SUSTAINABLE FINANCE LAB

MAKING PRUDENTIAL PLANS MATTER

Six questions to get right on net-zero (mis)alignment in 2026

In this paper

Implementing prudential plans as a robust ESG risk management tool will be a major undertaking and a multi-year endeavour.

Planning and implementing financed emissions reduction pathways and dealing with misalignment with EU climate objectives will be the key challenge for banks.

In 2026, these six questions will help supervisors determine whether banks are getting it right.

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POLICY PAPER

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The Sustainable Finance Lab (SFL) is an academic think tank whose members are mostly professors from different universities in the Netherlands. The aim of the SFL is to contribute to a financial system that serves people and planet. To this end the SFL develops ideas and provides a platform to discuss them, thus bridging science and practice.

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Policy Paper

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SUMMARY

It is important that the 2026 supervisory dialogues lead to an understanding of financed emissions reduction pathways and tackle the fundamental challenge of alignment with EU climate objectives.

Across the EU, new EBA guidelines for the management of ESG risk will apply as of January 2026. The prudential requirements on transition plans in these guidelines are expansive and comprehensive and will be a major multi-year endeavour to implement properly, both for banks and their supervisors. In 2026, supervisors across the EU will be able to get a first understanding of the quality of banks' transition planning processes.[1]

The key issue to contend with is that the banking sector, and the real economy it finances, are projected to fall short in aligning with the EU climate objectives. Most bank portfolios are also misaligned with the transition towards a sustainable economy. Banks still have incentives to set ambitious targets in line with EU climate objectives, but fewer incentives to take sufficient action to achieve them. This undermines the effectiveness of the transition planning process, increases both physical and transition risk, and consequently impacts the financial stability of the system as a whole.

The guidelines include requirements for prudential plans and an overview of potential outputs for banks to include in their plans. In 2026, supervisors will see whether prudential plans are adequate in meeting these requirements. But it is easy to miss the forest for the trees. To avoid prudential plans becoming paper exercises, dealing with misalignment head-on will be essential to ensure the effort spent on compliance actually improves resilience.

[1] Banks have already developed transition plans for public disclosure purposes in line with the Corporate Sustainability Reporting Directive (CSRD). As this paper will discuss, the CSRD plans and the prudential plans as prescribed in EBA guidelines should be coherent but serve different purposes.

It may take some years before a consensus can emerge on how to judge whether prudential plans are robust risk mitigation tools. In the meantime, a focussed approach is necessary to achieve clarity and coherence. A focussed approach also supports European priorities around simplification and competitiveness. This paper puts forward six questions for banks and their supervisors to focus on in 2026 to improve the quality of the transition planning process in the years to come:

1. **Risk assessment:** Has sector misalignment been systematically used as one of the criteria to assess transition risk?
2. **Risk mitigation approach:** Does the bank manage transition risk through targets that align with EU climate goals?
3. **Actions and engagement:** Do the proposed actions and engagement with counterparties support the attainment of stated targets?
4. **Internal process integration:** Does the transition planning process join up with front office processes, strategic planning, financial budgeting, risk appetite and performance appraisals?
5. **External dependencies:** Is there clarity over which actions the bank directly controls, and which depend on external stakeholders and developments?
6. **Phase-in:** Is the plan transparent regarding areas requiring further development and how these will be phased in?

The answers to these questions provide supervisors with a good indication whether bank prudential plans and planning processes have the potential to become robust risk mitigation tools.

CONTENT

1. INTRODUCTION

Implementing prudential plans as an effective ESG risk management tool will be a multi-year effort. 2026 will set a tone that matters.

2026 will be an important year for the supervision of environmental, social and governance (ESG) risks in Europe. It will be the first year that banks are required to produce prudential plans based on the new European Banking Authority (EBA) guidelines (EBA, 2025b). Supervisors will need to assess the robustness of the transition planning process as part of the Supervisory Review Evaluation Process (SREP).[2] The SREP is the core supervisory process that consolidates findings from all supervisory activities into a comprehensive assessment of a bank.

The EBA guidelines require banks to implement a holistic strategic planning process that considers EU climate goals and the net-zero trajectory. Banks need to assess risk with reference to misalignment with these goals, and to put in place risk management processes that control these risks over at least a ten-year horizon. Although the EBA guidelines build on the earlier ECB Guide on climate and environmental risks (ECB, 2020), the new guidelines represent a significant implementation challenge.

The implementation of the ECB expectations took most banks the better part of four years and is still ongoing. With this experience as an indication, 2026 will be a year of dialogue rather than assessment. Both banks and their supervisors will need time to learn from each other. Different banks will adopt different approaches, and the strengths and weaknesses of these approaches may not be immediately apparent.

[2] The EBA currently runs a consultation on its revised Guidelines on common procedures and methodologies for the SREP and supervisory stress testing. The revised SREP guidelines will more explicitly integrate ESG factors into existing SREP elements, rather than being a separate category (EBA, 2025a).

However, taking time to learn does not mean 2026 is without responsibility. Dialogues will set expectations for supervisory priorities in the coming years. They have the potential to nudge banks forward in helpful ways, and to provide supervisors with useful insights on which to base future assessment methodologies.

The EBA guidelines set requirements for elements to include in a prudential plan and provide an overview of potential qualitative and quantitative outputs.[3] Unlike many other regulatory implementations, however, a checklist approach will be unproductive. For example, all banks will have some sort of strategic planning process which may adequately meet the regulatory requirements. However, whether this process is singular, comprehensive and meaningfully integrates the banks' internal planning processes is not a simple yes/no question. The quality of this process matters, and it will take time before supervisors can form a view on whether a bank's transition planning process is 'good enough' and sufficiently robust to manage climate risk.

