ensure they possess sufficient capacity, expertise and resources to develop and implement their transition planning process as well as to regularly assess the robustness of their plans and monitor their implementation. Institutions should map existing gaps in skills and expertise and take remedial actions where necessary.

Credible transition planning also requires **sufficient internal capacity and expertise**, meaning that banks should address skills gaps by rolling out targeted training and awareness programs so that all staff involved understand climate risks, transition pathways and their own responsibilities in achieving the bank's related objectives.

Market overview: Luxembourg institutions are embedding sustainability as a core aspect of their internal culture. They build capacity using targeted training approaches, with a focus on equipping the first line of defense (i.e., front-line staff, relationship managers, and business functions) with the knowledge needed to identify, assess and manage climate-related risks.

All nine interviewed banks have implemented mandatory basic ESG training for all staff. We identified four core ESG and climate training topics commonly addressed by banks, with modules tailored to different roles across the organization, from boards and executives to managers, client-facing staff, and all employees.

Core topics and training modalities

ESG & Sustainability Fundamentals	Climate Risk, Transition Impacts and Opportunities	Client ESG Preferences and Advisory Skills	Client Engagement
▪ Intro to ESG concepts, sustainability risks, and regulatory expectations ▪ Modules on emissions, carbon footprinting, and transition challenges ▪ Foundational courses delivered by sustainability leaders (e.g., Group Head of Sustainability)	▪ Physical and transition climate risks; sector-level and portfolio impacts ▪ Training on climate targets, decarbonization levers, and net-zero pathways ▪ Sessions explaining how climate change affects financial decisions, underwriting, investment and advisory work	▪ Training for relationship managers (RM) and wealth advisors on identifying and incorporating clients' climate preferences ▪ How to explain to clients why climate topics matter (risk mitigation, long-term value, resilience) ▪ Education on sustainability frameworks to support conversations with clients and institutional investors	▪ RMs visiting client offices to provide sustainability briefing ▪ Workshops on recognizing sustainable investment opportunities and engaging clients on transition pathways

Sustainability departments often collaborate closely with other operational functions and business lines to share knowledge across the institution. Additionally, climate targets are being integrated into internal communication, including through ESG dashboard presentations to boards.

Nevertheless, banks perceive the existing off-the-shelf ESG training offerings available on the market as too elementary and expressed a need for deeper technical knowledge to enable staff to advise clients on transition planning. Other obstacles such as limited time and resources constrain banks' ability to scale training across all roles and, in particular, embedding sustainability expertise beyond dedicated ESG teams into frontline functions. The pace at which regulatory standards evolve make it difficult to keep training content up-to-date.

C. Remuneration policies

EBA/GL/2025/01 ¶109 (c) (Governance)

[Institutions should include in their plans] remuneration policies and practices to promote sound management of ESG risks in line with the institution's objectives and risk appetite.

Remuneration and incentive frameworks, including executive and non-executive management, should be aligned with the effective execution of the transition plan. This may take the form of linking variable pay to the achievement of climate-related objectives and climate risk management milestones, while remaining consistent with the institution's risk appetite.

Market overview: Banks demonstrate moderately converging practices in linking remuneration to climate and sustainability objectives. Some have already embedded ESG-related indicators directly into remuneration frameworks, notably for senior management, where breaches of climate risk indicators may adversely affect variable compensation. Several institutions tied variable remuneration to mandatory ESG training, with their completion as a prerequisite for full compensation to ensure a minimum level of awareness across all staff.

Most banks, however, remain cautious and adopt a gradual and qualitative approach. Some are conducting pilot exercises within selected teams (e.g., relationship managers) to integrate sustainability considerations into performance reviews, yet without explicit quantitative targets. These trials may lead to a broader rollout across all staff. Some other institutions voiced concerns that ambitious sustainability-linked reward mechanisms may lead to excessive risk-taking.

Key takeaways for governance

1. **Structure climate transition across the three lines of defense,** with clear responsibility allocation, escalation mechanisms and strong oversight by boards and senior management, and defined accountability for execution and control
2. **Embed climate considerations into core risk and business processes,** integrating the banks' climate targets into credit and investment decisions, while risk management and internal audit ensure methodological consistency, regulatory compliance and alignment with risk appetite
3. **Develop internal capacity through mandatory and specialized training,** rolling out general ESG and climate training across all roles, with a strong focus on first-line staff, and offer tailored modules to relevant business functions
4. **Address persistent capability and resourcing constraints,** as skills gaps, limited off-the-shelf training offerings, limited resources, and rapidly evolving regulatory standards continue to constrain the depth and scalability of climate-related capacity building
5. **Align remuneration cautiously with climate objectives,** linking variable pay and performance assessments to qualitative ESG risk/performance indicators and completion of mandatory ESG training

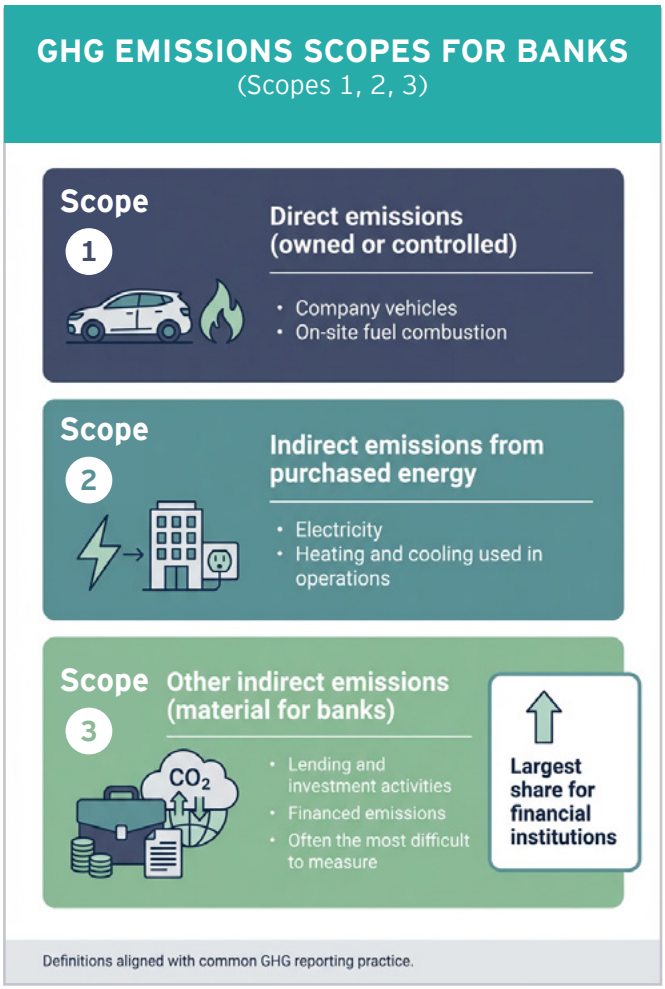
Best Practice 2 – Measurement and targets: GHG emissions and net-zero commitments

Measuring an entity's GHG emissions lays the foundations of transition planning. These establish the baseline for realistic climate targets, progress monitoring and accountability. For financial institutions, **decarbonization** means addressing both operational emissions and the far larger share from investment and lending activities.

Beyond measurement, **defining robust GHG emissions targets** is a key pillar of transition planning for banks, as they are essential to align financial activities with climate objectives.

A. Comprehensive measurement of Scope 1, 2 and 3 emissions

To accurately measure its climate impact, a bank needs to capture emissions data across all relevant sources:



Scope 1 and 2 emissions represent only 0.02% of the sector's total, while Scope 3 accounts for 99.98%.[17]

> Partnership for Carbon Accounting Financials (PCAF): The PCAF provides a global standard for measuring and reporting financed (Scope 3) emissions, helping financial institutions set baselines, track progress and align with science-based targets.

Market overview: Luxembourg banks are progressing at different speeds in building methodologies to measure their emissions. Most start with operational emissions (Scopes 1 and 2) and gradually expand to Scope 3, often relying on third-party providers for verification. Several banks are already signatories of PCAF and use its methodologies to establish baselines and identify material impact areas. Proxy data and sector averages remain common to address gaps, though improving granularity (especially for Scope 3) is a common challenge.

