AG response: Transition Finance Market Review call for evidence

May 2024

Background

The Aldersgate Group represents an alliance of major businesses, academic institutions and civil society organisations, which drives action for a competitive and environmentally sustainable UK economy.[1] Our corporate members represent all major sectors of the economy, such as Associated British Ports, Aviva Investors, BT, CEMEX, the John Lewis Partnership, Johnson Matthey, Michelin, Nestlé, Siemens, SUEZ, Tesco, and Willmott Dixon. They believe that ambitious environmental policies make clear economic sense for the UK, and we work closely with our members when developing our independent policy positions.

Chapter 2 – Scope of Transition Finance

1) Do you consider there to be a lack of clarity around the scope of transition finance? Why / Why not?

We do consider there to be a lack of definitional clarity around the scope of transition finance. Currently, no standardised definition of transition finance exists, nor a set of eligible sectors/activities or technical criteria that is commonly agreed upon.

As set out by Sikka, Khanna, and Purkayastha (*Transition Finance, 2023*), developing a universal definition of transition finance is inherently challenging for two reasons. First, transition finance is dynamic, meaning what today might be considered as in scope could rapidly change as new low-carbon solutions are developed and deployed. Second, the scope of transition finance is dependent on the underlying characteristics of a given economy, as low carbon solutions will exist in varying degrees of maturity and market readiness across countries and jurisdictions.

There is a clear opportunity for the UK Government to take on a leadership position by collaborating with national governments, standard-setting bodies, the private sector, and other stakeholders in international fora to develop a high-level description of transition finance to provide a clear direction to policies and the delivery of financing – ensuring credibility and supporting global alignment as far as possible.

2) Have you faced challenges in accessing or deploying transition finance because of a lack of clarity around its scope?

We agree with the finding from the Review's preliminary discussions that "the absence of an agreed core scope could be a barrier to building confidence in the transition finance market".

[1] Individual recommendations cannot be attributed to any single member and the Aldersgate Group takes full responsibility for the views expressed.

info@aldersgategroup.org.uk www.aldersgategroup.org.uk

Financial markets are global in nature and businesses operate across borders and jurisdictions. Significant divergences between national and regional approaches to transition finance, and between corporate-level transition finance frameworks, create uncertainty for investors – restricting the international flow of capital and potentially increasing costs.

A high-level description of transition finance would be helpful in unblocking this barrier to accessing and deploying capital. Crucially, national governments and jurisdictions need to set out a clear picture of what they are trying to achieve through transition finance and against what pathway.

3) Do you agree with the approach that transition finance includes all sectors of the economy to the extent that it is part of a credible net zero transition? Why / Why not? If not, please specify which should be excluded and why.

We agree with the Review's approach that "transition finance has relevance across all sectors to the extent it is part of a credible net zero transition".

All sectors of the economy are exposed to some level of physical risk (physical damage and financial losses caused by extreme weather events) and transition risk (financial impacts of changing regulation, policies, and technologies aimed at reducing greenhouse gas emissions). Excluding particular sectors of the economy from the scope of transition finance will restrict a sector's ability to access finance to reduce greenhouse gas emissions and support workers through the transition. This contributes to the risk not only of stranded assets, but of stranded communities. Additionally, excluding particular sectors could lead to 'paper decarbonisation', where entities green their balance sheets by simply divesting or terminating lending to high emitting sectors rather than supporting those sectors to cut their real-world emissions.

Where possible, transition finance should focus on sectors where the cost of capital is an inhibiting factor preventing companies from investing in new, low-carbon technologies (for example, steel, chemicals, and cement). The degree to which transition finance is supporting these 'tipping points' – that is, supporting investments being made or technologies being developed where it would not have otherwise been – is an important factor.

It will be important to ensure the risk of greenwashing is well managed and mitigated. Assessment of the 25 largest listed oil and gas companies by Carbon Tracker (*Carbon Tracker, 2024: Paris Maligned II*) found that that none are currently aligned with the goals of the Paris Agreement, with companies targeting new developments and production increases in the near-term. Whilst companies such as Ørsted A/S demonstrate that it is possible to successfully transition from a fossil fuel-based business model to a renewable-based one (see answer to Q22 for more details), high-level conditions are needed to ensure transition finance does not unnecessarily prolong the lifecycle of fossil fuel-intensive systems and delay the deployment of low-carbon alternatives. As set out by the Green Finance Institute (*GFI, 2023: Transition finance – new asset class or emperor's new clothes?*), transition-related finance should be limited to either asset-based green finance or ring-fenced finance for fossil-based asset decommissioning.