In this paper, we suggest a more pragmatic and strategic approach, focusing on a smaller set of priority questions around six challenges most banks will face.

While the EBA guidelines focus broadly on the management of ESG risks, including transition risk, physical risk and other ESG risks, this report focuses specifically on the microprudential use of banks' climate transition plans for transition risk management.[4]

Chapter 2 introduces the concept of misalignment and its link to transition risk, referencing an earlier and more comprehensive study on transition risk carried out by the Sustainable Finance Lab (Knijp & McKechnie, 2025). Chapter 3 reflects on different transition approaches and pathways banks may embed in their plans. Chapter 4 outlines supervisory objectives when dealing with the challenges for coherence and resilience. Chapter 5 sets out six priority questions for supervisors and banks to focus on in 2026. Chapter 6 discusses broader considerations for supervisors. Chapter 7 concludes. The annex to this paper supports the reader in cross-referencing the six priority questions and sub-questions to the EBA guideline requirements and example outputs.

[3] These requirements are listed in paragraph 109 of the EBA guidelines. The Annex provides examples, references and potential metrics that institutions may consider in their plans. They are structured around key content categories: Strategic objectives and roadmap of the plan, targets and metrics, governance, implementation strategy and engagement strategy.

[4] The EBA guidelines more broadly set requirements for the internal processes and ESG risk management arrangements that banks should have in place. This goes beyond the prudential transition plan and analysis of misalignment. In general, banks need to manage their resilience against a range of scenarios. These scenarios, such as the NGFS scenarios for climate, illustrate different future pathways of how the structure of the economy could evolve (NGFS, 2025). The focus on this paper is however on climate change mitigation.

2. MISALIGNMENT AND TRANSITION RISK

The banking sector and the real economy it finances fall short in aligning with EU climate objectives. This increases transition risk and consequently poses risks for the stability of the banking sector.

Misalignment refers to the current and future deviation of a bank's portfolio from climate objectives. It is generally measured as the difference between financed emissions of a counterparty or sector and the emissions pathway in a reference scenario in line with net zero or 1.5°C.

Misalignment itself is not a measure of risk, as it does not quantify expected losses.[5] Rather, it represents an adverse impact: by financing misaligned activities, a bank contributes to accelerating climate change. However, misaligned counterparties face higher transition risk because they are more vulnerable to increased carbon pricing, changes in government regulations, developments in green technology and shifts in customer preferences. These are financial risks. There are other metrics for assessing transition risk too which banks may want to use.[6] Nevertheless, misalignment is a useful proxy and key indicator for transition risk, both now and in the future. It helps banks evaluate the risks of being unprepared for the transition to a sustainable economy.

Although the EBA guidelines do not formally define misalignment, many banks already apply the concept in both internal tools and public disclosures. Misalignment at any point in time is the distance between the actual position of the bank vis-a-vis a net-zero reference scenario. Misalignment can also be forward-looking and be understood as the distance between the projected position of the bank and the reference scenario at any future point in time. It is typically calculated

[5] There is no standardised method yet to translate misalignment into transition risk measures. In their paper, Finance Watch defines a set of principles for identifying and managing transition risk resulting from misalignment (Finance Watch, 2025b).

[6] For example, a bank is fully aligned may nevertheless the wrong transition technologies resulting in transition risk.

at sector level and expressed in terms of financed emissions intensity.[7] For a number of large counterparties within specific sectors, it can be useful to also assess misalignment to understand transition risk at counterparty level.

Certain financed activities are, by definition, misaligned. For example, analysis from the International Energy Agency (IEA) demonstrates that there can be no expansion of fossil fuels in a net-zero 2050 scenario (IEA, 2025).

Misalignment is not only useful for assessing transition risk. When banks finance emission-intensive activities, they contribute to global temperature rise, increasing the likelihood of extreme climate events. The longer the transition is delayed, the more severe these physical risks become. The banking sector being misaligned with the transition therefore provides a forward-looking indication of system-wide physical risk. Having robust prudential plan information is key for supervisors' assessment of risks beyond transition risk alone. This paper, however, specifically focuses on transition risk.

Currently, a major driver of transition risk is uncertainty in the policy environment, which creates uncertainty about when and how the transition will occur. There is a gap between climate objectives and policy measures. While the EU Climate Law sets a legally binding goal of climate neutrality by 2050, current policies fall short in achieving this goal. Although progress is being made towards 2030 EU goals, existing policy measures are projected to achieve only around half of the required emission reductions by 2050.[8] In practice, the portfolios of most banks are reflections of the real economy and therefore misaligned and are projected to remain so.[9]

Some argue that a slow transition, or no transition at all, reduces transition risk (at the cost of higher physical risk). We argue the opposite: with the EU legally binding climate objective, delaying the transition increases the likelihood of a disorderly and abrupt transition later. This will only increase transition risk over time and may ultimately lead to financial stability concerns (Knijp & McKechnie, 2025).

As policy takers, supervisors must take the EU's 2050 net-zero objective at face value and, at a minimum, ensure that banks are resilient to policies designed to achieve legally binding objectives.

[7] Achieving net zero ultimately depends on reduction in real-world absolute emissions. Organisations like the IEA link absolute emission reductions to intensity metrics. To avoid emission efficiency improvements in certain sectors are be offset by increased output, intensity metrics must be based on credible and regularly updated reference scenarios to reflect real-world changes.

[8] In its report on GHG emissions trends and projections, the European Environment Agency (EEA) project emissions to fall from 2,971 $MtCO_2e$ in 2025 to 1,511 $MtCO_2e$ by 2050 (EEA, 2024).

[9] Finance Watch estimates that the world's largest banks have more that USD 1.1. trillion exposures to the riskiest fossil fuel activities (Finance Watch, 2025a).