Some institutions enrich internal databases with external providers, especially for data estimates. Best practice also includes using transition-aligned metrics, such as emission intensity indicators, to complement absolute GHG reporting and support more granular measurement of financed emissions.

B. Science-based, time-bound and alignment with a 1.5°C pathway

EBA/GL/2025/01 ¶100

Institutions should set milestones at regular time intervals to monitor and address ESG risks that stem from the short-, medium- and long-term regulatory objectives of the jurisdictions in which they operate. This includes the objectives of the EU to reduce GHG emissions by 55% by 2030 [...] and achieve Net-Zero emissions by 2050, other intermediate climate targets set by EU or, where applicable, national legislation.

UNEP FI[18] guidance recommends banks to set and publicly disclose both long-term and intermediate targets to support the achievement of net zero GHG emissions and alignment with the Paris Agreement. These targets should be science-based and time-bound, with intermediate milestones (e.g., 2030 or five years ahead) and long-term goals (2050 or sooner) that are consistent with the goals of high-level political climate objectives. A robust target-setting approach needs to cover the majority of banks' Scope 3-financed emissions, including those from most carbon-intensive sectors (e.g., energy, transport, heavy industry). Importantly, these targets should encompass clients' Scope 1, Scope 2 and Scope 3 emissions.

17 CDP Technical Note: Relevance of Scope 3 Categories by Sector (2024).
18 Guidance for Climate Target Setting for Banks.

The Science-Based Targets initiative (SBTi) provides the leading framework for setting and validating such emissions reduction targets in line with the Paris Agreement.

Market overview: Long-term net-zero commitments by 2050 are increasingly common among Luxembourg banks, in line with leading international frameworks. A subset of banks is beginning to anchor their strategies in science-based methodologies, using SBTi-aligned frameworks and external 1.5°C scenarios (e.g., IEA, NZE or NGFS pathways) to benchmark their reduction trajectories. However, the approach to setting intermediate targets, sectoral pathways and portfolio coverage varies significantly across institutions.

Portfolio and business line coverage: Interviewed banks are applying climate-related targets and monitoring metrics across a range of business lines and asset classes. The most material focus is on Scope 3 financed emissions. Key areas of coverage include:

- **Corporate lending:** Targets often prioritize high-emitting sectors such as energy, transport, heavy industry and agriculture. Some set qualitative objectives for client engagement (e.g., aiming for 80% of clients engaged on transition pathways by 2030). More advanced institutions map these commitments to sector-specific 1.5°C decarbonization curves, recognizing differentiated transition speeds across sectors
- **Real estate financing:** Quantitative targets are commonly set for real estate portfolios, with credit policies embedding minimum energy performance standards
- **Asset management and wealth management:** Targets are applied to listed equities, corporate bonds and thematic funds focused on environmental solutions. These are set in coordination with business lines and aggregated at group level
- **Other business lines:** Some banks extend targets to alternative assets, project finance and proprietary portfolios, though coverage is less consistent. Operational emissions (Scope 1 & 2) are also targeted but represent a small fraction of total emissions

Intermediate milestones, such as 2030 targets or five-year review cycles, are less common in the Luxembourg context. On the other hand, several interviewed banks defined **sector-specific targets** for high-impact areas like real estate, power generation and heavy industry. Some banks have set quantified objectives, such as a 50% reduction in overall emissions by 2032 or a 20% reduction in emissions intensity by 2028.

Others are still in the process of developing targets while data quality and availability improve, as these factors remain persistent **challenges** for target setting. This is particularly true for Scope 3 financed emissions and for smaller or non-EU clients. Many institutions rely on external data providers, proxies, or sector averages to address these gaps, and recognize the need to enhance data granularity over time. The ability to set measurable goals is closely linked to organizational upskills and continuous improvements in data management systems. In more mature setups, these targets are complemented by clear governance mechanisms, including annual progress reviews, board-level oversight, and linkage of climate objectives to remuneration.

Key takeaways for measurement and targets

1. **Improve measurement of GHG emissions,** across Scope 1, 2, and especially Scope 3 financed emissions, as these represent the lion's share of the sector's carbon footprint. Adopt recognized standards such as PCAF to improve the credibility and comparability of the measured emissions
2. **Develop robust methodologies, data partnerships, and continuous improvement** in data **granularity**, as issues with data availability and quality, especially for Scope 3 and smaller/ non-EU clients, persist. Make use of external providers, proxies and sector averages while data granularity and internal capabilities improve
3. **Set science-based, long-term and time-bound (e.g., 2050) GHG reduction targets,** that are publicly disclosed and aligned with the Paris Agreement and supported by frameworks like SBTi. Define targets for the most material portfolios and sectors, as well as sector-specific objectives
4. **Ensure portfolio-wide coverage**, applying climate-related targets across all relevant business lines (corporate lending, real estate, asset management, and more) with a particular focus on high-emitting sectors

Best Practice 3 – Alignment with business strategy

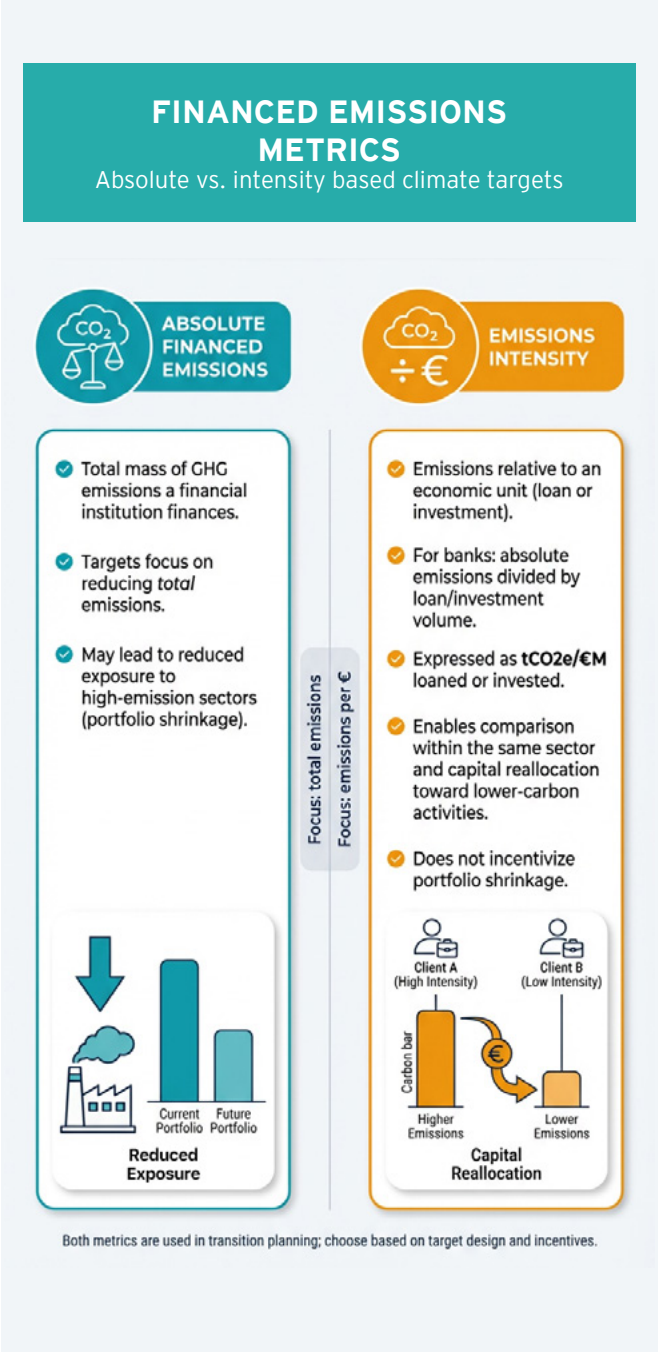
EBA/GL/2025/01 ¶109: […]

Plans should include […] strategic objectives and roadmaps [of the plans]: high-level overarching strategic objective to address ESG risks in the short, medium and long term, in line with overall business strategy and risk appetite.