4) Do you agree that the primary focus of transition finance should be on a credible net zero transition in hard to abate and high emitting areas of the economy? Why / Why not?

Transition finance should extend to the credible net zero transition of all sectors of the economy, although it makes sense initially to prioritise hard to abate and high emitting areas of the economy – such as the foundation industries – given their emissions intensity and their significant financing requirements to achieve decarbonisation.

Hard to abate and high emitting sectors have an essential role to play in the future net zero economy but face technological and commercial challenges to decarbonise. The glass sector, for example, uses high temperature melting furnaces and other heat intensive equipment (powered by natural gas) to manufacturer a range of products, including fibre glass (used in wind turbines and lightweighting of vehicles), glass wool (used for insulation), and flat glass (windows for construction industry). Analysis for the Aldersgate Group (*Aldersgate Group, 2023: Economic benefits of industrial decarbonisation*) found that the UK's industrial sectors and wider supply chain contribute £152 billion in gross value added to the UK economy and support over 1.4 million jobs.

To remain competitive with low-carbon industry in other countries, foundation industries will need to undergo 'deep decarbonisation' using a combination of energy and resource efficiency, fuel switching, and carbon capture technologies. This will require significant investment, from both the public and private sector, and policy support. According to the World Economic Forum, decarbonising ammonia, aluminium, oil and gas, steel, and cement will require over $2.1 trillion in capital expenditures in production assets (*WEF, 2022: Net-zero industry tracker, 2022 edition*).

There is a risk, however, that focusing on hard to abate and high emitting areas of the economy could channel capital towards incumbent industries without low-carbon solutions, and insufficiently to those developing solutions. To avoid this, high-level structure and conditions are needed for transition finance.

6) Do you agree with the approach to not demarcate between 'transition finance' economic activities and 'green finance' economic activities? Why?/Why not?

Unlike the Review, we think that drawing a distinction between 'green' and 'transition' finance is helpful, as they refer to different economic activities, financial products, and timeframes. Green finance economic activities (e.g., electric vehicles, offshore wind) are those that result in near-zero or zero emissions and are therefore already aligned with the Paris Agreement. Transition finance economic activities (e.g., aviation, cement), meanwhile, include hard to abate or high emitting sectors of the economy which are not yet aligned with the Paris Agreement.

Green finance economic activities are generally financed through green finance instruments, such as green loans and green bonds, whereas transition finance economic activities are financed through transition finance instruments, such as sustainability-linked loans and sustainability-linked bonds. Given national commitments to transition to

info@aldersgategroup.org.uk www.aldersgategroup.org.uk

net-zero emissions by mid-century, there is a time-limited need for transition finance to support hard to abate and high emissions sectors to decarbonise. In contrast, all finance will eventually need to become green finance - that is, aligned with international climate and environmental targets.

We encourage the Review to consider how to frame ‘transition finance’ for real economy companies, and particularly SMEs, as technical language may contribute to a lack of awareness and serve as a barrier to accessing investments, products, and services for transition finance.

7) Do you agree that transition finance includes all types of financial products and services that support a credible net zero transition? Why?/ Why not? If not, please specify which should be excluded and why.

We agree that transition finance should include all types of financial products and services which support a credible net zero transition. This is necessary to provide a variety of different options to companies with diverse needs and profiles, such as small and medium-sized enterprises, to access finance. We encourage the Review to consider which stages of financing and which areas of financial products are likely to be in short supply or more difficult to supply. Improving understanding in this area will help to effectively channel capital and support the development of necessary financial products.

General purpose financing should also be included, as excluding it could drastically reduce the potential size and impact of the transition finance market – and, by extension, the pace of real economy decarbonisation.

Crucially, issuers should be able to demonstrate ‘additionality’ across all types of financial products and services to external stakeholders (including investors, consumers, and the wider public). This means demonstrating how a particular financial product or service provides additional real-world impact. Companies, for example, will need to demonstrate why and how a sustainability-linked loan will have additional impact over a conventional loan.

8) Please describe any concerns you have with the application of transition finance through certain types of financial products or services?

Labelled transition finance instruments, such as sustainability-linked loans and sustainability-linked bonds, are examples of financial products which has attracted criticism over its integrity and transparency.

The FCA has expressed concerns in the sustainability-linked loans market over weak incentives, potential conflicts of interest, and suggestions of low ambition and poor design in Sustainable Performance Targets (SPTs) and KPIs (*FCA, 2023: FCA outlines concerns about sustainability-linked loans market*).