3. DECARBONISATION PATHWAYS

To align or not to align? That is the question!

Banks that are misaligned at a point in time but have a strategy to align in future will often determine a 'convergence pathway', which may be drawn as a 'dotted line' towards 2030 and 2050 targets that lie on the net-zero reference scenario. Banks may also determine targets and pathways that do not converge on the reference scenario and will therefore remain misaligned.

Most European banks have voluntarily set climate targets and disclosed them in annual reports under the Corporate Sustainability Reporting Directive (CSRD). The CSRD requires all large companies, including banks, to report on consistency with the Paris Agreement goal of limiting global warming to 1.5°C (Directive (EU) 2022/2464, 2022). Therefore, most of the voluntary targets set align with the Paris Agreement and European Climate Law goals.

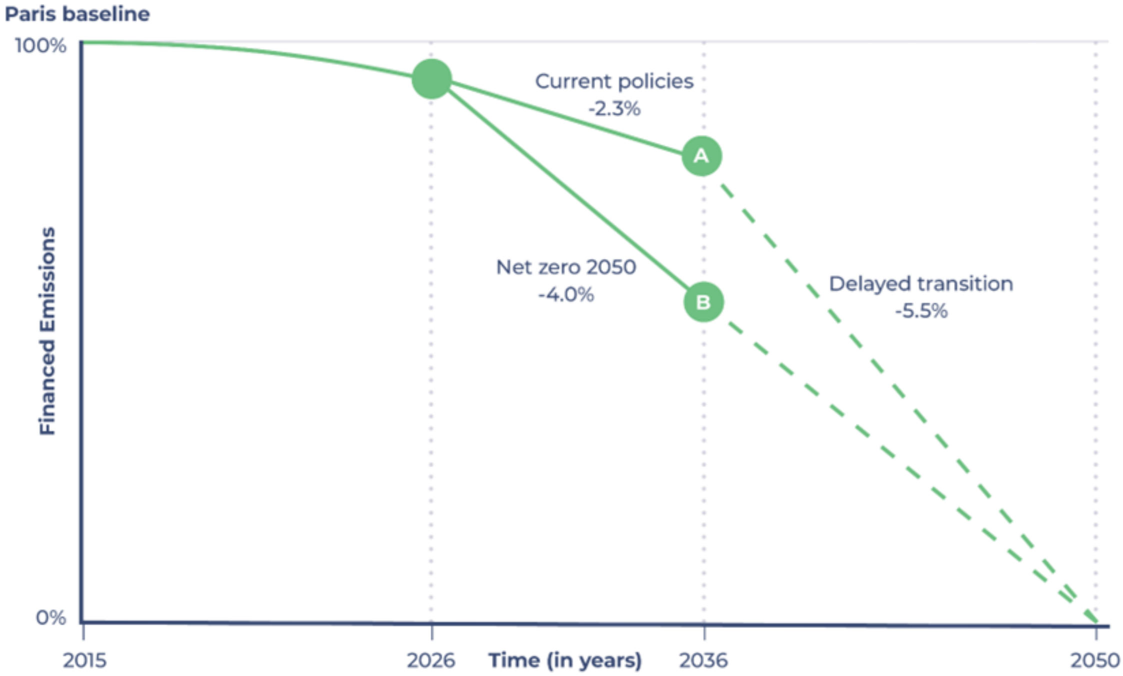
The Corporate Sustainability Due Diligence Directive (CSDDD) used to have a requirement to adopt or implement a transition plan to align with 1.5°C or Paris Agreement goals, but this requirement has been removed as part of Omnibus. The EBA guidelines do not require banks to have 1.5°C or Paris Agreement goals either. However, the EBA guidelines require consistency between internal risk mitigation actions and externally disclosed climate targets.

Over the course of 2026, supervisors will see what targets banks have included in their prudential plans. It is likely that the first prudential plans will include targets consistent with the targets the bank has already disclosed, as that is what they already have.[10]

[10] However, in the future, if banks find that their 1.5°C targets are hard to achieve, they may opt to set less ambitious, or misaligned, targets in both their prudential plans and CSRD disclosed plans.

Roughly speaking, this means setting targets to reduce financed emissions by 4 percentage points annually over the next ten years[11] (Figure 1 - pathway B). This is nearly twice the rate of decarbonisation currently projected for the European economy (Figure 1 - pathway A). Referring to the NGFS scenarios, pathway B is roughly in line with the 'Net Zero 2050' scenario (orderly transition) and pathway A corresponds broadly to the 'Current Policies' or 'Delayed Transition' scenario (disorderly transition).

Figure 1: Illustration of different pathways of banks across a horizon of ten years as of 2026



Source: Sustainable Finance Lab adapted from Schoenmaker & McKechnie, 2024

To achieve pathway B, banks would need to lead their clients to decarbonise faster than the real-economy projections. Banks can indeed incentivise their clients through new products, favourable pricing, or setting themselves sustainable finance targets. They could also discontinue financing companies that are by definition misaligned. In this way they can steer the direction of the economy while simultaneously reducing their exposure to transition risk.[12] This could also result in financial opportunities.

[11] The EBA guidelines require banks to manage their ESG risk over a time horizon of at least ten years.
[12] The risk mitigating approach of a bank pursuing a net-zero pathway (B) can be challenged. Financing green initiatives comes with risks too, for example risks around new green technologies. Such banks may also be vulnerable to future climate policy reversals. However, it is likely unproductive to push banks away from strategies in support of EU policy objectives. It is more constructive to challenge aligned banks on the robustness of their actions instead.

However, although banks have some agency to influence their clients, they typically have little incentive to push their clients too much, for fear of losing them to competitors and undermining short-term market share and profits.