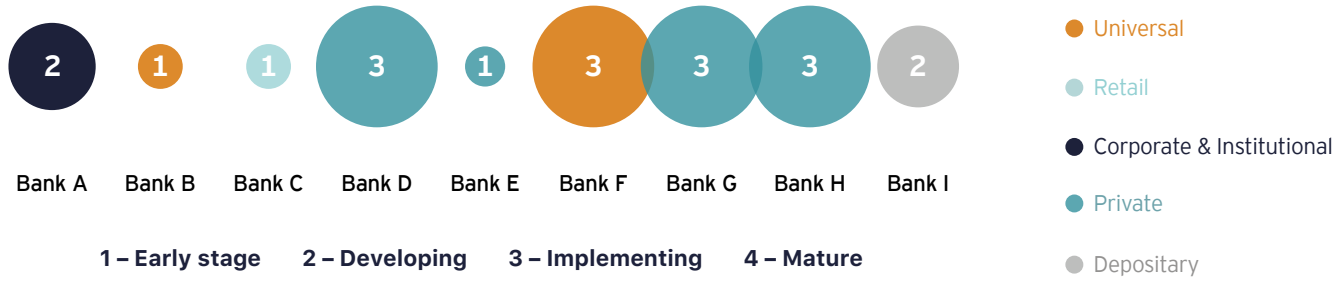
Climate transition plans and targets are not sustainability-related second-degree objectives. Instead, banks should treat them as core, forward-looking **strategic planning tools** which describe concrete strategic and risk management actions that ensure their business models remain resilient throughout the climate transition. Collaboration between multidisciplinary teams is key to ensure banks' climate objectives, actions and targets are embedded into their business strategy and risk appetite, including ICAAP and the risk-management framework.

Long-term commitments, such as achieving net-zero emissions, should link to medium-term business line strategies, such as sector-specific policies, including exclusion and divestment strategies, and short-term financial and risk metrics. Climate targets, whether expressed in absolute emission or emission intensity (i.e., per unit of economic output) reductions, should remain coherent with banks' business model and internal operations. They may require adjustments to an institution's risk appetite and, therefore, revisions to portfolio composition and capital allocation, including to climate-aligned or resilient business models.

Absolute emissions vs. emissions intensity



Self-declared maturity levels in climate transition planning among interviewed banks (n = 9)



Market overview: Across our sample, Luxembourg banks increasingly position climate transition plans as long-term strategic instruments. Six out of nine banks are now actively developing and implementing their climate transition plans. Most institutions interviewed are committed to net zero by 2050 and have aligned their high-level objectives with regulatory and voluntary frameworks, like CSRD, the EU Climate Law, PNEC, the EBA Guidelines, or SBTi. However, practices diverge in how these ambitions translate effectively into business-level action.

67%

Six out of nine interviewed banks are actively developing and implementing their climate transition plans

More advanced banks in the cohort explicitly link climate targets to core business lines and portfolios. Yet decarbonization levers differ significantly across activities. Banks generally prioritize cutting emissions in their lending, investment and real estate portfolios, where they may define sector-specific, portfolio-level or alignment-based targets. However, certain activities such as depositary or custodian banking offer limited possibilities to influence clients' own climate transition. Depositary banks may focus instead on assessing their exposures to climate risks assessments. Several banks chose to exclude certain asset classes from their transition target setting, such as alternative assets, where methodologies and levers remain underdeveloped.

A key market practice is to define climate transition targets with business lines in a collaborative and iterative manner. Rather than imposing top-down objectives, banks increasingly work bottom-up to identify realistic decarbonization pathways and levers and to secure ownership and accountability at business line level. This approach reflects a deliberate effort to strike a pragmatic compromise between financial performance and climate risk mitigation, ensuring that targets remain commercially viable while supporting long-term resilience.

Key takeaways for alignment with business strategy

1. **Develop transition plans as core business strategy tools**, i.e., forward-looking instruments that drive business model resilience, risk management and capital allocation, rather than as standalone sustainability initiatives. Link net-zero targets to sectoral strategies, portfolio objectives and short-term financial and risk metrics, ensuring alignment with ICAAP and risk appetite frameworks
2. **Embed climate targets in material portfolios and activities**, such as lending, investment and real estate portfolios through sector-specific or portfolio-level targets, while adapting tailored approaches for activities with limited influence or immature methodologies
3. **Develop climate targets collaboratively with business lines**, using bottom-up, iterative processes to identify realistic decarbonization pathways and strengthen ownership at business-line level and balance climate objectives with commercial viability

Best Practice 4 – Decarbonization levers and risk management

EBA/GL/2025/01 ¶109 (d) (Implementation strategy)

[Institutions should include in their plans] i. an overview of short-, medium-, and long-term actions taken or planned in core banking activities and processes to achieve the plan's targets, including how the institution embeds the plan's objectives into its decision-making process and its regular risk management framework […]; ii. adaptations to policies and procedures on financial risk categories and to lending and investment policies and conditions on key economic activities, sectors and locations; iii. changes introduced to the mix and pricing of services and products to support the implementation of the plan; iv. investments and strategic portfolio allocation supporting the institution's business strategy and risk appetite in relation to ESG risks, including information on sustainability-related and transition-related products and services, and how any changes in strategic financing choices are accompanied by commensurate risk management procedures.

To reduce their operational emissions (Scope 1 and 2), institutions can target facilities, energy use, fleets and employee travel, whereas tackling Scope 3 requires reallocating capital toward low-carbon technologies and sustainable business models, alongside exclusion policies for activities lacking decarbonization plans. Portfolio adjustments should favor entities with lower emissions or stronger climate strategies.

Financial institutions also drive the transition through innovating products, offering instruments like **green bonds**[19] and **green loans**[20] to fund renewable energy, clean transport, and other sustainable projects. **Sustainable investment funds** further align returns with climate and social goals. Proactive corporate client **engagement** to evaluate and support decarbonization plans, combined with **capacity building** through staff training and upskilling, is equally essential.

A. Decarbonizing own operations (Scope 1 and 2 emissions)

Though they account for a small share of a bank's total GHG emissions, addressing operational emissions remains essential for a definitive transition to net zero. Financial institutions may implement various measures related to their energy use, vehicle fleets and employee transportation.

Such measures typically involve sourcing energy from renewable or low-carbon sources such as solar, wind, geothermal or district heating and upgrading commercial sites and branch offices, including retrofitting buildings with better insulation, installing efficient lighting systems such as LEDs, and optimizing heating and cooling systems. Electrifying vehicle fleets and adopting policies that encourage low-carbon commuting and remote working[21] further contribute to reducing operational emissions.

Market overview: Banks are adopting strategies that combine technical upgrades, investments and cultural transformation to decarbonize their operations. Leading financial institutions address their own energy consumption through investments in smart building technologies, energy-efficient renovations, and the acquisition of green energy certificates. Nevertheless, these strategies are highly context-dependent and contingent on whether banks own the buildings they operate from. Renovations and retrofits may not be practicable for leased buildings. Banks are also implementing water-saving and waste sorting initiatives. Fleet electrification is gaining traction, with banks setting short-term targets to decarbonize company vehicle fleets. Beyond technical measures, banks foster a culture of sustainability through employee engagement, capacity building and awareness campaigns help ensure that operational improvements are embedded in the day-to-day practices.

B. Decarbonizing portfolios (Scope 3 financed emissions)

While operational decarbonization is necessary, the decisive challenge for banks is to reduce their Scope 3 emissions, which make up the bulk of their GHG emissions. For financial institutions, Scope 3 is driven primarily by financed emissions from lending and investment activities. Separately, Scope 3 also includes other indirect categories (such as emissions from purchased goods and services, business travel, employee commuting, and leased assets) which are typically immaterial compared to financed emissions but should still be managed appropriately. However, credible transition plans for banks are built around portfolio alignment with net-zero pathways and on shifting capital toward lower-carbon assets and business models. In practice, banks typically combine two complementary approaches:

1. Weighting assets based on climate performance

Portfolios are tilted toward companies with lower absolute emissions, lower emissions intensity (e.g., per unit of revenue or output), and credible transition strategies (often evidenced by SBTi validation or "best-in-class" criteria).