The Climate Bond Initiative (*CBI, 2024: Sustainability-linked bonds – building a high-quality market*) has also estimated that 80% of 768 sustainability-linked bonds issued between 2018-2023 are not aligned with global climate goals. According to the Climate

Bond Initiative, the problem lies in the “design and execution” (including structural characteristics, poor reporting, and weak decarbonisation plans by issuers), rather than the concept. Exit clauses and flexibility clauses, which enable issuers to sidestep financial penalties if they are likely to miss targets or adjust targets after the bond has been issued, have been highlighted as being particularly problematic.

Barclays, for example, has recently been accused of greenwashing for facilitating Eni (an Italian oil company) to raise a sustainability-linked bond worth €1bn and a revolving sustainability-linked loan worth €3bn (*Guardian, 2024: Barclays accused of greenwashing over financing for Italian oil company*). The goals in the contract of these sustainable debt arrangements have been criticised over their lack of ambition, incompatibility with the Paris Agreement, and crucially, exclusion of scope 3 emissions – which make up most of Eni’s emissions. Importantly, these sustainable debt arrangements could act as a loophole to enable financial institutions to continue to provide financing for new oil and gas exploration as they are not considered ‘direct’ project financing. According to the report, Eni plans to increase oil and gas production by 12.6-17% over the next four years, investing between €24-26bn in total.

If these concerns are not addressed through regulation and market mechanisms, there is a risk that the sustainable debt market will lose credibility, hindering market growth. Here, clear standards as well as guidelines for accreditation and evaluation will help to improve confidence in labelled transition finance instruments.

9) Do you agree with the approach that non-emissions-based and non-climate-based considerations are included in the scope of transition finance? Why?/ Why not?

We agree that the scope of transition finance should include non-emissions-based and non-climate-based considerations.

Climate change is not the only strand to sustainability. Factors such as biodiversity protection, nature-based solutions, and ensuring a just transition are also key to transitioning to a sustainable economy and must be addressed in tandem.

Transition finance, therefore, should enable companies to finance not only activities that reduce emissions and enable the achievement of climate objectives, but broader sustainability objectives too – such as those outlined in the UN Sustainable Development Goals.

Non-emissions-based and non-climate-based considerations are already being factored into transition finance instruments too. According to Environmental Finance (Environmental Finance, 2022, Sustainability-linked debt – carbon emissions KPIs), 75% of the KPIs used in sustainability-linked bonds and sustainability-linked loans relate to carbon and greenhouse gas emissions, 10% relate to water, 10% relate to social issues, and less than 5% relate to governance issues.

info@aldersgategroup.org.uk www.aldersgategroup.org.uk

Chapter 3 – Ensuring the Credibility and Integrity of Transition Finance

10) Do you agree there is a significant role for good quality transition plans aligned with the TPT Disclosure Framework in the provision of transition finance? Why/ Why not? If yes, please describe this role?

Good quality transition finance starts with good quality transition plans.

Transition plans set out a company's overall approach to the net-zero transition, including emissions reduction targets, short and medium-term actions, and accountability and governance mechanisms. They provide the basis on which issuers and investors can propose and evaluate transition strategies, actions, and investments to ensure transition finance is delivering tangible, real-world improvements.

The data from credible, time-bound, and target-based transition plans will enable investors to make more informed decisions about the credibility of companies' climate pledges and their exposure to climate risks. This can help facilitate investors' assessments around the value of providing transition finance to high emitting borrowers/investee – driving wider adoption and market growth.

Finally, published transition plans will help to inform and enhance the structure of transition finance instruments, such as KPI and Sustainability Performance Targets (SPT) selection in sustainability-linked bonds and loans. Corporates can tether metrics and targets to those set out in their transition plans (disclosure recommendation 4.1), detail how it expects to resource current and planned activities (disclosure recommendation 2.4), and communicate transition challenges at an entity, sector, and whole-economy level to provide context for the evaluation of missed targets or circumstances beyond an entity's control (disclosure recommendation 1.3).

Given the importance of transition plans in underpinning transition finance, it is challenging that many corporates haven't yet disclosed transition plans with sufficient transparency or detail. According to research by EY, just 5% of FTSE 100 businesses in April 2023 had disclosed plans with sufficient detail to meet the Transition Plan Taskforce's (TPT) draft disclosure framework (*EY, 2023: EY Analyses published FTSE 100 transition plan material*). It is worth acknowledging that transition planning is, by nature, an iterative process and the quality of transition plans will continue over time.

