TheCityUK Response to Transition Finance Market Review Call for Evidence

About TheCityUK

TheCityUK is the industry-led body representing UK-based financial and related professional services. We champion and support the success of the ecosystem, and thereby our members, promoting policies in the UK and internationally that drive competitiveness, support job creation and enable long-term economic growth. The industry contributes 12% of the UK's total economic output and employs over 2.4 million people – with two thirds of these jobs outside London across the country's regions and nations. It pays more corporation tax than any other sector and is the largest net exporting industry. The industry plays an important role in enabling the transition to net zero and driving economic growth across the wider economy through its provision of capital, investment, professional advice and insurance. It also makes a real difference to people in their daily lives, helping them save for the future, buy a home, invest in a business and manage risk.

Executive Summary

- Transition finance is an economy-wide issue that is dynamic and continually evolving. The transition to net zero is not a point-in-time assessment, but a process that is context and location specific, with different jurisdictions at different starting points and transition stages.
- Greater clarity on the scope of transition finance would be helpful to deliver more consistency across sectors and jurisdictions. Any recommendation should be suitably broad and adaptable for use in multiple contexts.
- Transition finance should be directed towards economic activities that are compatible with a credible net zero transition, in particular those activities in high-emitting and hard-to-abate sectors.
- Transition plans and taxonomies can provide helpful tools to support the provision of transition finance by allowing informed decision making.
- A lack of favourable conditions in the real economy and policy measures to support transition activities are key barriers to accessing and deploying transition finance.
- Government has a critical role to play in creating a supportive ecosystem for transition finance by creating the right economic conditions to make investments commercially viable and introducing policy measures and incentives to enable private finance to be directed to transition activities.
- Government should optimise blended finance solutions to de-risk investments and generate the necessary flow of transition finance as these solutions can play a key role in addressing investment risks in transition finance.
- Public finance bodies and multilateral development banks (MDBs) can play a key role in de-risking and scaling transition finance.
- The financial and related professional services industry is crucial to the provision of transition finance both domestically and globally. Government should focus on making the UK an attractive destination for transition finance.
- There is an opportunity for the UK to lead by example through its approach to transition finance.

Call for Evidence Questions

Chapter 2 – Scope of transition finance

Q1) Do you consider there to be a lack of clarity around the scope of transition finance? Why / Why not?

TheCityUK considers that there is a need for greater clarity on the scope of transition finance, in particular the means to deliver the results consistently across all sectors and jurisdictions. At present, there is uncertainty over what is and is not within scope of transition finance. There is potential for better articulation of what "transition" investments are for the purposes of understanding and measuring finance flows and providing more insight into how finance is supporting the transition.

Transition finance is an economy-wide issue that is dynamic and continually evolving as targets shift, new technologies become available, and science develops. The transition to net zero is not a point-in-time assessment, but a process that will play out over decades and is context and location specific, with different jurisdictions at different starting points and transition stages. A recent paper by the International Capital Market Association (ICMA) on 'Transition Finance in the Debt Capital Market' characterises the transition as a "theme" and identifies three overlapping definitions of transition finance: (i) economy-wide transition, (ii) climate transition, and (iii) hard-to-abate transition.[1] These can be differentiated from the wide lens of the transformation of the entire economy with the objective of meeting the Paris Agreement goals, to the narrow lens of specific challenges involved in reducing the emissions of hard-to-abate sectors.

While greater clarity around the scope of transition finance would be helpful, a framework that is too rigid or restrictive could create confusion and negatively impact the ability of investors to allocate capital to the transition. To foster consistency, the Transition Finance Market Review (the "Review") should develop a recommendation that is suitably broad and adaptable for use in multiple contexts (e.g. taxonomies, transition plans, financial instruments etc.).

Q2) Have you faced challenges in accessing or deploying transition finance because of a lack of clarity around its scope?

It can be difficult for high-emitting and hard-to-abate companies to raise transition finance because of the lack of consensus on acceptable and credible technologies and trajectories, and "greenwashing" fears for issuers and investors. For example, investors find it challenging to explain why they are financing fossil fuel companies instead of renewable projects, even if the funding is dedicated to decarbonisation. In some instances, there is not a clear understanding that transition finance is required to facilitate lower carbon pathways. These pathways may not, in the first instance, be fully green and/or net positive (for example, they may still involve emissions, but have an overall lower carbon footprint). Nevertheless, financing such pathways is crucial to meeting the transition challenge.

Alongside a lack of clarity around the scope of transition finance, key barriers to accessing or deploying transition finance include the lack of favourable conditions in the real economy, and lack of

[1] International Capital Markets Association (ICMA), February 2024, 'Transition Finance in the Debt Capital Market'

government policy to create opportunities for finance and investment to support transition activities. The government has a key role to play in addressing this through creating the right conditions and policy environment to catalyse transition activity across the entire economy.