As a result, it is expected that many banks set ambitious targets, but take insufficient action to achieve them (Knijp & McKechnie, 2025). This is also an issue in publicly disclosed transition plans, which fall short in terms of scope, reference scenarios, and methodologies used for target setting and concreteness and reliability of actions to meet the targets (AFM, 2025; TPI & LSE, 2025).

During the first year of implementation, banks are likely to focus on achieving consistency between disclosure and prudential requirements. Consistency between targets and actions may be a concern for later. Banks may judge that their failure to achieve climate targets can be justified by pointing to policy dependencies which did not materialise.

What complicates matters is the fact that the CSRD requirements and EBA guidelines differ. A bank may fail to achieve its climate targets and still comply with the CSRD's reporting requirements by simply disclosing that. However, if those same targets serve as a part of the prudential risk-mitigation strategy, failing to meet them could indicate weaknesses in risk management.

Without coherence between targets and actions prudential plans are in danger of becoming paper tigers. Consequently, although prudential plans have significant potential as a risk management tool, their efficacy depends on the implementation of the plans and therefore the quality of supervision (Knijp & McKechnie, 2025).

4. SUPERVISORY OBJECTIVES

Supervisors should challenge coherence around the banks' chosen transition pathway and their resilience across plausible transition scenarios.

Robust prudential plans must first be coherent, whether or not the chosen decarbonisation pathway is in line with EU policy objectives or not. This requires consistency across risk assessment, targets and actions.

From the perspective of financing the transition, the best outcome is that banks present coherent plans with targets in line with net-zero objectives (pathway B). Indeed, there will be banks that will seek competitive advantage by leading the market in financing the transition. They will either select leading counterparties or encourage misaligned counterparties to move faster than the market is projected to do.

A key challenge for supervisors will be to determine whether banks with prudential plans on pathway B genuinely intend to lead the market and have set actions to do so. Or whether pathway B targets are chosen primarily for convenience while the bank effectively intends to follow the market.[13]

Some banks may explicitly state in their plans that they will not set targets in line with net zero and will instead follow the market (pathway A).[14] These banks might find it easier to demonstrate coherence between targets and actions. However, such banks will see a build-up of transition risk that they will likely struggle with in the medium and long term. Such banks are more vulnerable to a delayed

[13] For many banks the development of their first prudential transition will have been a steep learning curve. There is a strong rationale for leveraging what has already been developed, such as the targets disclosed in the CSRD transition plan. Less thought may have been given to implementation and engagement actions required to attain these targets. And banks could judge that the non-attainment of targets could simply mean that they restate their targets in future.

[14] Banks may even determine strategies with financed emissions above Pathway A. Rather than following the market. They may seek short-term competitive advantage by financing the most misaligned counterparties.

transition scenario and will likely face greater business model risk and higher credit losses related to transition risk. The robustness of the transition planning process also depends on being able to demonstrate that its business model and capital position are sufficiently resilient to withstand such conditions.

Although supervisors will not formally assess the full plans in 2026, the dialogues are an opportunity to do useful groundwork to assess coherence and robustness in 2027. The questions asked will set expectations. Asking the right questions matters.

5. SIX QUESTIONS TO ASK IN 2026

Of the hundreds of potential questions supervisors could ask, we propose a short list of six questions that will provide insights into the robustness of banks' transition planning processes. Asking these questions in 2026 will help banks to implement a holistic strategic planning process that is effective as a transition risk management tool over the coming years.

1. Risk assessment

Has sector misalignment been systematically used as one of the criteria to assess transition risk?

The EBA guidelines require banks to assess transition risk, including the risk of misalignment with EU climate goals.[15] This implies that banks need to calculate misalignment using a reference scenario consistent with these goals at sector level.[16]

This requirement is new. Few banks have a history of using misalignment structurally in their risk assessment. In 2026, it is expected that most banks will rely on earlier materiality assessments or stress test outcomes instead of using misalignment to assess transition risk. Where this is the case, banks will not have a full view of their transition risk. Supervisors could challenge risk assessments through the following sub-questions:

[15] The text in the EBA guidelines is as follows (Section 2.3, paragraph 17): *"while these guidelines do not prescribe any particular business strategy, institutions need to assess financial risks stemming from misalignments of their portfolios with relevant EU regulatory objectives (....) including targets for 2030 and 2050 included in the European Climate Law."*

[16] It is worth noting that misalignment does not necessarily fully capture transition risk. Even banks that are completely aligned with the transition still face transition risk. These banks will still have to assess this risk using materiality assessments, risk heatmaps and/or stress tests.

Constructive sub-questions

1.1 Does the bank systematically calculate (mis)alignment at sector level?
1.2 Does the bank calculate (mis)alignment of select counterparties?
1.3 Does the calculation rely on a science-based scenario consistent with climate goals (e.g. net zero or 1.5°C)?
1.4 Is the reference scenario used for misalignment consistent with one of the scenarios used for climate stress testing?
1.5 Does the bank separately assess exposure to activities that are by definition misaligned (e.g. fossil fuel extraction and broader fossil fuel-related activities)?
1.6 Does the bank link higher misalignment to higher transition risk?
1.7 Does this analysis feed into the holistic assessment of transition risk across all financial risks (e.g. credit, market, operational, etc.)?

2. Risk mitigation approach

Does the bank manage transition risk through targets that align with EU climate goals?

Based on their assessment of transition risk, banks will need to make their own judgements about their risk mitigation approach, whether to set targets to reduce misalignment or accept misalignment.

A potential issue is that the portfolio coverage of such targets may be limited, and that the sectors covered do not entail the most misaligned activities. It will therefore be important that supervisors understand what proportion of the bank's activities are covered by targets, in terms of balance sheet and financed emissions.