19 EU Green Bond Regulation (EuGB) - Regulation (EU) 2023/2631 on European Green Bonds.
20 International Capital Market Association (ICMA), 2018.
21 Cornell Chronicle, "Lifestyle impacts green benefits of remote work", 18 September 2023.

2. Adjusting portfolio composition

Banks can adjust their portfolio of investments and lending to favor companies with lower emissions or stronger climate strategies. Adjusting portfolio composition can be implemented through three main levers:

- **Exclusion**: Restricting financing for activities or sectors that lack credible decarbonization plans. In practice, this often targets high-emitting industries such as coal mining, oil and gas extraction, agriculture, and industrial processes
- **Support for emission improvers:** Supporting and continuing to finance clients, including high-emitting ones who can demonstrate having put in place science-based, time-bound transition plans ; pairing financing with conditionality (e.g., energy-efficiency or emission reduction milestones, technology shift commitments) and active engagement
- **Developing sustainable products:** Accelerating the shift to a low-carbon economy through sustainable finance products. Examples of such products include **green bonds** and **loans** that channel capital into the energy transition and energy efficiency projects, and sustainability-linked loans that tie interest rates to a borrower's climate performance

Overall, banks should **set portfolio-level decarbonization targets** to monitor progress through financed GHG emissions (absolute), emission intensity metrics, and portfolio-alignment indicators derived from sector climate pathways and scenario analysis. Targets should be reviewed periodically to remain consistent with regulatory changes, market conditions and financial priorities (e.g., liquidity).

Market overview: Luxembourg banks are reducing exposure to high-carbon sectors (such as coal and oil & gas) in key areas of action:

- **Corporate lending:** Several banks have already integrated climate metrics into portfolio design, tracking financed GHG emissions and using emission intensity metrics (such as emissions per unit of revenue) to monitor progress. Portfolio alignment is reinforced by applying SBTi validation criteria, prioritizing companies with credible climate strategies. Moreover, segmentation of the counterparties (such as red/yellow/green categories) and structured questionnaires are being used to assess the credibility of transition plans. Conditional financing, such as penalties for missed renovation commitments or requirements to present transition plans, is emerging, though escalation measures like restricting or terminating business relationships remain rare. Some institutions further strengthen this approach by applying sector-specific policies covering high-emitting industries (such as oil & gas, mining and coal). A few banks are offering sustainability-linked loans, with interest rates tied to borrower climate performance, using KPIs or third-party ESG ratings to set incentive mechanisms
- **Real estate financing:** In the real estate sector, minimum energy performance standards are embedded in credit policies, with financing contingent on renovation commitments for properties below threshold. The collection of Energy Performance Certificates (EPCs) is also increasing across both residential mortgages and commercial real estate portfolios. Some banks strengthen this further by applying pathways for residential vs. commercial portfolios, aligning renovation expectations with 1.5ºC-compatible building-sector decarbonization curves. More advanced institutions supplement these measures with property-level alignment indicators (e.g., gCO/m^2 trajectories) and leverage partnerships with specialized data providers to improve building-level climate analytics, including physical-risk exposure to floods, heatwaves or storms. Green mortgages and renovation loans are also promoted, with banks offering products for home energy renovations. These offerings are often tied to minimum energy performance standards, ensuring that funding supports properties committed to energy efficiency improvements
- **Asset management and wealth management:** Offerings are frequently aligned with Article 8 Sustainable Finance Disclosure Regulation (SFDR)[22] standards and supported by exclusion lists (for example, thermal coal). In addition, several banks are utilizing scenario analysis and sectoral decarbonization pathways to assess both portfolio alignment and climate-related risks. Leading institutions introduce policies tailored to each business line, such as asset management, wealth management and alternative assets, to ensure integration of climate objectives across all activities. Banks are deploying green bonds and sustainable investment funds, channeling capital into renewable energy and energy efficiency projects. These products are available to both individual and corporate clients

Despite this progress, Luxembourg banks continue to face **capacity and data constraints**. Limited resources and time make it challenging to provide customized guidance to counterparties on how to lower their carbon footprint, particularly for small and medium-sized enterprises (SMEs), where ESG maturity and disclosure rules are less advanced. Data gaps persist, especially regarding Scope 3 emissions, EPC coverage, and non-EU exposures. To address these, banks rely on external data providers, proxies, and increased engagement to improve data quality.

22 The EU is currently reviewing the SFDR framework. The first legislative proposals for "SFDR 2.0" were published in November 2025, introducing stricter sustainability categories and simplified disclosure rules. The updated regime is expected to be adopted by mid-2026 and come into force in 2028.

3. Best practices for implementing decarbonization levers across business lines

The interviews conducted as part of this paper uncovered several best practices in Luxembourg banks' approach to climate action. The table below illustrates examples of decarbonization levers pulled across core business lines:

Business Line	Example 1	Example 2
Lending	The bank sets decarbonization targets for its lending portfolio and applies requirements to steer borrowers toward reduced emissions (but without applying actions such as restricting mortgage issuance). The bank relies on pathways identified through NGFS-aligned analysis, ensuring that the transition remains both feasible for clients and aligned with the bank's own long-term goals.	The bank is reducing the GHG emissions linked to its lending activities by prioritizing low-emitting sectors and relying on improving carbon-footprint data. Credit decisions are shaped in a way that encourages clients to move toward lower-emission business models, while ensuring that lending remains aligned with its long-term climate commitments.
Real Estate Financing	Real estate exposures are aligned with the bank's transition plan, applying building-level data collection, minimum EPC or emissions-intensity expectations, and targeted engagement when progress declines. While recognizing significant data limitations, especially for inherited or historically protected assets, the bank focuses on engagement and renovation measures to improve energy performance of its real-estate exposures wherever possible.	The bank reduces emissions associated with its real estate exposures, via increasing expectations on energy performance to ensure that financed buildings remain aligned with credible decarbonization pathways. Through renovation-linked financing and closer scrutiny of EPC outcomes, the bank supports clients' efforts to improve buildings' energy efficiency.
Asset Management	The bank embeds its 20% emissions intensity reduction target into investment processes. It applies portfolio-level decarbonization levers such as sector re-allocation, engagement with investment managers and governance--led escalation when progress is insufficient. Because investment returns remain a priority, the bank adopts a balanced approach, gradually raising ambition as data quality and internal expertise mature.	The bank advances the decarbonization of its investment portfolios and applies sector-specific intermediate 2030 targets aligned with IEA scenarios to guide portfolio construction and engagement. This approach centers on identifying credible transition strategies from issuers, reinforcing expectations through voting and stewardship, and ensuring that investment selections reflect the bank's commitment to science-based climate pathways.
Wealth Management	The bank incorporates sustainability objectives into advisory activities and applies client-facing engagement, and portfolio transparency, through trained client advisors to support the implementation of its transition plan at the client-portfolio level.	The bank integrates its transition plan into wealth management activities, and it applies sustainability-aligned product selection supported by well-trained relationship managers who can advise clients on climate considerations.
Alternative Assets	The bank integrates climate- and environmental-risk considerations into due diligence processes for alternative assets. It also assesses transition plans of investee companies, and applies sustainability-aligned voting or stewardship practices as part of its decarbonization approach.	The bank enhances the climate resilience of alternative assets by applying ESG and climate-risk due-diligence, evaluating counterparties' transition commitments, and, where necessary, ending relationships when climate-related expectations are not met.