Q3) 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.

Transition finance should include all sectors of the economy, to the extent that it is part of a credible net zero transition. However, it is important to recognise that some sectors have a more significant role to play, and activities and interventions should prioritise carbon intensive sectors, covering both green and transition activities (such as renewables, carbon capture, sustainable aviation fuel, hydrogen, and green buildings). Transition finance will be most effective if it is directed at sectors that are at the heart of the transition: food and fuel. These include but are not limited to: (i) heating and cooling, (ii) electricity, (iii) mobility, (iv) products/materials, and (v) agriculture.

Different financing needs are required for different technologies and projects. We encourage the Review to explore and map these investment needs, alongside minimum safeguards to ensure that transition finance does not unnecessarily prolong the life of legacy assets.

Q4) 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?

We consider that the key focus of transition finance activity should be to support the credible net zero transition of hard-to-abate and high-emitting areas of the economy. These sectors are often the supply chain of the wider economy, and their decarbonisation journey is essential to ensuring the UK's wider economic transition aligns with the UK's net zero target and Paris Agreement goals.

The World Economic Forum (WEF) states that heavy industry (cement, steel, chemicals, and aluminium) and heavy-duty transport (shipping, trucking, aviation) are together responsible for nearly one-third of global CO_2 emissions – this is expected to double under business-as-usual scenarios.[2] Significant financing is therefore needed to decarbonise their operations and innovate low carbon production processes and transportation.

To align with net zero targets, we need to accelerate access to capital required to facilitate progressive emissions reductions for hard-to-abate and high-emitting areas of the economy. Nevertheless, the financing of hard-to-abate sectors should not be to the exclusion of other areas of the economy and activities which are critical to the transition and require investment.

Q5) Do you agree with the approach that transition finance includes all types of economic activity that are compatible with a credible net zero transition? Why?/Why not? If not, please specify which should be excluded and why.

We recognise that transition finance is necessarily less clear cut than green finance. As such, the approach should be flexible and capable of accommodating a broad range of economic activities and different pathways to achieving net zero across different sectors and jurisdictions as required.

[2] World Economic Forum, July 2020, "Unlocking the Hard to Abate sectors"

However, it is also important to ensure that transition finance is used by a company for activities that are compatible with a credible net zero transition.

Transition finance should be directed towards economic activities that are compatible with a credible net zero transition, in particular those activities in high-emitting and hard-to-abate sectors (e.g. fossil fuels, mining extraction, cement manufacturing and aviation). This includes, for example, specific investments in transition technologies for hard-to-abate sectors and the financing of climate solutions and enablers. However, any approach to transition finance should also avoid excluding certain activities which are critical to the transition but may have high greenhouse gas (GHG) emissions, for example lithium mining for batteries.

Q6) Do you agree with the approach to not demarcate between 'transition finance' economic activities and 'green finance' economic activities? Why?/Why not?

While this remains a topic of discussion among our membership, we broadly consider that it is helpful to recognise the difference between 'transition finance' economic activities and 'green finance' economic activities. There are many overlaps between the two sets of activities, and both aim to promote improvements to environmental outcomes of companies. However, there are also some key distinctions.

- The purpose of 'green finance' is to finance projects and initiatives that have positive environmental impacts, such as reducing GHG emissions and promoting renewable energy.
- The purpose of 'transition finance' is to help companies align with the Paris Agreement goals by providing the capital needed to facilitate progressive emissions reductions and transition to sustainable systems and practices. There is, therefore, a case for transition products that can clearly and transparently demonstrate that they are investing in key processes for the transition.

The policy architecture needs to allow for both sets of economic activities. Transition finance also needs to dovetail with green finance. This is necessary to ensure that transition activities can access finance even though they are not deemed 'green', and so that there is no gap in the middle preventing investment for companies that have become 'greener' to progress to being 'green'. From a market disclosure perspective, it is also important to have a demarcation to make clear where finance contributes to the transition (even though it is not 'green'). This is useful for financial services providers to assist them in justifying, for example, why they are still financing activities in the hard-to-abate sector, and to mitigate actual or perceived greenwashing risks.

In practice, it is unlikely to be helpful to develop an exhaustive demarcation. However, a conceptual delineation between these two economic activities could be helpful if it is pragmatic and principles based, so that it accommodates future innovation, does not unintentionally exclude certain activities, and so that these concepts do not quickly become outdated.

Q7) 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.

Yes, TheCityUK considers transition finance to be an economy-wide issue and widely applicable across a range of financial products and services that support the net zero transition. Therefore, a more holistic view should be adopted.

Q9) 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 consider that non-emissions-based and non-climate-based considerations should not be excluded from transition finance. Nature, climate, and biodiversity are all inter-linked and it is important to not treat them separately. However, we do not consider that non-emissions-based and non-climate-based considerations should be a mandatory part of transition finance activities. At present this is not operationally feasible at scale and could risk stranding certain businesses and clients from access to transition finance activities.