The Government and regulators can support the adoption of high-quality transition plans by: issuing good-quality guidance; continuing to champion the TPT's final disclosure framework domestically and internationally; and providing clarity on the phased rollout of mandatory transition plan disclosure requirements across the economy, including private companies. As a matter of urgency, the Government should launch the delayed consultation on introducing requirements for the UK's largest companies to disclose plans, as committed to in the 2023 Green Finance Strategy.

info@aldersgategroup.org.uk www.aldersgategroup.org.uk

15) Do you consider there to be a role for taxonomies in the provision of transition finance? Why / Why not? If yes, please describe this role and consider any interaction with the role of transition plans?

'Green taxonomies' play a significant role in the provision of green finance (that is, finance for economic activities that result in near-zero or zero emissions and are aligned with the Paris Agreement), having already been widely adopted by corporates at the project level through use-of-proceeds green bonds.

For example, one member of the Aldersgate Group, CBRE Investment Management, has aligned its Green Finance Framework with the EU Taxonomy, helping it to meet market expectations and reduce the risk of 'green' being interpreted as CBRE IM's own opinion. In 2021, CBRE IM raised €1bn in two issuances of green bonds. The proceeds of these instruments were allocated to green projects, as defined by the EU Taxonomy. In CBRE IM's view, "the EU Taxonomy helped facilitate a successful Green Bond, indicated that the UK Taxonomy could help drive similar green finance activity in the UK". For more information, see *APPG on ESG, 2022: The UK Green Taxonomy*.

Green taxonomies also have an important role to play in the provision of transition finance. By developing clear definitions, thresholds and criteria for transition activities, taxonomies will help financial institutions to identify and direct capital towards transition areas of the economy with confidence.

The EU Green Taxonomy captures 'transition' both through the 'transitional activities' category and the dynamic review process where Technical Screening Criteria (TSC) thresholds are ratcheted up over time in line with the transition of the wider economy. Transitional activities must contribute to climate mitigation and a Paris Agreement-aligned pathway. To qualify, transitional activities must meet three criteria: (1) there are no technologically or economically feasible low-carbon alternatives; (2) greenhouse gas emission levels correspond to the best performance in the sector or industry; and (3) the activity does not lead to carbon lock-in or hamper the development/deployment of low-carbon alternatives.

As a matter of urgency, the UK Government needs to implement its own green taxonomy – beginning with the long-awaited consultation expected in Autumn 2023. To avoid market fragmentation, the UK should look to align closely with the EU. In agreement with GTAG, we believe the UK should prioritise the delivery of a credible, robust, and usable green taxonomy before any exploration of a transition taxonomy or 'extended taxonomy' (*GTAG, 2023, Developing a UK taxonomy adopted to the UK's needs in the short and medium term: scope, coverage, and reporting considerations).*

17) Do you think there is a need for different approaches to transition finance across different jurisdictions, considering they may have different transition pathways?

Different jurisdictions will develop different approaches to transition finance in line with the unique underlying characteristics of their economies, as well as their environmental objectives and industrial policy issues, which will shape their specific financing needs. Transition finance in economies like South Africa and Australia, for example, will be more focused on decarbonising mining than in other jurisdictions, as mining accounts for a significant portion of both countries' economic activity.

Additionally, low-carbon technologies and solutions exist in varying degrees of maturity and market readiness across countries and jurisdictions. Energy infrastructure in emerging markets and developing economies, for example, are often in the 'brown' stage (such as coal-fired power plants) which are very young compared to the EU and US. There should be consideration for what this means for the potential and financial incentives of phasing out or transitioning high emitting infrastructure in different regions. Additionally, thought should be given to the scale and resulting requirements not just of retiring fossil-fuel intensive infrastructure, but financing renewables and the related distribution roll-out.

Given the different economic and environmental objectives across different jurisdictions, a one-size-fits-all approach to transition finance is clearly not appropriate. That being said, it is crucial that a minimum degree of interoperability (for example, in definitions, criteria, and standards) is upheld between approaches. Financial markets are global in nature and businesses operate across borders. In this context, market fragmentation risks creating confusion to investors and restricting the international flow of capital across and between jurisdictions.

19) Are there any unintended consequences of scaling up transition finance in the UK or internationally that you are concerned about? If so, what can be done to avoid or mitigate them?

There is a risk that scaling up transition finance in the UK or internationally could produce unintended consequences.