Key takeaways for decarbonizing portfolios

1. **Enhance energy efficiency and source renewable energy** for offices, vehicle fleets, and employee travel to reduce operational emissions. Upgrade buildings, electrify fleets, and promote low-carbon commuting and remote working
2. **Perform portfolio alignment** by reallocating capital toward low-carbon assets and business models, excluding financing for high-emitting sectors lacking credible decarbonization plans, and supporting emissions improvers with credible, science-based, time-bound transition strategies
3. **Monitor progress** using financed GHG emissions (absolute), emissions intensity metrics, and portfolio-alignment indicators derived from sector pathways and scenario analysis. Use frameworks like PACTA to assess portfolio alignment with climate scenarios and identify misalignments
4. **Integrate climate risk assessments and ESG criteria into credit approval processes,** prioritizing lending to companies with SBTi-validated targets or credible transition plans. Apply sector-specific ESG risk scoring and monitor exposures through dedicated dashboards
5. **Offer renovation loans and preferential rates for energy-efficient developments in real estate financing** and embed minimum energy performance standards in credit policies. Collect energy performance certificates for both residential and commercial real estate portfolios
6. **Align asset management and wealth management offerings with Article 8 SFDR criteria.** Incorporate scenario analysis and sectoral decarbonization pathways into investment risk models and portfolio strategies
7. **Embed responsible investment principles into client offerings,** inform clients on climate risks and opportunities. Integrate ESG due diligence into private markets and alternative assets

C. External stakeholder engagement for climate transition

Engagement with counterparties, in particular clients and investee firms, on their exposure to climate risks and the credibility of their transition plans is a key pillar of transition planning. Banks increasingly expect clients to align with net-zero objectives while also supporting their transition. Such engagement is particularly crucial in high-emitting sectors, where the pace and credibility of transition plans are intrinsically linked to climate risk exposure.

Market overview: Engagement with clients on climate topics is becoming more structured across Luxembourg banks. Some institutions are beginning to operationalize more structured external engagement by meeting strategic clients on a systematic, multi-year schedule to discuss transition readiness and sector-specific risks. Others are putting greater effort into data collection, using questionnaires and public sources to assess counterparties' ESG sustainability performance. Overall, while progress is evident, systematic engagement and support for clients, especially SMEs, are still developing.

BANK CLIENT ENGAGEMENT MODELS FOR CLIMATE TRANSITION

Across the market, three broad engagement models can be observed, ranging from highly structured and criteria-based approaches to more relationship-driven, capacity building models.

D. Risk management: integrating climate risks into ICAAP and ILAAP

The EBA now requires banks to integrate climate risks into their core risk management frameworks, ensuring that climate risks are treated as material alongside traditional financial risks. Institutions must identify, assess and manage these risks within their Internal Capital Adequacy Assessment Process (**ICAAP**) and Internal Liquidity Adequacy Assessment Process (**ILAAP**). This includes conducting materiality assessments, using scenario analysis and iterative stress testing based on climate scenarios internationally recognized.

Market overview: In line with evolving regulatory expectations, banks in Luxembourg are integrating both physical and transition climate risks into their risk appetite frameworks and scenario analyses. Climate scenarios, such as those developed by the NGFS, IEA and IPCC, are used to stress test portfolios and inform capital and liquidity planning.

For ICAAP, climate risk indicators are incorporated by different institutions alongside traditional risk metrics, with scenario analysis serving as a key driver for risk assessment. Some banks leverage external data providers and sector-specific scenarios to evaluate exposure to transition and physical risks over short-, medium-, and long-term horizons. In practice, climate risks are treated as material financial risks by several banks. This includes qualitative and quantitative assessments of how these may impact **credit, market and operational risk profiles**, as well as the bank's **overall capital and liquidity** position. One institution has also begun piloting climate-aligned valuation models, such as **climate value-at-risk tools,** to estimate long-term financial impacts of physical and transition risks through 2050, improving the link between climate scenarios and capital adequacy metrics. In addition, others have introduced dedicated internal governance structures, such as cross-functional sustainability committees reporting to senior management, to coordinate the integration of climate risks across business lines and risk functions.

Despite this overall progress, several challenges remain. While integration within ICAAP is advancing, progress on ILAAP is less mature; most banks are still developing methodologies to assess the impact of climate-related events on liquidity. Nevertheless, some institutions have already begun addressing physical risks, such as flood exposure, within their liquidity risk frameworks.

Overall, banks also report difficulties in quantifying climate risks in monetary terms, particularly for physical risks, and in developing more granular methodologies tailored to different risk types. Finally, there is also a need for ongoing upskilling of risk teams to ensure integration of climate factors into ICAAP and ILAAP frameworks.

Key takeaways for risk management

1. **Develop and offer sustainable products** (e.g., green bonds, green loans and sustainability-linked funds) to channel capital toward climate solutions and support clients' transitions
2. **Engage with counterparties** to set clear expectations for transition planning, require credible transition plans as a condition for financing, and provide advisory support, especially in high-emitting sectors
3. **Build internal capacity** by implementing ESG training for all staff, focusing on the first line of defense, and integrating sustainability expertise into decision-making processes
4. Integrate climate and transition **risks into core risk management frameworks** by performing **scenario analysis, stress testing, and reviews of ESG data and methodologies**

Best Practice 5 – Monitoring and verification

EBA/GL/2025/01 ¶112

Institutions should monitor the implementation of their plans using monitoring processes and metrics [and] perform regular projections to assess their ability to achieve their targets.

A credible transition plan requires continuous oversight to ensure progress and credibility. Banks should establish mechanisms to **monitor implementation**, using metrics to track alignment with decarbonization objectives. Transition plans ought to be regularly updated to reflect evolving regulations, market conditions, risk assessments and climate finance. To reinforce transparency, these monitoring processes may be complemented by independent external assurance.

A. Monitoring progress vs. transition plan targets

Monitoring progress towards transition plan targets is a regulatory expectation of both the CSRD and the EBA guidelines. Institutions are required to track and evidence their progress in implementing plans and assess their ability to achieve targets. This involves reviews (at least in line with business strategy revisions) considering portfolio developments, counterparties' activities, emerging scenarios, benchmarks, sectoral pathways and regulatory changes.

Market overview: Luxembourg banks are implementing KPI-based review processes to monitor their transition plans, though at various frequencies ranging from once a year to monthly assessments to ensure alignment with their objectives. One of the banks interviewed employs regression analysis to assess alignment, identify any potential deviations from their net-zero trajectories and adjust their strategies accordingly.

Another bank has fully integrated transition planning in its risk management framework which is reviewed as part of regular risk reporting. One bank is developing a traffic light indicator system to visually track performance. Once or twice a year, the bank's executive management receives updates on the progress towards their climate targets either in dedicated sessions or as part of broader sustainability-related updates.

However, several challenges persist. Diverging local regulations and market practices impede consistent review processes across jurisdictions for multinational groups. Data quality issues, resource constraints, and the rapidly evolving regulatory requirements can also further complicate the updating of transition plans.

B. Data management: gaps and quality for monitoring

EBA/GL/2025/01 ¶93

Institutions should have in place sound governance processes to collect, validate and aggregate the data that are needed to inform their transition planning efforts and monitor their implementation, including using available public information and counterparties' transition plans [...]

Banks should establish processes to identify and address data gaps, particularly for smaller clients and non-EU exposures, leveraging frameworks and integrating controls that guarantee data integrity. High-quality data enables the tracking of ESG risk metrics and progress toward transition, while providing explanations for deviations and assessing their impact on financial risk.

Market overview: Luxembourg banks are strengthening data management for transition plans through a combination of external partnerships, internal data quality validation processes, and targeted client engagement.

Regarding **data sources and collection**:

- For **large corporate clients**, banks collect information from regulatory ESG disclosures (e.g., under CSRD) and rely on external ESG data providers (e.g., automated feeds for emissions, ESG ratings, real estate datasets), which reduce internal workload but require mapping and centralized quality controls
- For **SMEs and clients headquartered outside the EU or which are not listed**, data gaps are addressed mainly through direct engagement, using both generic and sector-specific questionnaires and requesting Energy Performance Certificates (EPCs) for commercial real estate exposures
- For **retail clients**, banks mainly request the EPCs of the buildings collateralized in mortgage loans
- Proprietary internal tools such as ESG dashboards support the consolidation, validation, and tracking of KPIs

Banks collect a wide range of **indicators** of their counterparties to track the progress of their transition plans including Scope 1, 2, and 3 GHG emissions, taxonomy alignment of capital expenditures, client scoring across ESG dimensions, science-based targets, exposure to stranded assets, asset-specific information, and responses from sector-specific questionnaires.

To improve **data quality and governance**, institutions follow the trend toward standardized processes across entities, especially in multinational groups, with ESG data committees and validation workflows ensuring periodic review. It is important to highlight the increasing reliance on automated external sources, which reflects a growing trend towards technology, although manual data collection remains necessary in certain cases, particularly for SMEs.