Chapter 3 – Ensuring the credibility and integrity of transition finance

Q10) 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?

Yes, we consider that good quality transition plans aligned with the Transition Plan Taskforce (TPT) Disclosure Framework can provide a helpful tool to support the provision of transition finance and progress towards net zero. TheCityUK is strongly supportive of the TPT and pleased to see the progress made within a short time.

In terms of the role of TPT-aligned transition plans, transition plans establish trust (i.e. credibility and integrity) and provide useful information about what an investee company sets out as its long-term strategy to achieve its climate related goals. A transition plan provides a baseline against which a company's progress can be assessed over time. It will help investors assess where a company is relative to portfolio trajectories and the approach taken to managing financially material risks, thus enabling the investor to make more informed decisions. For these reasons, we consider good quality transition plans to be a key enabler of transition finance – providing a basis on which investors and lenders can confidently proceed in providing transition finance. Transition plans also enable companies to credibly demonstrate that they are progressing on net zero goals, for customers, reputation, investors or otherwise.

While transition plans provide useful information to the market, we do not consider that they will in and of themselves drive transition finance. For example, a company having a transition plan in place will not ensure that the company will be able to deliver on that plan. Commercially viable opportunities to invest in the transition are also needed.

Furthermore, although transition plans will provide an important tool for businesses and investors, it will take time for the necessary skills and knowledge to be embedded in organisations, particularly in SMEs. Therefore, it will be important to take a phased approach and consider alternative methods to determining robust transition activities and transition finance for SMEs.

As regards the international arena, the TPT remains an example of best practice and individual countries and regions will need time to develop and incorporate disclosure frameworks and guidance. Firms will also need to be able to flex their approach based on jurisdiction. However, it will be important for the UK to engage with international organisations and standards setters to encourage

global convergence in transition plan expectations and frameworks to ensure as much international harmonisation as possible.

Q11) Which core transition principles, such as transition plan disclosures, science-based targets, and capital allocation plans, and other key metrics and tools for assessing the credibility and integrity of transition finance do you consider essential for its success? Please describe these in detail.

We are supportive of the standards, tools and guidance included in the call for evidence. They are instrumental in promoting consistency and helping to improve the quality of transition plans and climate reporting. These tools and the accuracy of reporting will continue to evolve over time and these standard setters help drive progress. For example, we note the importance for companies and sectors of a clear approach to Scope 3 emissions in transition planning and transition finance.

The disclosure of specific science-based temperature and decarbonisation targets (Science Based Target initiative (SBTi) verified) with regular progress reporting is important in helping to assess a company's current position against various climate scenarios (e.g. the Network for Greening the Financial System (NGFS) Net Zero 2050), as well as enabling forward projections in the form of implied temperature rise scores (ITR).

The use of a standardised set of scenarios (such as NGFS) and metrics (such as ITR score) which can take into account historical and current progress, together with ambition and potential for a company to meet its targets, allows markets to assess the relative performance and credibility of an individual company's transition plan.

Q14) Do you consider there to be a role for regional or national pathways to be incorporated in transition finance standards, frameworks or guidance? Why / Why not? Please describe any international examples.

The UK should continue to work towards greater harmonisation of standards at an international level and work with the international community to ensure these standards take into consideration different regional pathways. Given that banks, asset managers and institutional investors operate globally to such a significant extent, international standards have clear benefits from an efficiency and trade perspective. There is also a benefit in terms of achieving global net zero goals – i.e. credible information generated by companies in the real economy in developing countries in line with international standards is likely to support access to transition finance from international firms.

However, this may take a considerable time to develop, and we should not let "the perfect be the enemy of the good". It is therefore necessary to find ways to make progress, even if not all aspects of what is proposed are perfect. For this reason, in our view:

- Regional and national pathways should be embraced and encouraged in practice as there is no standard pathway to meet net zero;
- There must be acceptance that a company's decarbonisation trajectory may move at different speeds across different jurisdictions and may not be consistently linear due to wider external factors; and
- Thought should be given as regards interoperability of standards, cross-mapping to identify common ground, and equivalence mechanisms or similar concepts so that it is acceptable (from a reputational perspective and from a regulatory perspective) for a company to

recognise domestic pathways and frameworks, rather than necessarily requiring a third country investee to adhere to UK standards.

Q15) 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?

We appreciate that taxonomies do not come without complexities in terms of interoperability and useability, and some impose requirements that are stringent and far-reaching, such that they are not easily usable. However, we consider that this was largely unavoidable given their novelty as a concept.