As pointed out by the Green Finance Institute (*GFI, 2023: Transition finance – new asset class or emperor's new clothes?*), too much emphasis on scaling up transition finance (finance for economic activities in heavy emitting or hard to abate sectors that are not yet aligned with the Paris Agreement) could serve as a "distraction" from the need to scale up green finance (finance for economic activities that result in near-zero or zero emissions and are aligned with the Paris Agreement) for proven low-carbon technologies and solutions, such as electric vehicles in the transport sector and heat pump technologies in the buildings sector.

In addition, there is a risk that transition finance leads to 'carbon lock-in'. This is where investment is made in carbon intensive infrastructure or assets, despite the possibility of substituting them with low-carbon alternatives, resulting in greenhouse gas emissions being locked-in for years or even decades.

Robust criteria for transition finance economic activities will help to prevent the risk of carbon lock-in. To qualify as a 'transitional activity' in the EU's green taxonomy, the activity must meet three criteria: (1) there are no technologically or economically feasible low-carbon alternatives; (2) greenhouse gas emission levels correspond to the best performance in the sector or industry; and (3) the activity does not lead to carbon lock-in or hamper the development/deployment of low-carbon alternatives. There is also a minimum requirement to review (and update) the EU green taxonomy every three years to capture market, technological, and methodological developments.

Chapter 4 – Barriers to the Applications of Transition Finance

20) Do you consider there to be major barriers that currently limit your ability to access or deploy capital or financial services to support a credible net zero transition? Why / Why not? If so, what are these?

There are several major barriers that limit the ability of companies to access or deploy capital/financial services to support a credible net zero transition: (1) the lack of definitional clarity on the scope of transition finance, (2) risk, (3) information asymmetry, and (4) skills.

First, the lack of definitional clarity on the scope of transition finance. As set out in our answer to Q1, there is currently no standardised definition of transition finance, nor a commonly agreed set of eligible sectors/activities or technical criteria. Divergences between national and regional approaches to transition finance, and between corporate-level transition finance frameworks, restricts the international flow of capital.

Second, transition finance carries additional risk (both perceived and actual). Financing transitions in emissions-intensive sectors will require investment in early-stage low-carbon technologies which have uncertain commercial viabilities because of their capital-intensive nature, long-term time horizons, and unknown payback periods. This is particularly difficult given the sheer scale of investment required, such as the estimated £3 billion to decarbonise a blast furnace. Investors are also cautious over: (1) being locked into unsuitable investment choices due to the high capital costs and the fast pace of technological development and (2) the reputational risk arising from financing an activity which is not already green.

Third, a lack of access to consistent, comparable, and decision-useful climate and nature-related information. As set out in our answer to question 10, investors need this information to make informed decisions about the credibility of company's climate pledges and their exposure to climate risks. Data availability and quality, though, remains patchy – particularly in emerging markets and developing economies and amongst SMEs.

Finally, skills. According to a Chartered Banker survey of UK financial services firms (*Chartered Banker, 2023: State of the nation – building green and sustainable finance capacity and capability in UK financial services*), 'transition finance' was considered to be the largest skills gap ahead of natural capital markets, international standards and regulations, and 17 other areas. Capacity and capability gaps hinder the ability of corporates (particularly SMEs) to access transition finance. In addition, investors may lack the capacity or resources to assess the credibility of transition finance instruments such as low-quality sustainability-linked bonds or loans.

21) What barriers or disincentives do you face in providing or accessing investments, products and services for transition finance?

A barrier or disincentive that investors face in providing investments, products, and services for transition finance is the reputational risk associated with investing in hard to abate or high emitting sectors.

By financing a hard to abate or high emitting company to decarbonise, an investor's financed emissions may increase – or decrease more slowly than expected – in the short-medium term. This can be perceived as performing badly against climate commitments, even if they are supporting real world decarbonisation in the long-term.

Providers of finance will need to communicate clearly with stakeholders and set expectations to enable them to continue to provide transition finance to hard to abate and high emitting sectors, in favour of a divestment approach which does not achieve real-world emissions reductions ('paper decarbonisation').

The TPT's banking sector guidance recommends entities consider three inter-related channels in designing their transition plans:
1) Ambitions and actions to reduce scope 1, 2 and 3 (including financed and facilitated) greenhouse gas emissions.
2) Set out how the bank is responding to climate-related risks and opportunities.
3) Contribute to an economy-wide transition. This may include investing in high-emitting sectors with the intention of decarbonising via investing in climate solutions infrastructure.