Key challenges encountered include limited data coverage for SMEs and non-EU clients (e.g., some banks record "zero emissions" in the absence of data), low EPC coverage for portfolios, operational data gaps (e.g., commuting, business travel, IT/cloud services), and the need for mapping and consistency checks when using third-party feeds. The use of proxies, while necessary, can impact comparability and trend analysis, particularly in high-intensity portfolios. In private banking, information requests are balanced with client relationships, often favoring data from public sources.

C. Third-party assurance of climate-related disclosures

Transition plans may benefit from external assurance to enhance their credibility and accountability to stakeholders. Such third-party assurance should be conducted by independent reviewers who will evaluate key elements such as calculations of GHG emissions, review of targets and decarbonization strategies, or methodologies used to identify ESG risks. Organizations should prepare for third-party assurance in anticipation of the upcoming mandatory limited assurance requirements under CSRD.

Market overview: Banks are taking a cautious approach to third-party assurance for climate-related disclosures, often prioritizing internal assessments over external verification. While some institutions engage in voluntary assurance to prepare for future requirements, others are waiting for clearer guidelines before committing to formal processes. There is a strong emphasis on aligning internationally recognized methodologies, which lays the groundwork for future assurance. It is important to note that the priority of third-party assurance is not unanimous among banks: while some banks perceive it as a main priority, others view it as a secondary focus. Nevertheless, a few market-leading institutions have already begun obtaining independent limited assurance over selected climate-related metrics (such as financed emissions, operational emissions, and sustainable-finance activities) in accordance with ISAE 3000 and ISAE 3410.

D. Transition plan disclosure and reporting frameworks

The publication of the transition plan is supporting organizations in the communication of their objectives, initiatives and progress to relevant stakeholders. Although no single sustainability disclosure standard prevails, internationally recognized frameworks such as ESRS, TCFD or GRI provide structure, comparability and credibility to climate disclosures.

Market overview: In the preparation of their transition plans, Luxembourg banks are currently using multiple frameworks such as the ESRS, the TCFD and the GRI. Transition plans can be integrated into various reports, including CSRD, Pillar 3, Sustainable Development, and Net-Zero Climate Target Reports, depending on the bank. Finally, there is a structured reporting process in place, which typically involves board updates and validation prior to publication, ensuring that the information presented is accurate and aligned with the banks' strategy.

Key takeaways for monitoring and verification

1. **Establish monitoring mechanisms to track progress** against transition plan targets, using metrics and performance indicators
2. **Strengthen data management by identifying and addressing data gaps,** validating methodologies, integrating quality controls, and leveraging both internal and external data sources to ensure accuracy and consistency
3. **Obtain independent third-party assurance for climate-related disclosures,** including GHG emissions calculations and decarbonization strategies, to enhance credibility and prepare for upcoming CSRD requirements
4. **Disclose transition plans and progress transparently,** aligning with internationally recognized frameworks such as ESRS and ensure that all key elements of the plan are included in public reports
5. **Update transition plans regularly** to reflect evolving regulations, market conditions, risk assessments and portfolio developments, ensuring ongoing relevance and regulatory compliance

5. Implication for banks: key challenges and opportunities

For banks, transition planning is a regulatory and financial imperative.Supervisors warn that annual credit losses could rise exponentially in the next few years, driven directly by climate-related factors. Failure to act will result in significant financial losses. While regulatory pressure, investor scrutiny, and the accelerating shift toward a low-carbon economy remain important, the primary driver is clear: maintaining profitability and financial stability.

However, data gaps, regulatory uncertainty and integration into risk frameworks pose significant challenges, while resource constraints and governance alignment add further pressure. At the same time, these efforts create opportunities: stronger governance, sustainable products, scenario analysis and technology-driven data solutions can position banks as leaders in sustainable finance.

KEY CHALLENGES IN IMPLEMENTING TRANSITION PLANS

1 Target setting & verification

- 2050 net-zero targets are common within banks, but interim milestones are often missing
- Sector pathways unclear; limits operational clarity
- Assurance still limited; credibility and comparability need strengthening

2 Data availability & accuracy

- Scope 3 and real estate energy data hard to obtain
- Low client response; external data coverage gaps; proxies needed
- System inconsistencies and non-harmonized methods hinder measurement
- Omnibus I/CSRD changes mean more manual collection and proxies

3 Integration into risk & financial

- Transition risk integrated into ICAAP (more than ILAAP)
- Physical risk integration uneven and less mature
- Monetization still developing; limits capital planning, liquidity, stress testing

4 Resource constraints & expertise gaps

- Smaller banks constrained on staff training and client engagement
- SMEs less mature on decarbonization; dialogue and data collection slow

5 Regulatory uncertainty & governance alignment

- Evolving ESRS, CSRD, CRD VI increases burden (esp. smaller banks/subsidiaries)
- Group governance vs. local strategies hard to align (boards outside EU)
- Luxembourg subs as knowledge hubs; reliance on consultants raises costs (EY/ABBL Cost of Regulation Survey 2025)[23]

23 EY Luxembourg & ABBL. (2025). EY-ABBL Cost of Regulation Survey 2025.

OPPORTUNITIES IN TRANSITION PLANNING

1 Portfolio realignment

- Divestment & exclusions
- Align with SBTi / net-zero pathways
- Transparency on fossil fuel phase-out & engagement

2 Net-zero targets

- 2050 target + sector milestones
- Scenario analysis (NGFS, IEA, IPCC)
- Disclose steps & progress

3 Proactive client engagement

- ESG questionnaires & sector dialogues
- Integrate ESG into credit process
- Assess credibility of client transition plans

4 Data quality & monitoring

- Automate ESG data collection
- Dashboards + harmonized methods
- Close gaps in emissions & EPC coverage

5 Operational emissions reduction

- Energy renovations & smart buildings
- Digitalization + waste reduction
- Cost savings + stronger reputation

6 Sustainable product innovation

- Renovation loans & sustainable financing
- Sustainability-linked products
- Global sustainability loan market €907B in 2024 (+17% YoY); SLLs 72%[24]

7 Organizational expertise

- ESG training across staff
- Programs for client-facing teams & leadership
- Partner with universities & experts

8 Governance & oversight

- Board validation of plans
- ESG committees & cross-functional governance
- Quarterly/semiannual reviews + escalation

Focus: manage climate risk, build trust, unlock new revenue.

24 BBVA Corporate & Investment Banking. (2025, February). Selected Sustainable Loans (SLLN).

6. Conclusion

The findings of this research confirm that while banks recognize the strategic necessity of robust transition plans, significant challenges persist, especially in implementation, data management, and risk integration.

At the early stages of the application of the EBA Guidelines, implementing transition plans remains a complex task, as institutions work to embed climate objectives into business strategies, risk frameworks and daily operations. Data management is an important barrier: persistent gaps in emissions data, particularly for Scope 3 and smaller or non-EU clients, undermine the credibility and comparability of transition plans, complicating progress monitoring and reporting. Risk management integration is advancing, especially within ICAAP frameworks, but quantifying climate risks and fully embedding them into capital and liquidity planning is still developing.

Regulatory uncertainty, intensified by the constantly evolving legislative landscape, continues to challenge banks as they adapt their transition planning and compliance strategies.

Key priorities:

1. **Set targets and identify clear strategies to achieve them:** Move beyond long-term net-zero commitments by establishing intermediate milestones, sector-specific pathways and actionable implementation plans. Regularly review and update targets to reflect evolving market conditions and regulatory expectations

2. **Improve data management and quality**: Invest in data collection processes, leverage external partnerships, and enhance internal systems to address gaps and ensure consistency across all metrics

3. **Strengthen internal knowledge**: Implement ESG training for staff at all levels, focusing on technical expertise and capacity building to embed sustainability into decision-making and client engagement

By following these recommendations, banks can enhance the credibility of their transition plans, strengthen governance and stakeholder confidence, and position themselves as leaders in climate risk management and the journey toward climate neutrality, where success will depend on continuous improvement, collaboration, and commitment to transparency.