The outcome of these developments in our view is that:

- Taxonomies can provide a helpful tool to promote trust and confidence. A green/transition taxonomy could therefore play a useful role in helping the market to distinguish between what is and is not eligible for transition finance and providing useful information to investors.
- Attention should now be turned to how taxonomies can best evolve and draw upon lessons learnt, so that they can achieve their potential, evolve with emerging transition and climate technologies, and avoid adding to the tapestry of divergent approaches.

In addition, the UK should continue to seek international consensus on how taxonomies can best interact. This is important because (for example) a UK fund seeking investors on a transition finance strategy, investing in companies (for example) in Singapore, Brazil, and Vietnam: (i) to the extent there are taxonomies in each of these four countries, must find a viable way for them to interact; and (ii) if there is not a taxonomy in a particular investee country (the "third country"), the taxonomy in the fund's country (the UK) must be workable or viable for use in that third country.

In our view, this is a critical strand, so that taxonomies can best be leveraged to support the mobilisation of transition finance globally.

Q16) What are the specific challenges in ensuring both the credibility and integrity of transition finance, whilst addressing the contextual needs of local decarbonisation pathways? What can the UK market for financial and professional services do to address these challenges?

We recognise that local decarbonisation pathways are designed to meet the needs of individual jurisdictions. We suggest that the Review consider how to ensure that definitions of "transition activities" are sufficiently comprehensive to cover the variety of activities that need to be undertaken in a local context, and pay due regard to just transition considerations, so that as far as possible no credible transition activity misses out on accessing finance.

In addition, different countries have different local law requirements. For example, in the case of a transition finance fund being established in the UK:

i. The investors in the fund will wish for credibility and integrity in the fund's internal processes and procedures, so they have confidence that the transition finance purpose of the fund will be properly executed and monitored;
ii. They may also have needs or preferences in terms of policies within investee companies on broader environmental and social matters; and

iii. The fund may wish to invest in or make loans to investee companies in developing countries, where (a) climate change related statutory reporting does not apply; and (b) the approach to environmental and social requirements and disclosures is evolving.

This is a routine challenge for banks, asset managers and institutional investors lending into or investing in developing countries. However, we encourage the Review to investigate this challenge and include specific recommendations to remove some of the practical barriers to firms fulfilling transition finance needs in developing countries.

Q17) Do you think there is a need for different approaches to transition finance across different jurisdictions, considering they may have different transition pathways?

We consider that jurisdictions may place varying levels of importance on different transition activities, and therefore require finance to flow towards different transition activities. However, there should be commonalities in approaches to transition finance across different jurisdictions. We would encourage the Review to identify these commonalities, so as to pave the way for the UK to play a role in the provision/facilitation of transition finance internationally.

In addition, we consider that it is not just about the fact that different jurisdictions may have different pathways per se. The issue also arises from differences in local law, industrial needs, and levels of sophistication. For example, it is a barrier to transition finance if the standards imposed on UK-based transition finance providers cannot realistically or readily be fulfilled in relation to investee companies in developing countries. As outlined above, we encourage the Review to investigate this challenge and include specific ideas on how to address it.

Q19) 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?

We consider that it will not be possible for the UK to become a leader in transition finance if it does not bring the economies that need to transition along with it on the transition journey. There is an opportunity for the UK to learn from the EU here (for example, the EU only rewards compliance with the EU Taxonomy, which only reflects activity in the EU).

Chapter 4 – Barriers to the applications of transition finance

Q20) 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?

Yes, we consider there to be several barriers limiting the ability to access or deploy capital or financial services to support a credible net zero transition:

- Absence of policy measures and incentives (e.g. grants, blended finance mechanisms, tax incentives) to encourage capital expenditure by corporates and/or make transition finance projects commercially attractive to investors;
- Limited public sector involvement and policy leadership to help identify and de-risk investments to kickstart the market;

- Uncertainty/delay from government in progressing key initiatives (e.g. transition plans and adoption of ISSB standards);
- Lack of sectoral and technology roadmaps with public policy support and private sector buy-in;
- Lack of favourable economic conditions to make investments commercially viable;
- Existing barriers to finance in developing economies (bankability);
- Differences in local law requirements and levels of sophistication across different jurisdictions;
- Limits at present for third party assurance around reports, information, data provided for due diligence and ongoing monitoring;
- Reputational risk due to concerns around greenwashing;
- Lack of regulatory certainty – i.e. in a rapidly developing area, the laws and regulatory requirements in force now may be different to those in force in 5 -10 years. This may be a particular point of concern for longer term projects/investments, although these areas are where transition finance could have the most impact and are essential to achieving the net zero transition; and
- Limited coverage of the UK Emissions Trading Scheme (ETS), meaning that most companies do not have a carbon price.

Q21) What barriers or disincentives do you face in providing or accessing investments, products, and services for transition finance?