Relatedly, the absence of regulations around ESG ratings may also act as a barrier or disincentive in providing investments, products, and services for transition finance. According to Bloomberg, bond issuers are increasingly using ESG ratings when selecting bond underwriters (*Bloomberg, 2024: Bankers doing bond deals jolted by new era of issuer clauses*), raising concerns around the transparency, quality, and reliability of ESG rating providers given the lack of regulation. The UK Government's plans to introduce regulation for the providers of ESG ratings is a welcome step forward and should help to improve consistency and reliability.

22) What examples are there of where finance is being deployed effectively to support a credible net zero transition, and what lessons or precedents can be learnt from this which could be expanded further?

Ørsted A/S, the Danish state-owned multinational energy company, is a good example of where finance has been deployed effectively to support a credible net zero transition.

Formerly Danish Oil and Natural Gas, Ørsted was one of the most coal-intensive companies in Europe, responsible for one third of Denmark's carbon emissions. In 2009, the company set out a '85/15 vision' to transition its generation mix from 85% fossil-fuels and 15% renewables to 85% renewables and 15% fossil fuels by 2040. Ørsted achieved this target, ahead of time, by 2019 and is now ranked amongst the world's most sustainable energy companies in the Corporate Knights Global 100 Index.

Ørsted has been able to achieve this energy transformation, in part, through transition finance. Since 2017, all new Ørsted bonds have been issued in a green format, with total issuances of green bonds and green hybrid bonds totalling DKK 62.9bn between 2017-2022. The proceeds from these sustainable debt instruments have been allocated to eligible projects, as defined in their Green Financing Framework, which relate to the development, construction, or installation of offshore wind farms.

Ørsted's success in transitioning its energy portfolio and deploying transition finance should be replicated across other sectors and industries. It is worth noting, though, that Ørsted's transition began in 2009. Given the alarming rate of global heating and biodiversity decline, there must be particular focus on how sector/market transitions can be carried out at an accelerated pace.

23) Do you consider risk to be a major barrier to accessing or deploying capital or financial services to support a credible transition? If so, please provide examples and highlight any supportive de-risking tools.

Risk is a major barrier to accessing/deploying capital or financial services to support a credible transition.

Transition finance carries additional risk (both perceived and actual) compared with green finance. Financing transitions in emissions-intensive sectors will require investment in early-stage low-carbon technologies, bringing a degree of cost and time uncertainty, as well as unknown payback periods. This is particularly difficult given the sheer scale of investment required, such as the estimated £3 billion to decarbonise a blast furnace. Investors are also cautious over: (1) being locked into unsuitable investment choices due to the high capital costs and the fast pace of technological development and (2) the reputational risk arising from financing an activity which is not already green.

Government has a role to play in de-risking these investments to scale the transition finance market. This begins with setting out robust sectoral decarbonisation pathways. For industry, for example, this means setting out a clear, joined up plan for how, where, and by whom different fuels will be used, with guidance around how decisions have been made about prioritising limited technology such as CCUS and green hydrogen. This will provide certainty on the direction of travel as well as the timing and delivery of other enabling policies such as new infrastructure and electricity market reform affecting the industrial cost of electricity. For more information, see *Aldersgate Group, 2023: Economic benefits of industrial decarbonisation*. The Government can also help reduce the risk of greenwashing – both intentional and unintentional – by providing greater clarity on the implementation timelines on the delivery of a UK green taxonomy and the rollout of mandatory transition plans across the economy.

The Government should also use mechanisms to support risk mitigation, for example, co-investment, loan guarantees and public seed capital/grants. This could be delivered through the UK Infrastructure Bank, the British Business Bank, and other public financial institutions to support investment into hard to abate and high emitting sectors. A good example of where Government intervention has crowd-in private investment into new, emerging technologies is the Contracts for Difference (CfD) regime, which has helped the UK to become a world leader in offshore wind while delivering cost reductions that would have seemed unimaginable 20 years ago.

27) Do SMEs face particular barriers to the access and deployment of transition finance? If so, please provide examples and highlight any good examples of efforts to address these.

According to the SME Climate Hub 2023 Survey, the top reasons preventing SMEs from acting on climate change are: skills and knowledge (58%), lack of funds (55%), and lack of time (44%).

Whilst transition finance products and services would help SMEs to act on climate change, they are often disadvantaged in accessing finance due to high transaction costs. SMEs also struggle to access transition finance because they often lack the skills to develop transition plans and are unable to produce the granular data on their sustainability performance which is needed by financial institutions to manage climate-related risks, develop relevant sustainable financing instruments, and meet reporting requirements. The TPT has recently published a paper (*TPT, 2024: Considerations on SMEs and transition plans*), offering guiding principles for SME transition plans, which will support SMEs.