A criticism that readers of publicly disclosed plans have made is that the coverage ratio of targets is hard to determine (AFM, 2025; DNB, 2024). In addition, there is ambiguity as to whether scope 1, 2 and 3 financed emissions are included. The EBA guidelines require banks to include the coverage of targets in terms of portfolios, sectors, asset classes, business lines and, where applicable, economic activities.[17]

Banks with targets on a net-zero pathway (B):

In this approach, the bank commits to maintaining or to converging towards the sectoral net-zero trajectory. Leaving the implementation issues of this risk mitigation approach aside for now, strategies to reduce misalignment have the advantage that they support EU policy objectives.

[17] As outlined in paragraph 109. This also holds for SNCIs and other non-large institutions (paragraph 110).

Banks with targets that deviate from a net-zero pathway (A):

Here, the bank determines to remain misaligned, potentially for commercial reasons. These banks would have to manage the transition risk resulting from misalignment. These banks would have to manage, per sector, the risk of misalignment.[18] Banks could for example choose to hold more capital against misaligned loans, set more stringent loan conditions or shorten loan maturities, or transfer risk through insurance.

A key consideration is whether banks that remain misaligned can demonstrate the resilience of their business model under a delayed transition scenario. The longer a bank remains in misalignment, the steeper the curve towards net zero to match a delayed transition. A bank may be challenged to generate sufficient new business with aligned counterparties to compensate for the rapid disengagement from misaligned counterparties.

Constructive sub-questions

2.1 What proportion of the portfolio is covered by these targets? And which emission scopes are included?

Additional question for banks with targets that deviate from a net-zero pathway (A):[19]

2.2 What risk mitigation strategies does the bank propose to manage the risk of misalignment and are these sufficient?[20]

2.3 Over a ten-year long-term planning horizon, how would the bank cope with a delayed transition scenario? Is the bank's business model resilient to such a scenario?

3. Actions and engagement

Do the proposed actions and engagement with counterparties support the attainment of stated targets?

Consistency between the targets and the proposed actions to achieve them is likely one of the key challenges of many banks in 2026.
Banks with targets on a net-zero pathway (pathway B) will need to propose actions to accelerate client decarbonisation beyond current real-economy projections. A

[18] Banks that are currently misaligned but have targets on a net-zero pathway also have to manage transition risk resulting from misalignment. But the expected future transition risk is lower, and therefore the need for the implementation of other risk mitigation actions is less urgent.

[19] This also holds for banks with targets on a net-zero pathway (pathway B) but actions that are not consistent with those targets. These banks are likely not achieving their targets and will deviate from the net-zero pathway too.

[20] Banks that choose to remain misaligned may propose to increase capital to cover potential losses. In 2026, during the first dialogue on the new transition planning guidelines, a useful question may be whether banks recognise this risk mitigation approach. In 2027 and beyond it will be a different question to assess whether the amount of capital held against misaligned assets is sufficient.

'follow-the-market' approach is clearly insufficient if the sector that the bank finances is itself projected to be misaligned.

To demonstrate that a bank can lead the market, it would either need to be highly selective about the counterparties with which it engages (e.g. only aligned counterparties) or would need to propose incentives for misaligned counterparties to decarbonise faster. Such actions would need to include tailored product offerings, proactive client engagement, differentiated pricing, or possibly divestment.

Banks with targets that deviate from a net-zero pathway (A) do not have to demonstrate the same effort to incentivise their clients to lead the market. However, there are different issues these banks have to deal with. There is a risk that these banks fall behind the market if they disproportionately attract counterparties with higher transition risk. This could result in increased exposure to stranded assets. Consequently, such banks would still need to have strong internal controls in place to enable them to meet their targets.

Constructive sub-questions

Banks with targets on a net-zero pathway (B):

3.1 Through what actions does the bank incentivise counterparties to accelerate decarbonisation beyond real-economy projections?
3.2 Does the bank mobilise sufficient human and financial resources to implement these actions?
3.3 What actions does the bank take regarding exposures that are by definition misaligned?

Banks with targets that deviate from a net-zero pathway (A):

3.4 What actions does the bank define to mitigate transition risk resulting from inadvertently attracting the most misaligned counterparties?

4. Internal process integration

Does the transition planning process join up with front office processes, strategic planning, financial budgeting, risk appetite and performance appraisals?

Transition planning and effective ESG risk management are an all-bank endeavour. The EBA guidelines require a 'single, comprehensive strategic planning process'. Prudential plans therefore cannot be a stand-alone exercise. They must be embedded in the core steering processes of the bank, including:

- Longer-term strategy and business planning processes (Strategy)
- Shorter-term budgeting processes (Finance)
- Core risk management processes, including setting and review of risk appetite and limits (Risk)
- Client-onboarding, pricing, credit review and client engagement (Business)
- Performance metrics and remuneration (Human Resources)

In many banks, these processes remain siloed across control functions. Risk functions typically lead implementation of the EBA guidelines, which is logical. However, in the first year since the EBA guidelines were published, banks are unlikely to have achieved full integration across functions. Moreover, earlier publicly disclosed plans have usually been developed by Strategy or Sustainability functions, which can create inconsistencies with prudential plans. The publicly disclosed plans should be the result of the same holistic planning approach and allow supervisors to check for consistency.

There is also a potential issue of time horizon. Many internal processes are run for a period of one, three or maybe five years ahead. This horizon is typically significantly shorter than the ten-year horizon the guidelines require. This can make it challenging for banks to steer on long-term targets.

In general, the prudential plan should describe who is accountable for achieving targets, and how the board is involved. It should also describe what happens in case targets are not met.

Constructive sub-questions

4.1 How does the prudential plan integrate with long-term business planning, short-term budgeting, risk appetite and limits, credit and pricing decisions and performance appraisals?

4.2 Who is accountable for meeting targets? What happens in each of these processes when targets are going to be missed? Is the accountability for actions and targets anchored at board level?