Glossary

Acronym	Details	Description
CREEM	Carbon Risk Real Estate Monitor	A methodology and analytical tool used to assess transition risk in real estate portfolios and evaluate building alignment with climate pathways.
CRD	Capital Requirements Directive	EU legislation governing prudential rules for banks, including governance, risk management and supervisory expectations.
CRR	Capital Requirements Regulation	EU regulation setting binding capital, liquidity and leverage requirements for banks and investment firms.
CSRD	Corporate Sustainability Reporting Directive	EU directive that expands sustainability reporting obligations and requires companies to disclose in line with ESRS.
EBA	European Banking Authority	EU regulatory authority responsible for developing technical standards and ensuring consistent supervisory practices in the banking sector.
ECB	European Central Bank	Central bank of the euro area responsible for monetary policy and banking supervision, including climate risk expectations under the SSM.
EPC	Energy Performance Certificate	A standardized rating of a building's energy efficiency, widely used in real estate lending and risk assessments.
ESG	Environmental, Social and Governance	A framework evaluating an organization's sustainability performance across environmental, social and governance dimensions.
ESRS	European Sustainability Reporting Standards	The mandatory disclosure standards under CSRD specifying detailed sustainability reporting requirements.
GHG	Greenhouse Gases	Atmospheric gases such as CO, CH, and NO that contribute to the greenhouse effect and global warming.
IEA	International Energy Agency	Intergovernmental organization providing global energy analysis, modelling and policy guidance.
IEA NZE	IEA Net Zero Emissions Scenario	A scenario developed by the IEA modelling a global pathway to net-zero emissions by 2050.
IIGCC	Institutional Investors Group on Climate Change	A European investor network promoting climate-aligned investment strategies and corporate engagement.
NGFS	Network for Greening the Financial System	A global network of central banks and supervisors producing climate risk scenarios and guidance for the financial sector.
NZAM	Net Zero Asset Managers Initiative	A global initiative committing asset managers to align their assets under management with net zero by 2050.
PACTA	Paris Agreement Capital Transition Assessment	A methodology used to measure the alignment of financial portfolios with Paris-aligned decarbonization pathways.
PCAF	Partnership for Carbon Accounting Financials	A global standard for measuring and disclosing financed emissions across financial asset classes.
PNEC	National Energy and Climate Plans / NECPs	EU Member State plans outlining strategies and measures to achieve national and EU-level climate and energy targets.
SBTi	Science Based Targets initiative	A global initiative guiding companies in setting emissions-reduction targets aligned with climate science and the Paris Agreement.
SFDR	Sustainable Finance Disclosure Regulation	EU regulation requiring transparency on sustainability risks, product classification and adverse impact reporting at entity and product level.
SME	Small and Medium-Sized Enterprise	A company meeting EU criterion on staff headcount, turnover, or balance sheet size; relevant in sustainable finance for risk assessments and engagement.
UNEP FI	United Nations Environment Programme Finance Initiative	A global partnership between UNEP and the financial sector promoting sustainable finance practices.

Annex I

The table below summarizes the **core components** of a compliant transition plan and highlights how requirements apply to different sized institutions.

Disclaimer: The table below offers an indicative mapping between the EBA's prudential expectations on transition plans and the disclosure requirements in the ESRS. It aims to support consistency between risk-management and reporting, but it should not be read as implying that the two frameworks are identical or fully interchangeable.

Required transition plan elements (EBA GL/2025/01)*	Large/ significant institutions	Non-large/ less significant institutions	SNCIs	Section of the Paper	CSRD reference**
From	**11.01.2026**	**01.04.2026**	**11.01.2027**		
a. Governance				Section 4.1	
i. governance structure for the plans including roles and responsibilities	✓	✓	✓		ESRS 2 GOV-1_AR 4
ii. capacity and resource-related actions to ensure appropriate knowledge, skills and expertise	✓				ESRS 2-GOV-1 - para 23 ESRS G1 GOV-1 - para 5b
iii. remuneration policies and practices to promote sound management of ESG risks	✓				ESRS 2-GOV-2 - para 29 ESRS-E1-GOV-3
iv. data and systems used for the transition planning process	✓				ESRS 1 Appendix B ESRS 2 AR 2 ESRS 2 SBM1_42a ESRS-E2-4_30c ESRS-S1-6_50d ESRS-S1-7_55b

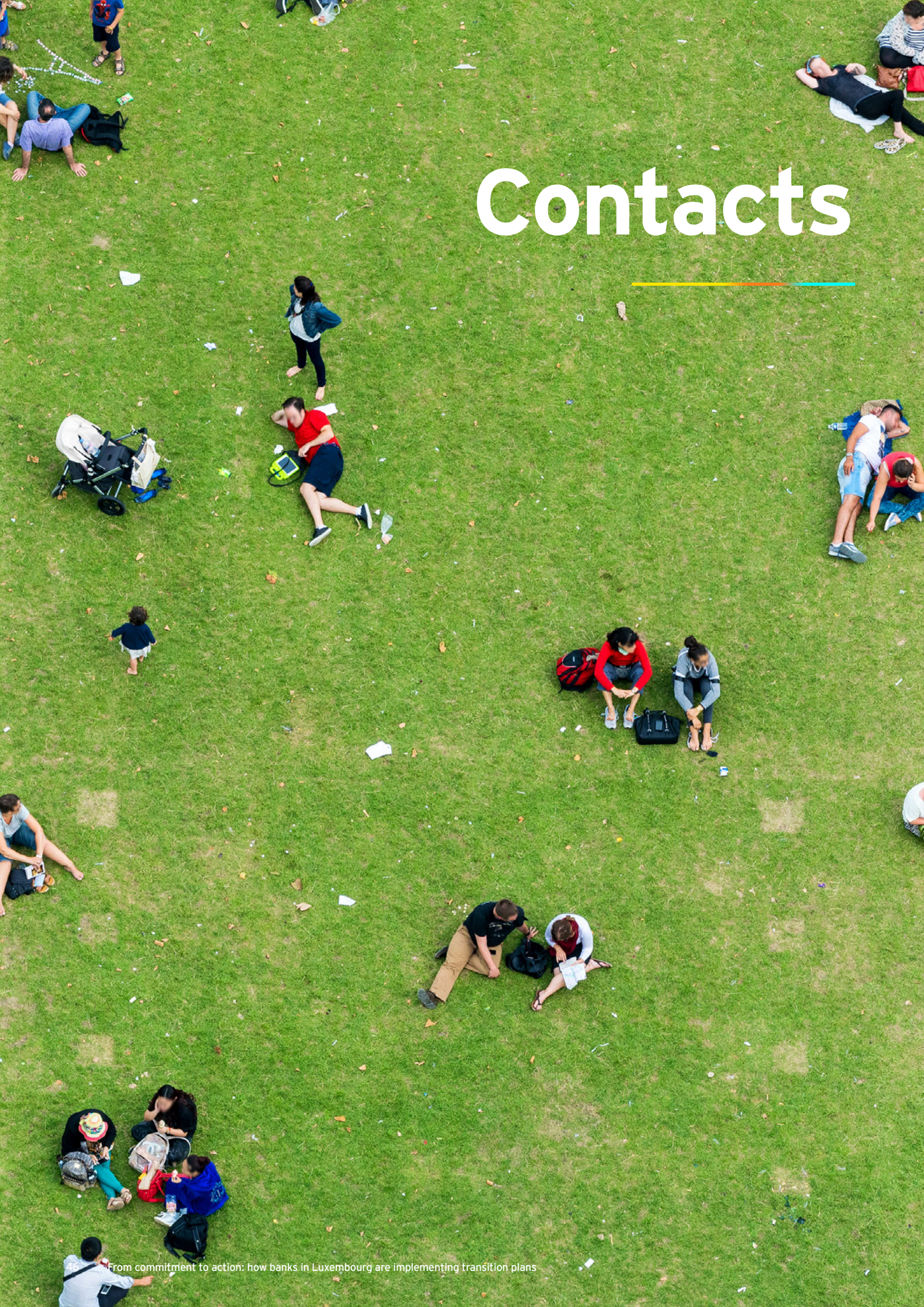
Required transition plan elements (EBA GL/2025/01)*	Large/ significant institutions	Non-large/ less significant institutions	SNCIs	Section of the Paper	CSRD reference**
b. Targets and metrics				Section 4.2	
i. quantitative targets set to address ESG risks [...] and metrics used to monitor ESG risks and progress in achieving the targets	✓	✓	✓		ESRS-E1-1 GHG reduction targets: ESRS E1-4
ii. portfolios, sectors, asset classes, business lines and economic activities covered by targets and monitoring metrics	✓	✓	✓		ESRS-E1-1 ESRS 2 - MDR-T Current revenues by sectors: ESRS 2 - SBM -1 GHG reduction targets: ESRSE1-4
iii. time horizons over which targets and metrics apply	✓				ESRS-E1. IRO1_10_ AR 12a ESRS-E4-1_04 13d
c. Alignment with business strategy				Section 4.3	
i. high-level strategic objective to address ESG risks in the short, medium and long term	✓	✓	✓		ESRS-E1-1 ESRS 2 - BP1 ESRS-E1-MDR-P ESRS-E1-2
ii. long-term goals with intermediate milestones	✓	✓	✓		ESRS-E1-1 GHG reduction targets: ESRSE1-4
iii. key assumptions, inputs and background in formation	✓				ESRS-E1-SBM3 ESRS-E1-IRO ESRS-E1-9