The current absence of policy incentives and long-term policy certainty are key barriers to accessing transition finance opportunities. The government needs to create the right economic conditions to make investments commercially viable and opportunities for finance to support transition activities. This includes putting in place the right policy measures and incentives (e.g. blended finance mechanisms to de-risk and crowd in investment) to kick start the market (successful examples include the Low Carbon Contracts Company).

The lack of standardisation and different local law requirements also creates barriers to accessing transition finance in terms of cost and risk. For example:

- If a UK lender or fund manager wishes to provide transition finance to an investee company, it must conduct due diligence on the opportunity. At present, there is limited standardisation on how to determine whether an activity is a "transition activity".
- If there is no transition plan or reporting/disclosure on relevant issues, this also presents barriers – i.e. practical requirements must be considered on a case-by-case basis, by contract.
- The lack of standardisation also gives rise to cost and delay for both the transition finance provider, and the investee company.

Another key area of concern is the risk of greenwashing, or the perception of greenwashing, and the potential reputational impacts. Concerns around greenwashing risk may lead companies not to disclose information around their activities. Increased clarity on the principles and parameters of transition finance, including regulatory expectations, could help address this challenge.

Overly stringent regulations could also inadvertently hinder capital flows to sectors that need investment for sustainable transformation. If businesses perceive the regulatory environment as too restrictive, they may be discouraged from pursuing necessary changes due to the increased complexity and cost of compliance. This could lead to a slower pace of transition, ultimately delaying progress towards global sustainability goals. While we acknowledge the importance of rigorous standards, it is

important to appreciate that transition finance inherently presents shades of ambiguity. To navigate this, a more adaptable and measured regulatory framework is necessary that recognises the complexities involved. It will also be crucial for supervisors to acknowledge that assessments are often made at specific points in time. To that, as technologies and pathways evolve, a degree of "grandfathering" will need to be considered. This would allow businesses to continue with activities that were approved before the implementation of new regulations for a limited period, and therefore time to adjust.

Q22) 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?

The Low Carbon Contracts Company (LCCC) serves as a good example of leadership from the government to attract investment. In 2011, the government estimated that around £100 billion of investment would be needed by 2020 in the electricity sector alone, to replace the UK's ageing power stations and create secure, low-carbon electricity at a cost-effective price. To attract this investment, the government set up a programme consisting of a contract for difference (CfD) scheme and a capacity market. The goal was to build confidence in the market reforms and maintain investor confidence. The success of the initiative has led the government to expand the scope into carbon capture, utilisation and storage (CCUS), low carbon hydrogen production, and the nuclear regulated asset base (RAB) model.[3]

Q25) Do you consider there to be gaps in the provision of advisory or transactional services (e.g. legal, consulting, data provision, or analytical support services) that you need to support your approach to transition finance? If so, what are these and what recommendations would you have to develop these?

The reporting of company level emissions data has continued to improve globally in terms of both the number of companies reporting and the quality of reporting. However, gaps in reported data remain an issue often cited by market participants. These data gaps can be addressed with inferred data. The models used to infer emissions data also continue to improve along with the reported data, which is used as an input. Higher quality and more frequently reported data enables the increasingly sophisticated models to consider more company specific nuances.

These inference models are not only used to fill in the gaps for incomplete reported data, but to also produce a full emissions profile for non-reporting companies, including listed, unlisted, and private companies as well as SMEs. A full set of emissions data across Scope 1 and 2, and all 15 categories of Scope 3, can be inferred for non-reporting companies and enterprises.

Q26) Do you consider the availability or cost of developing viable capital projects to be an issue for the access or deployment of transition finance? If so, please provide examples and highlight any good examples of efforts to address this.

Yes, with regard to the UK, we consider the availability or cost of developing viable capital projects to be an issue for the access or deployment of transition finance. The cost of capital for nascent technologies (e.g. hydrogen and carbon capture, utilisation, and storage) required for the transition

[3] Low Carbon Contracts Company, "How it all started"

to net zero of specific companies is often more capital-intensive than for tested technologies where the risk is significantly lower. In the current economic environment, less capital is being raised in general and investors are more risk-averse when investing in capital-intensive projects for nascent technologies. The UK, alongside South Korea, the US and China saw a year-on-year percentage decline in climate-tech corporate financing in 2023. While China saw a 51% drop in 2023, it remains the biggest market for climate-tech and the only region where the majority of funding comes from the public market.[4]

The significant degree of risk and uncertainty associated with low-carbon technologies and climate solutions needed for the transition makes long-term investments in these sectors commercially unviable at present. Public finance can play a key role addressing this, through providing early-stage investment and creating the right risk/reward profile to attract private investors. Examples of public guarantees and instruments that could play a role in mobilising more capital for the transition include CfDs and RAB models (such as the LCCC referenced earlier).