5. External dependencies

Is there clarity over which actions the bank directly controls, and which depend on external stakeholders and developments?

Banks can influence real-economy decarbonisation through products, pricing, and engagement. However, ultimate investment decisions by counterparties also depend on technology performance, policy incentives, and customer demand. In other words, banks can influence but not force their counterparties to make investment decisions that may or may not support the attainment of bank targets (and therefore the success of a bank's risk mitigation approach).

A lack of clarity about dependencies weakens accountability and makes it harder to judge whether a prudential plan is coherent. If targets are not achieved, there is a risk that actions and dependencies are conflated to provide ex-post justifications for failure.

A hypothetical example illustrates the issue. Say that a bank relies on two elements to meet the emissions intensity target of a non-road transport sector: 1) incentivising counterparties to invest in more efficient 'Stage-V' engines[21], through favourable pricing; and 2) the implementation of the EU Renewable Energy Directive (RED) III locally[22] requiring ships to use a certain percentage of biofuels. If in time the target is missed, the cause matters. A regulatory delay may be a legitimate explanation[23], a flawed pricing strategy is not.

It is important to establish clarity about dependencies up front, to assess the robustness of transition planning over time. Banks should be able to describe this for their larger portfolios or sectors, and in some cases also for their larger counterparties. Over time, supervisors could gather a view on the proportion of targets that can be achieved through bank-controlled actions versus external dependencies. In turn, this could enable them to carry out a comparison between planned and actual decarbonisation outcomes.

Constructive sub-questions

5.1 Is the bank confident the target can be achieved through bank-controlled actions?

5.2 Does the bank have insights into dependencies on external stakeholders and developments for achieving the target?

5.3 What actions does the bank take to reduce or influence dependencies?

[21] Emissions from non-road mobile machinery (link)
[22] Directive (EU) 2023/2413 of the European Parliament and of the Council of 18 October 2023 amending Directive (EU) 2018/2001, Regulation (EU) 2018/1999 and Directive 98/70/EC as regards the promotion of energy from renewable sources, and repealing Council Directive (EU) 2015/652 (link)
[23] In 2025 the EU Commission was forced into taking action to ensure complete and timely transposition of EU directives (link)

6. Phase-in

Is the plan transparent regarding areas requiring further development and how these will be phased in?

Although banks need to comply with the EBA guidelines by 2026, it is expected that many banks still have outstanding actions to implement all requirements in their first submission. It has been recognised that for both banks and supervisors this will be a learning exercise. It may take some time to identify good practices and for supervisors to articulate what 'good enough' looks like.

The implementation process would be improved if banks proactively propose implementation roadmaps based on gap analyses rather than wait passively for supervisors to identify gaps.

Moreover, the implementation of the new EBA guidelines should not be shown in isolation. Rather it should be part of a broader programme of work that has built off the earlier ECB Guide implementation, and links with other change initiatives. For example, it should build on implementation actions resulting from publicly disclosed plans following voluntary initiatives.[24]

Banks could also distinguish between pre-existing gaps and new gaps identified during EBA guideline implementation. This reflects a more proactive approach towards prudential plan implementation and broader ESG risk management.

Constructive sub-questions

6.1 For which parts of the guidelines do you have actions that you still need to implement? When do you expect to complete these actions?

6.2 How does the operationalisation of the transition planning process relate to other bank-wide initiatives?

[24] The Dutch central bank for example did a high-level review of the climate transition plans of the Dutch financial sector following the Dutch Climate Commitment (DNB, 2024).

6. BROADER CONSIDERATIONS

Coherence around (mis)alignment is a necessary first step upon which other important ESG risk management considerations can be built.

This paper recommends a 2026 supervisory approach focussed on (mis)alignment. The reason is that a coherent treatment of alignment with climate objectives is a minimum precondition for a robust planning process. However, additional considerations will become increasingly important over time.

Broader ESG risks

ESG risk management is not limited to climate risk but also includes nature-related risk and risk related to governance and social issues. The EBA guidelines recognise that some climate transition risk outputs lend themselves to quantitative approaches, whereas other ESG risks remain less mature and may initially require a more qualitative assessment. Prudential plans should further evolve to better address these broader ESG risks as methodologies and data improve.

ESG risk management also includes physical risk. The increase in frequency and severity of extreme weather events affects the financial system through multiple channels. Banks therefore need to address physical risk too, for example through climate adaptation policies.

Macroprudential considerations

At the macroprudential level, supervisors should enable policy makers to achieve Climate Law objectives while safeguarding financial stability. This includes avoiding situations in which many banks struggle simultaneously with policies implementing a delayed transition, potentially generating system-wide effects. If a sufficiently large number of banks continue financing of misaligned assets, this can lead to financial stability issues. Consequently, policy makers may be prevented from introducing measures to accelerate the transition.

In 2026, bank targets and pathways are likely too immature to support strong macroprudential conclusions. However, macroprudential authorities have limited time to develop forward-looking views of system-wide physical and transition before these risks may materialise. Such risks cannot be mitigated by microprudential supervision alone. The sooner supervisors assess that most banks have coherent prudential plans, the sooner macroprudential authorities can use this information to assess system-wide risk.

This information can then be used to calibrate macroprudential measures like systemic risk buffers, concentration limits or bank-specific limits for financed emissions (Monnin & Ikeda, 2025; Schoenmaker & McKechnie, 2024). These tools may also help level the playing field by reducing short-term commercial upside to finance misaligned assets.

Third-country banks and non-bank financial institutions

Local branches of third-country banks fall within the microprudential remit of European supervisors. However, there will always be finance available through third-country banks and non-bank financial institutions.