Required transition plan elements (EBA GL/2025/01)*	Large/ significant institutions	Non-large/ less significant institutions	SNCIs	Section of the Paper	CSRD reference**
d. Decarbonization levers and risk management				Section 4.4	
i. overview of short-, medium-, and long-term actions taken or planned in core banking activities and processes to achieve the plan's targets	✓	✓	✓		Key actions: ERSR-E1-1_16b ESRS-E1 MDR-A ESRS 2 MDR-A ESRS-E1-2 ESRS-E1-3 ---------- ESRS-E2-E5 ESRS-S1-S4 ESRS-G1 MDR-A ESRS-E3 MDR-A ESRS-E4 MDR-A ESRS-E5 MDR-A
ii. adaptations to policies and procedures on financial risk categories and to lending and investment policies and conditions	✓	✓	✓		ESRS-E1-1_16b ESRS-E1-2 ESRS-E1-3 Activities related to sites in/near biodiversity-sensitive areas: ESRS E4.IRO1_19a
iii. changes introduced to the mix and pricing of services and products	✓				Activities incompatible with transition: ESRS-E1.IRO-1 AR12

Required transition plan elements (EBA GL/2025/01)*	Large/ significant institutions	Non-large/ less significant institutions	SNCIs	Section of the Paper	CSRD reference**
iv. investments and strategic portfolio allocation supporting the institution's business strategy and risk appetite	✓				ESRS-E1-3 ESRS-E4-1 AR 1 e Outcomes for affected communities: ESRS-S3-4 AR 34 b
e. Monitoring and verification				Section 4.5	
i. policies for engaging with counterparties	✓	✓	✓		ESRS 2-SBM 2
ii. processes, methodologies and metrics used for collecting and assessing information related to counterparties	✓	✓	✓		ESRS-E1.IRO-1 ESRS-E4-1. AR1a
iii. outcomes of engagement practices	✓				ESRS-E1 ESRS 2 -SBM2_45a AR 1

* Please note that the titles of the sections in this paper have been adapted for clarity and narrative flow. As per the EBA Guidelines on the management of ESG risks, the core pillars of a transition plan are: (i) Strategic objectives and roadmap of the plan, (ii) Measurement and targets, (iii) Decarbonization levers and risk management, (iv) Governance, and (v) Monitoring and verification. The structure presented in this report reflects these pillars while tailoring terminology to the specific purpose and analysis of the paper.

**This analysis is based on the ESRS as published under the CSRD in Commission Delegated Regulation (EU) 2023/2772. It does not yet reflect the Draft Simplified ESRS currently under consultation by the European Commission.



Contacts

Vanessa Müller

EY Luxembourg Partner
ESG Services Lead

Dorian Rigaud

EY Luxembourg Partner,
Banking and Capital
Markets Leader

Anna Illarionova

EY Luxembourg
Senior Manager
ESG Services

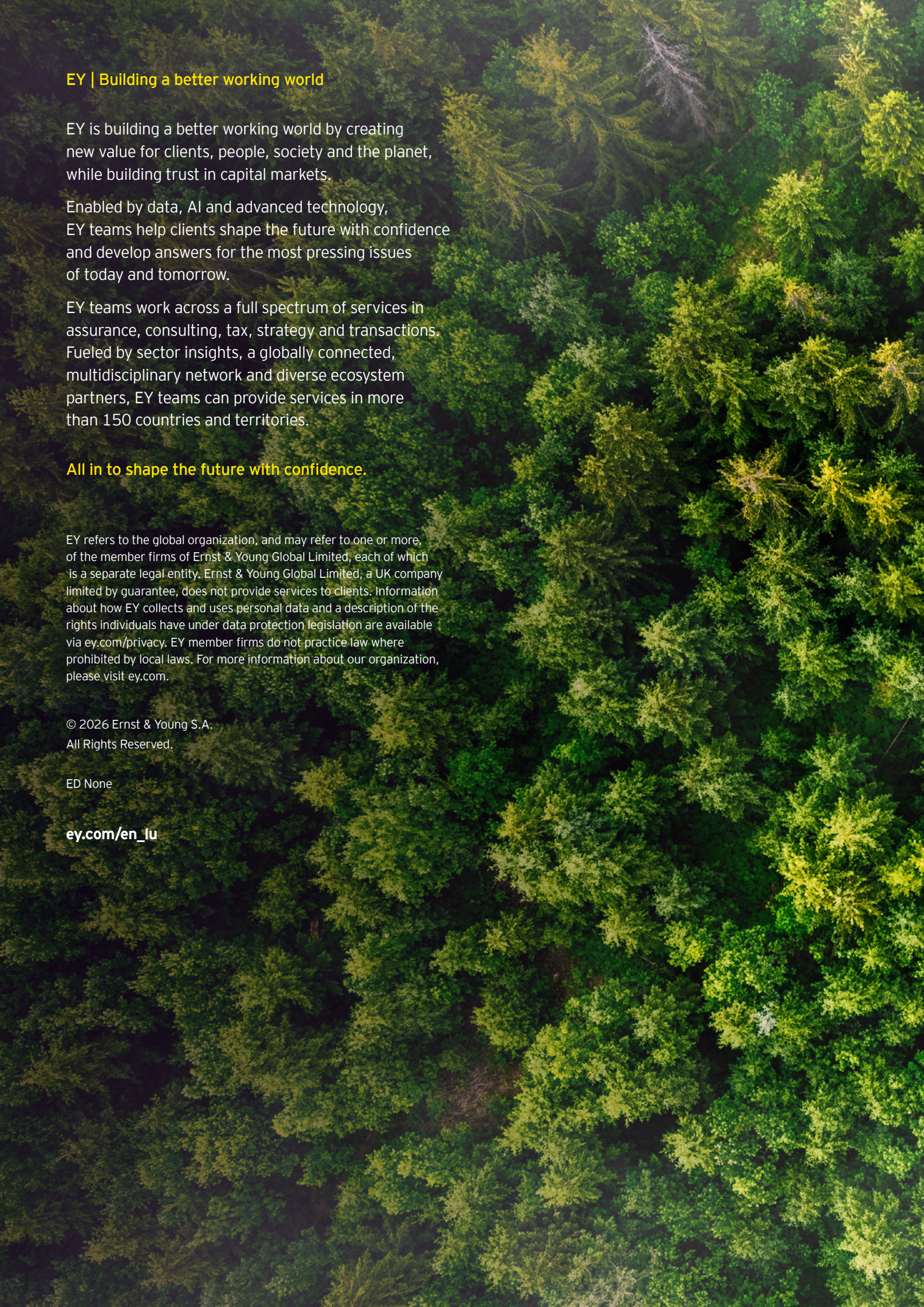
Marilyn Rinck

Head of Banking Regulation
Financial Markets and ESG
ABBL

Thomas Collin

Advisor, Regulatory
Reporting and ESG
ABBL

This document has been produced with the support of EY professionals Andrea Zara, François Guillaume Mourier, Beatrice Vinaccia and Fanny Pirenne.



EY | Building a better working world

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multidisciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

All in to shape the future with confidence.

ED None

ey.com/en_lu