There is a key role for MDBs and public finance institutions to play in identifying viable transition finance projects, providing early-stage investment, and making such projects commercially attractive to the private market. The recent $5 billion green bond for battery maker Northvolt, co-led by J.P Morgan, was enabled by public-private financing from the European Investment Bank (EIB) and exemplifies the key role that MDBs can play in mobilising private finance for the transition.[5] The UK Infrastructure Bank (UKIB) will be a crucial player in the UK-context, given its mandate to provide £22 billion of infrastructure finance and partner with the private sector and local government to support the transition to net zero in the UK.

Q27) 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.

We would welcome special consideration for UK SMEs in the review, as we believe there is significant potential for progress, and they are a key area that needs to be addressed in relation to net zero goals in the UK.

If large UK corporates face challenges in terms of developing and executing robust and reliable transition plans and developing ways to generate reliable data internally (both for their own use, and for the use of lenders, investors, and other stakeholders), these challenges are much more acute for SMEs. Given their size, they will necessarily have more limited resource and it is likely that they may take more time to build the capability and expertise.

Policymakers should therefore help catalyse solutions in the real economy by convening public-private partnerships to solve for data issues. Addressing this issue is an industry-wide challenge. One initiative that aims to address this is the Monetary Authority of Singapore (MAS) and Singapore Exchange (SGX Group) jointly launching ESGenome.[6] This is a digital disclosure portal for companies to report Environmental, Social and Governance (ESG) data in a structured and efficient manner that will allow

[4] Bloomberg, 2024, “Energy Transition Investment Trends 2024”
[5] J.P Morgan, February 2024, “A $5 billion supercharge for battery maker Northvolt”
[6] Monetary Authority of Singapore, September 2022, “MAS and SGX Group Launch ESGenome Disclosure Portal to streamline sustainability reporting and enhance investor access to ESG data”

investors to access such data in a consistent and comparable format. We recommend that policymakers consider this approach.

Furthermore, the system needs to be designed to help SMEs get started. The burden of proof for SMEs to report against frameworks should be proportionately lower, with corresponding proportionately afforded to larger corporates who will rely on the data provided by SMEs in their supply chain. Another potential solution to support SMEs could be to consider a tailoring and materiality assessment for SMEs, following implementation of transition plans in larger firms. SMEs could also be invited to report under a small set of metrics in the short term, with additional metrics added on a sector-by-sector basis as capacity is built and input from SMEs is sought and reflected.

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

Q28) What good examples are there of effective investments, products, mechanisms (e.g. results-based payments) and services for deploying transition finance to date? Are there opportunities to scale up or replicate these further?

The following products were identified as examples of effective products and mechanisms: social impact bonds (SIBs), supply chain financing, 'first of a kind' projects, and risk distribution products.

Carbon credits were also identified to be a form of result-based mechanism to enable transition finance. For example, the Monetary Authority of Singapore (MAS) has proposed to use high-integrity transition credits to accelerate the early retirement of coal-powered plants. In September 2023, MAS and McKinsey & Company jointly published a paper setting out how high-integrity transition credits could potentially close the economic gap and be utilised as a complementary financing tool to accelerate and scale the retirement of coal-fired power plants.[7]

Q29) Are there any needs or use cases that are not being met by the current instruments? Are new or additional financing strategies, market tools, practices or products needed?

There is a need to examine the relationship between transition finance and carbon pricing. Sectors subject to the Emissions Trading Scheme (ETS) are required to convert their physical emissions into a financial liability (these are energy intensive and hard-to-abate sectors which are the key focus of transition finance). When they buy an emission allowance, they offset that financial liability and therefore pay to use the atmosphere. The cost companies incur when they buy allowances – together with the diminishing allowances over time – creates an incentive for companies to invest in reducing their emissions so that over time they need to pay for fewer allowances. Many companies employ a carbon price so that they can create a more accurate relationship between their emissions and their balance sheet.

Companies in sectors outside of the scope of the ETS do not have a compliance obligation to see their emissions as a financial liability. These companies, therefore, do not price the cost of their emissions into their decision-making and there is a reduced incentive to reduce emissions. This is a barrier to

[7] Monetary Authority of Singapore, "Working Paper on Accelerating the Early Retirement of Coal-Fired Power Plants through Carbon Credits"

driving corporate climate action and directing finance to decarbonisation efforts. We suggest the Review look at how carbon pricing can support credible transition finance.

Q30) 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 products need to demonstrate alignment to emerging industry standards, for example referring to common terms such as the Science Based Target initiative (SBTi), and principles from existing voluntary regimes such as the International Capital Markets Association (ICMA) and the Loan Market Association (LMA). Labelling should explain the purpose and goals of each product in a manner that is clear, fair, and not misleading. It should also do so in a manner that complies with the suitability tests that need to be applied.

Labelled instruments could use a carbon price as a KPI to establish an economical relationship between the instrument and the way in which it is used by the company. This is particularly important for hard-to-abate sectors that are part of the ETS and are likely to have a carbon price.

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

Q31) How should 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.