Chapter 5 - The opportunity for investments, products and services to advance transition finance globally

30) Do certain 'labelled' transition finance instruments need to adopt additional requirements? Why and how could this be done in a way that is commercially viable?

Labelled transition finance instruments, such as sustainability-linked loans and sustainability-linked bonds, have attracted criticism over their integrity and transparency.

The FCA, for instance, has expressed concerns about the sustainability-linked loans market over weak incentives, potential conflicts of interest, and suggestions of low ambition and poor design in Sustainable Performance Targets (SPTs) and KPIs (*FCA, 2023: FCA outlines concerns about sustainability-linked loans market*). Addressing these concerns through regulation and market mechanisms is key to ensuring the sustainable debt market does not lose credibility, hindering the market's growth.

The quality of transition finance instruments could be improved if they were required to adopt the following, additional requirements:

- Clawback-style clauses. The Green Finance Institute suggests that clawback-style clauses – expressed as a contingent higher cost of borrowing – should be included in the terms and conditions of labelled transition finance instruments, to mitigate against the risk of clients backtracking on net zero commitments without reasonable cause (*GFI, 2023: Transition finance – new asset class or emperor's new clothes?*).
  - Greater transparency and consistency in the methodologies used in labelled instruments to provide comparable and credible forward-looking metrics.
  - Uniform disclosure and independent monitoring and verification of targets.

Chapter 6 - Building the UK as a global hub for transition finance

31) How should the government, and other public bodies such as public finance institutions and local authorities, collaborate with industry, the finance sector and investors to create a supportive ecosystem for transition finance? Please considering factors such as i) the balance of public and private capital risk responsibility and ii) where expertise is located.

To create a supportive ecosystem for transition finance, the Government could meaningfully collaborate with other stakeholders through the three following actions.

First, the Government and regulators should work with industry, the finance sector, and investors to drive the uptake of good-quality transition plans aligned with the TPT's disclosure framework. As set out in our answer to question 10, good quality transition finance starts with good quality transition plans. It is challenging, therefore, that many corporates have not yet disclosed transition plans with sufficient transparency or detail. According to research by EY, just 5% of FTSE 100 businesses in April 2023 had disclosed plans with sufficient detail to meet the Transition Plan Taskforce's (TPT) draft disclosure framework (*EY, 2023: EY Analyses published FTSE100 transition plan material*). It is worth acknowledging that transition planning is an iterative and continuously improving process, the Government and regulators can support the adoption of high-quality transition plans by: issuing good-quality guidance; continuing to champion the TPT's final disclosure framework domestically and internationally; and providing clarity on the phased rollout of mandatory transition plan disclosure requirements across the economy, including private companies. As a matter of urgency, the Government should launch the delayed consultation on introducing requirements for the UK's largest companies to disclose plans, as committed to in the 2023 Green Finance Strategy.

Second, to build capacity in the financial services sector, the Government should work closely with professional bodies, such as the Sustainable Finance Education Charter, to integrate transition finance within relevant professional courses. UK financial regulators should also look to follow the example of Singapore's central bank, the Monetary Authority of Singapore (MAS), which worked with the Institute of Banking and Finance Singapore (IBF) to produce 12 technical skills and competencies – including green taxonomies, natural capital, and sustainability reporting – needed for financial professionals to perform various roles in sustainable finance.

Third, the Government needs to provide industry, the finance sector, and investors with certainty around decarbonisation pathways – including policy, regulation and financing mechanisms, to encourage investment and increase the demand for transition finance. For example, industry needs a clear, joined up plan for how, where, and by whom different fuels will be used, with clear guidance around how decisions have been made about prioritising limited technology such as CCUS and green hydrogen. Public financial institutions can also increase private sector demand for transition finance through risk mitigation mechanisms, including co-investment, loan guarantees, and public seed capital/grants.

32) Are there any international examples of best practice in providing the right ecosystem for transition finance that can be drawn on?

Since transition finance is still in its nascency, there are few concrete examples of international best practice to draw from. One country, though, which has made a concerted effort to build a supportive ecosystem for transition finance is Singapore.