There is an often-made argument that if European banks step away from financing misaligned assets, then third-party banks or non-banks will step in to fund them instead. This argument has some merit but risks conflating separate points. First is that protecting deposit-holders in European banks through robust risk management is a supervisory primary objective. Better management of transition risk of European banks is therefore a worthwhile goal even if it were to result in the transition risk shifting outside of the European banking system and not result in a decrease in financed emissions and the associated increase in physical risk. Second, in practice, many European companies rely predominantly on bank financing.[25] The extent to which firms may seek funding for misaligned activities outside of the European banking sector needs to be examined by macroprudential supervisors but may be quite limited.

Transition opportunities

The guidelines for prudential plans necessarily emphasise risks rather than opportunities. Yet, the economic transitions to which the EU is committed (e.g. energy, mobility, food, circularity), require substantial investments and may generate financial opportunities. From a microprudential perspective, these opportunities are mainly visible through business model viability and sustainability assessment conducted under SREP. Nonetheless, it is important to retain a broader perspective: predictable and orderly transitions are in the long-term interest of the financial sector as a whole.

[25] In the EU, credit-markets financing is still dominant for EU companies: about 80% of external financing for EU firms comes from banks, and only about 20% from capital markets (European Parliament, 2025).

7. CONCLUSION

In 2026, supervisors will need to strike the right balance between learning from the different planning approaches that banks will propose, whilst at the same time setting expectations for the assessment of prudential plans in 2027.

This paper proposes a focussed approach for 2026 supervisory dialogues based on six no-regret questions to deal with the biggest challenge to the robustness of the transition planning process: (mis)alignment with EU climate objectives.

Structural issues around misalignment could undermine the credibility of the transition planning process. Unless plans call out and deal with the divergence between real-economy projections and EU climate goals, they will lack coherence and become ineffective ESG risk management tools.

2026 is an opportunity to learn, to set expectations and to nudge banks to make improvements that make prudential plans more effective risk management tools. In the years to follow, supervisors will formally assess the prudential plans through the SREP process. The supervisory dialogues can then result in the communication of (non-binding or binding) corrective actions. For banks without adequate and robust prudential plans, this can eventually lead to the enforcement of supervisory measures such as administrative penalties, fines or sanctions (EBA, 2025a).

2026 is an opportunity for banks and their supervisors to develop a solid foundation of mutual understanding. Getting the basics right will set the scene for the successful implementation of prudential plans as an effective ESG risk management tool for years to come. Asking the right questions will help make prudential plans matter.

ANNEX – CROSS-REFERENCE GUIDELINE REQUIREMENTS

Ref.	Question	Requirement and example outputs	
1	**Has sector (mis)alignment been systematically used as one of the criteria to assess transition risk?**		
1.1	Does the bank systematically calculate (mis)alignment on sector level?	109 a.iii	*“conclusions stemming from … portfolio alignment assessments”*
		6.4.a.iii	# degree of alignment or misalignment compared to climate-related pathways and/or benchmark scenarios…
1.2	Does the bank calculate (mis)alignment of select counterparties?	109.e.ii	*“assessing information related to counterparties’ exposure to ESG risks and alignment towards the institution’s objectives”*
		37	*“assessing the alignment at counterparty level”*
		6.4.e.ii	# methods for measuring alignment of select counterparties against climate pathways
1.3	Does the calculation rely on a science-based scenario consistent with climate goals (e.g. net zero or 1.5°C)?	38	*“institutions should use scenarios that are science-based”*
		95.a	*“likely pathways originated from the European Green Deal, the EU Climate Law, and the latest reports and measures.. ”*
		97.a	*“… against a scenario compatible with the limiting of global warming to 1.5°C in line with the Paris Agreement and with the objective of achieving climate neutrality by 2050 as established by the EU Climate Law”*
		6.4.a.iii	# identification of and justification for scenario(s) selected

Ref.	Question	Requirement and example outputs	
1.4	Is the reference scenario used for misalignment consistent with one of the scenarios used for climate stress testing?	98	*"scenarios and pathways used as part of their plans are consistent across the organisation and time horizons considered"*
1.5	Does the bank separately assess exposure to activities that are by definition misaligned (e.g. fossil fuel extraction and broader fossil fuel-related activities)?	15.a.iii.1	*"Institutions should assess … transition risk… with respect to climate-related risks…with particular consideration given to exposures towards fossil fuel sector entities"*
1.6	Does the bank link higher misalignment to higher transition risk?	109.a.iii	*"conclusions stemming from … portfolio alignment assessments"*
1.7	Does this analysis feed into the holistic assessment of transition risk across all financial risks (e.g. credit, market, operational etc.)?	6.4.a.iii	# qualitative description of material environmental transition … risks faced by the institution
		6.4.a.iii	# quantitative measures of environmental risk impacts on financial risk categories
2	**Does the bank manage transition risk through targets that align with EU climate goals?**		
2	Does the bank manage transition risk through targets that align with EU climate goals?	109.a.i	*"overarching strategic objective to address ESG risks…"*
		6.4.a.i	# qualitative description of strategies to ensure compatibility of the business model…
		109.a.ii	*"comprehensive set of long-term goals"*
		6.4.a.ii	# long-term goals to address risks stemming from the EU objective to achieve net-zero GHG emissions by 2050
		6.4.a.ii	# portfolio alignment metrics
		6.4.a.ii	# business strategy metrics: … pricing, capital, liquidity, balance sheet allocation
		109.b.i	*"quantitative targets set to address ESG risks, including those stemming from the process of adjustment towards the legal and regulatory sustainability objectives"*
		6.4.b.i	# portfolio alignment metrics and targets
		6.4.b.i	# financed emissions across relevant break-downs
2.1	What proportion of the portfolio is covered by these targets? And which emission scopes are included?	109.b.ii	*"portfolios, sectors, asset classes, business lines and where applicable economic activities (i.e. individual technologies) covered by targets"*