The government has a critical role to play in creating a supportive ecosystem for transition finance in the UK. It should promote the importance of transition finance as part of the net zero transition and create favourable conditions for investment in the real economy. It also needs to put in place the right policy incentives to enable the redirection of private financial sources to activities that encourage the transition and decarbonisation of high-emitting activities.

Key steps that should be considered by government to foster a more supportive ecosystem include:

- **Policy conditions.** Development of a long-term net zero strategy to provide policy clarity and create the right conditions to make the transition commercially viable.
    - New, or existing, policy tools to ensure private investment is aimed at, and supports, activities which target priority areas for the transition (e.g. UK mirroring the EU's Infrastructure Supporting Factor or consideration of alternatives (e.g. tax credits) to remain competitive).
    - Creation of long-term transition finance products to support long-term targets.
    - Increased investment in R&D and innovation.
    - Expand the scope of the ETS so that more sectors are exposed to the carbon price.
- **Blended finance.** Introduction of a broader range of blended finance solutions to secure capital from the maximum range of investors, catering for the appetite from debt and equity markets, and ensuring risk/return offers are available to short and long-term partners.
    - Partner with traditional and non-traditional financial institutions to expand the range and accessibility of financial strategies available.
    - Review frameworks and regulations governing blended finance in the UK to ensure they are optimal for scale-up of transition finance (e.g. the EU's Undertaking in Difficulty regulation in relation to State aid).

- **Regulatory framework and corporate reporting.** Sufficient infrastructure and a clear regulatory framework that supports the market (e.g. clarity on use of TPT Disclosure Framework).
  - Creation of a 'UK best practice' approach to transition finance to be applied to the most appropriate corporate sectors.
  - Support for proposals to develop standardised investment terminology and consistent corporate reporting on transition.
- **Skills and capability.** Action is needed to enhance skills, knowledge, capability and capacity across national and regional government and public bodies – including greater understanding of how the private sector works.

Q32) Are there any international examples of best practice in providing the right ecosystem for transition finance that can be drawn on?

There are evolving approaches to transition finance across certain corporate sectors in Japan, Singapore, the US, Canada, and Australia that we would encourage the Review to consider. Recent developments in Japan are particularly interesting.

- The Japanese government has introduced the transition as an industrial policy rather than a sustainability policy, with a framework that has been designed like an industrial plan.[8]
- In 2023, Japan launched their Green Transformation (GX) programme and Climate Transition Bonds Framework.[9] The GX programme is a public-private partnership which seeks to catalyse $1 trillion of investment over 10 years towards reaching its nationally determined contribution.
- The Japanese government has created 10 net-zero technology roadmaps and an overarching "Basic Policy for the Realisation of GX", which will include roadmaps for the decarbonisation of 22 sub-sectors.
- Japan's Climate Transition Bond has been certified by the Climate Bonds Initiative (ClimateBonds) and is identified as an example of global best practice.[10] Significant financial support will go into R&D, with 55.5% of the use of proceeds earmarked for R&D of 'deep green' activities needed to facilitate the transition (e.g. low-carbon buildings, batteries, solar cells, and hydrogen). The remaining 44.5% of the funds will support decarbonisation objectives. The structure has been fully aligned with the ICMA Green Bond Principles and its Climate Transition Finance Handbook. Certification by ClimateBonds adds an additional layer of credibility.

Further international examples include:

- The US Department of Energy launched a consortium to bridge early demand for clean hydrogen and support the launch of the Regional Clean Hydrogen Hubs (H2Hubs). The consortium will design and implement demand-side support mechanisms for unlocking the market potential of the H2Hubs.[11]

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[8] Capital Monitor, January 2023, "Why Japan embraces transition bonds"

[9] Environmental Finance, February 2024, "Japan leads the way as investors turn their sights to transition impact"

[10] Climate Bonds Initiative, February 2024, "Japan's Climate Transition Bond"

[11] Office of Clean Energy Demonstrations, January 2024, "DOE selects consortium to bridge early demand for clean hydrogen, providing market certainty and unlocking private sector investment"

- The MAS launched initiatives to (a) use high-integrity carbon credits for the early retirement of coal-fired power plants (see question 28), and (b) create their "Finance for Net Zero Action Plan" which sets out strategies to mobilise financing to catalyse Asia's net zero transition and decarbonisation in Singapore and the region.[12]

Q33) 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?

To better leverage the expertise of financial and related professional services, we consider that the government should focus on making the UK an attractive transition finance market for investors. Financial institutions are crucial to the provision of transition finance through various instruments such as sustainability-linked loans, transition bonds, project finance, and blended finance vehicles. However, the industry is international in nature and companies are looking to invest in projects and companies which are regarded as attractive propositions for likely investment returns. The government needs to focus on creating favourable conditions to make private investment in the transition commercially viable in the UK. This includes developing new innovative financial products (such as a transition or 'greening' bonds) and financing mechanisms (such as blended finance solutions) to de-risk and support the growth of transition finance activity.