In Singapore's Green Plan 2030, Singapore set the target becoming "a leading centre for green finance and services to facilitate Asia's transition to a low-carbon and sustainable future". To achieve this target, Singapore's central bank, the Monetary Authority of Singapore (MAS), has developed a Finance for Net Zero Action Plan (FiNZ) with four strategic outcomes:

info@aldersgategroup.org.uk www.aldersgategroup.org.uk

1) Promote consistent, comparable, and reliable climate data and disclosures to prevent greenwashing and guide decision making.
2) Engage with financial institutions to foster sound environmental risk management practices.
3) Support financial institutions to adopt credible, science-based transition plans.
4) Promote innovative and credible green and transitioning financing solutions and markets.

These four outcomes are also supported by two key enablers: one, fintech solutions to help solve problems in sustainable finance, and two, skills and capabilities to create a pipeline of talent in sustainable finance.

There are two key lessons the UK can draw from Singapore's approach to transition finance:

1) Proactively deploy regulators. In Singapore, MAS takes the view that "regulators have a role in facilitating sound transition planning and has proposed supervisory guidelines for banks, insurers, and asset managers".
2) Work collaboratively with the financial ecosystem. MAS has sought to galvanise collective action from across the financial ecosystem, including financial institutions, industry, the professional services sector, and international partners. The Singapore-Asia Taxonomy was developed in tandem with industry through multiple public consultations.

33) How can the UK better leverage its existing financial and professional services expertise to support the growth of transition finance capacity and related activity and revenue?

As set out in our answers to questions 20 and 31, a lack of skills represents a barrier which limits the ability of companies to access or deploy capital/financial services to support a credible net zero transition.

To support the growth of transition finance capacity, the Government should work closely with professional bodies, such as the Sustainable Finance Education Charter, to integrate transition finance within relevant professional courses. UK financial regulators should also look to follow the example of Singapore's central bank, the Monetary Authority of Singapore (MAS), which worked with the Institute of Banking and Finance Singapore (IBF) to produce 12 technical skills and competencies – including green taxonomies, natural capital, and sustainability reporting – needed for financial professionals to perform various roles in sustainable finance.

34) Do you think the UK government could make better use of blended finance approaches to de-risk and scale up transition finance? Why / Why not? If yes, please explain.

Well deployed, blended finance can help to overcome a range of investment barriers, reduce risk, and leverage multiples of private investment for every £1 of taxpayer money spent.

The UK Government should ensure that public financial institutions are setting sufficient guardrails to ensure that blended finance tools contribute to credible transition pathways and are not used to invest in high-carbon activities.

In 2021, the Wood Group (an international engineering company) secured a £430 million loan with UK Export Finance as part of the Transition Export Development Guarantee, a facility aimed to support UK exporting companies to invest in low-carbon growth markets. After receiving the loan, however, the Wood Group grew its upstream oil and gas business by 17% (increasing revenue from $2.6bn in 2021 to $3bn in 2022) and reduced the size of its renewable, hydrogen, and carbon capture business units by 35% (decreasing revenue from $344.6mn in 2021 to $222.8mn in 2022). For more information, see *Guardian, 2023: UK firm given £430 green transition loan then expanded oil and gas business*.

35) Do you think the UK's public finance institutions could play a greater role to de-risk and scale up transition finance. If yes, please provide examples?

Public financial institutions (such as UK Research & Innovation, UK Infrastructure Bank, and the British Business Bank) have an important role to play in de-risking and scaling-up transition finance through various mechanisms, such as co-investment, loan guarantees, and public seed capital/grants.

Public financial institutions, though, are limited by their capitalisation. The UK Infrastructure Bank, for example, was provided with up to £22 billion of financial capacity over its first five years by HM Treasury, which is a reduction on the level of investment the UK formerly received from the EU's European Investment Bank. To ensure public financial institutions can play a greater role, their capitalisation and risk appetite must be increased over time.

36) Do you think there is a role for the UK to facilitate the development of global thought leadership on transition finance, and if so, what strategies could it employ to influence and facilitate this development?

Since the UK has an ambition to be the 'world's first net zero-aligned financial centre', with London ranked as the top financial centre for green finance (*Long Finance & Financial Centre Futures, 2024: The Global Green Finance Index 13)*, there is a compelling case for the UK to facilitate the development of global thought leadership on transition finance.

One way the UK Government can influence and facilitate global thought leadership on transition finance is by championing the transition plans internationally, including through the promotion of the TPT's Disclosure Framework as a 'gold standard' that other countries can draw upon, and ensuring alignment – where possible – with international sustainability disclosure standards, such as the EU's Corporate Sustainability Reporting Directive and the IFRS' S2 Climate-related Disclosure Requirement.

info@aldersgategroup.org.uk www.aldersgategroup.org.uk