Ref.	Question	Requirement and example outputs	
		6.4.b.ii	# for each target, what are the activities, asset classes, sectors and business lines covered
2.2	What risk mitigation actions does the bank propose to manage the risk of misalignment and are these sufficient?		As per 2 above
2.3	Over a ten-year long term planning horizon, how would the bank cope with a delayed transition scenario? Is the bank's business model resilient to such a scenario?	48.b	*"institutions should consider... environmental risk scenario analyses, taking into account the (potential) business environment(s) in which they might be operating in the short, medium and long term including a time horizon of at least 10 years"*
3	**Do the proposed actions and engagement with counterparties support the attainment of stated targets?**		
3.1	Through what actions does the bank incentivise counterparties to accelerate decarbonisation beyond real-economy projections?		The guidelines refer to many possible actions. The below list is not comprehensive:
		109.d.i	*"overview of ... actions"*
		109.d.ii	*"adaptations to policies and procedures ... and to lending and investment policies"*
		109.d.iii	*"changes introduced to the mix and pricing of services and products"*
		6.4.d.iii	# risk-based pricing ...
		6.4.d.iii	# incentives for risk mitigation...
		109.d.iv	*"investments and strategic portfolio allocation ... including information on sustainability-related and transition-related products and services"*
		109.e.iii	*"overview of counterparties' adaptability and resilience to the transition towards a more sustainable economy"*
		6.4.e.iii	# adjustment of credit terms such as interest rates or collateral requirements ...
		6.4.e.iii	# targeted engagement... such as setting improvement targets or offering new financial products...
3.2	Does the bank mobilise sufficient human and financial resources to implement these actions?	109.c.i	*"Governance structure for the plans"*
		109.c.ii	*"Capacity and resources-related actions"*
		6.4.c.ii	# training and development...
		6.4.c.ii	# hiring and recruitment plans...

Ref.	Question	Requirement and example outputs	
3.3	What actions does the bank take regarding exposures that are by definition misaligned?	15.a.iii.1	As per 3.1 above
3.4	What actions does the bank define to mitigate transition risk resulting from inadvertently attracting the most misaligned counterparties?		Guidelines are not explicit about this question but answers could be found in the engagement requirements and example outputs:
		109.e.ii	*"policies for engaging with counterparties"*
		6.4.e.ii	# due diligence screening to identify high-risk counterparties
		6.4.e.ii	# ESG risks reflected in … scores and/or ratings
		109.e.iii	*"outcomes of engagement practices"*
		6.4.e.iii	# Enhanced due diligence …
4	**Does the transition planning process join up with front office processes, strategic planning, financial budgeting, risk appetite and performance appraisals?**		
4.1	How does the prudential plan integrate with long-term business planning, short-term budgeting, risk appetite and limits, credit and pricing decisions and performance appraisals?		Many references across the guidelines. The below list is not comprehensive. Long-term business planning, short-term budgeting, risk appetite and risk:
		109.a.i	*"overarching strategic objective in line with overall business strategy and risk appetite"*
		109.a.ii	*"Comprehensive set of long term goals … including consistency of business structure and revenues with such milestones."*
		6.4.a.ii	# business strategy metrics: … pricing, capital, liquidity, balance sheet allocation
		109.d.i	*"how the institution embeds the plan's objectives into its decision-making process and its regular risk management framework"*
		6.4.d.i	# integration of ESG risk-related objectives into the medium and long-term strategic planning and decision making processes
		6.4.d.i	# incorporating… into the risk management framework
			Performance appraisals:
		109.c.iii	*"Remuneration policies"*
		6.4.c.iii	# metrics used to embed the risk appetite… in remuneration policies
			Credit risk policies:
		6.4.d.iv	# credit risk policies…

Ref.	Question		Requirement and example outputs
		 6.4.e.iii 6.4.e.iii	Engagement: # (More) targeted engagement... # ... assessment of counterparties' resilience and alignment against targets and risk appetite
4.2	Who is accountable for meeting targets? What happens in each of these processes when targets are going to be missed? Is the accountability for actions and targets anchored at board level?	109.c.i 6.4.c.i 6.4.c.ii 109.c.iii 6.4.c.iii 6.4.c.iii	*“Governance structure for the plans including roles and responsibilities”* # deviation protocols # leadership commitment *“practices to promote sound management”* # proportion of staff with ESG risk-related metrics... # weighting of ESG risk-related metrics...
5	**Is there clarity over which actions the bank directly controls, and which depend on external stakeholders and developments?**		
5.1	Is the bank confident the target can be achieved through bank-controlled actions?		There is no direct reference in the guidelines to ‘dependency’ but rather on expected effectiveness:
5.2	Does the bank have insights in dependencies on external stakeholders and developments for achieving the target?	109.d	*“overview of short-, medium- and long-term term actions... complemented by information on the observed effectiveness or expected contribution of each action to the relevant targets"*
5.3	What actions does the bank take to reduce or influence dependencies?		
6	**Is the plan transparent regarding actions requiring further development and how these will be phased in?**		
6.1	For which part of the guidelines you have actions which you still need to implement? When do you expect to complete these actions?	109.a 109.d.i	*“plans include... strategic objectives and roadmap..."* *“Overview of short-, medium-, and long-term actions taken or planned”*
6.2	How does the operationalisation of the transition planning process relate to other bank-wide initiatives?	 109.d.i 6.4.d.i	The guidelines indirectly refer to other bank wide initiatives insofar that it is implied that there is integration with other processes: *“actions ... in core banking activities and processes ... including how the institution embeds the plan’s objectives into its decision-making process ...”* # integration ... into medium and long term strategic planning and decision making processes

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