To further leverage financial and related professional services, the government should work with the financial services industry to establish financial products, tools, and regulatory frameworks to compete with international competitors (for example, the EU taxonomy or the EU Green Bond Standard) and tap into the demand for investments.

There also needs to be closer linkage and co-working between regulatory imperatives (such as the Sustainable Disclosure Requirements (SDR) and Taskforce on Climate-related Financial Disclosures (TCFD) compliance), the TPT Disclosure Framework, and the application of the UK's Green Taxonomy Advisory Group's (GTAG) taxonomy principles. To further support the growth of transition finance activity and draw on the expertise of financial and related professional services, the government should work with corporations, institutional investors, and downstream financial institutions to create a transition pathway roadmap for the next 3-5 years.

Q34) 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.

The government should optimise blended finance solutions to de-risk investments and generate the necessary flow of transition finance. Government support through blended finance solutions could play a key role in addressing and sharing investment risks in transition finance and scaling investment. Greater deployment of blended finance solutions could also help create the governance and policy frameworks capable of overseeing co-investment and capacity building in transition finance. It could also support project preparation partnerships, risk mitigation and knowledge sharing.

We welcome the government's Net Zero Blended Finance Project and the objective to improve government capacity and expertise to explore innovative blended finance approaches to support the

[12] Monetary Authority of Singapore, April 2023, "MAS Launches Finance for Net Zero Action Plan"

UK's transition to net zero.[13] However, we note that the project is focused on the UK context. The transition to net zero is a global problem with global companies that need to transition. It therefore requires global solutions. Blended finance will be an important mechanism to support the transition to net zero, both domestically and internationally – in particular, in emerging markets and developing economies. We therefore encourage the government to look at opportunities for deploying blended finance approaches to de-risk and scale up transition finance both in the UK and internationally.

Q35) 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?

Yes, there is a greater role for public finance institutions to play in de-risking and scaling transition finance in the UK. According to the Climate Change Committee, for the UK to meet its 2050 net zero target, low carbon investment will need to increase from £10 billion per year to around £50 billion per year by 2030. Public finance institutions could play a key role in scaling finance for low carbon technologies through providing "patient financing" – i.e. long-term financing with no need for high returns in the short term.

Public finance institutions such as the Green Investment Bank (GIB) and the European Investment Bank (EIB) provided a significant amount of finance for climate related projects in the 2010s. They were important in helping the UK develop its onshore and offshore wind industries and energy efficiency measures in infrastructure and housing.[14] Government needs to create more risk-sharing opportunities with the private sector, as it did for offshore wind. This includes through increasing the level of targeted government investment into priority sectors for the net zero transition.

A recent report by the Institute for Public Policy Research (IPPR) highlighted that public finance could play a greater role in mobilising the level of capital required to meet the UK's net zero challenge.[15] In particular, the report identified that UKIB could play a more prominent role through amendments to its risk appetite and mandate. Since the government established UKIB in 2021, it has only provided £0.9 billion of lending and investment to support the UK's transition to a green economy.[16] The current tranche of £22 billion for investment by UKIB must be scaled up further, both in terms of volume and speed. The IPPR report also identified that a potential separate fund, working at an earlier investment stage than UKIB, could provide catalytical capital for high-risk low carbon sectors which are not feasible investments currently.

Q36) 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?

Yes, there is a role for the UK to facilitate global thought leadership on transition finance. There is an opportunity for the UK to lead by example through the approach that the government takes to transition finance domestically. The UK should showcase that, while the solutions at this point might

[13] House of Commons Environmental Audit Committee, November 2023, "The financial sector and the UK's net zero transition: first report of session 2023-24"
[14] UK in a Changing Europe, October 2023, "The UK's green investment gap"
[15] Sam Alvis, Institute for Public Policy Research, February 2024, "Making markets: The City's role in industrial strategy"
[16] UK in a Changing Europe, October 2023, "The UK's green investment gap"

not be perfect, we need to start to move the dial on transition finance. The priority must be mobilising finance towards decarbonising activities at a faster pace and scale to deliver on the Paris Agreement goals.

The UK could further facilitate development of global thought leadership on transition finance through:

- Strong international collaboration (e.g. through the G7, G20, and the International Platform on Sustainable Finance (IPSF)) in creating transition taxonomies that are interoperable and a transition finance framework that works globally;
- Advocating for common implementation of international standards;
- Working with IOSCO and other international bodies to develop trans-regional approaches which also overlap with trade finance;
- Spearheading technology use-cases via the UK’s regulatory sandboxes; and
- Helping to clarify the treatment of transition finance from a legal point of view (particularly in relation to considering transition finance as part of “good governance” arrangements).