

Presentation for ADB's East Asia Forum

Towards a framework for financing climate transition

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Part 1

An Evolving Framework for Transition Finance

G20 Sustainable Finance Roadmap

- The G20 has formed a strong consensus that the financial sector should play a critical role in supporting the **transition of currently GHG-intensive sectors towards net-zero emissions**.
- However, the current green and sustainable finance market, which has been largely focusing on “pure green” activities, has not been effective in channeling sufficient financial resources to transition activities.
- G20 Sustainable Finance Roadmap outlines the need to develop a transition finance framework.



Key Elements of the Transition Finance Framework



**Identification Of
Transition
Activities**



Disclosure



Financing Tools



Incentives



**Mitigating
Negative Social
Impact**

1. Identification of transition activities

Broadly speaking, two approaches are taken for identifying transition activities: **principle-based approach** and **taxonomy-based approach**.

Principle-based approach

- It is used by Climate Transition Finance Handbook developed by ICMA and the Basic Guidelines on Climate Transition Finance released by Japan Financial Services Authority;

The taxonomy-based approach

- It takes the form of a list of specific “transition” or “transitory” activities classified by sector.
- These taxonomies, with varying levels of specificity in terms of technical pathways and emission reduction targets, sometimes reflecting local circumstances and availability of resources, are used by the EU, and China, and considered by many other jurisdictions.

Identification of Transition Activities: Current Practices

Type	Country/Region	Institution	Time	Title
Principle-based	Japan	FSA (Financial Services Authority)	2021.05	Basic Guidelines on Climate Transition Finance
Both principles and taxonomy	Japan	Transition Finance Study Group organized by RIEF (A group of Japanese academic researchers)	2020.10	Transition Finance Guidance
Taxonomy	Singapore	DBS	2020.06	Sustainable & Transition Finance Framework & Taxonomy
Taxonomy	EU	European Commission	2021.04	COMMISSION DELEGATED REGULATION (EU) of 4.6.2021
Taxonomy	China	government of Huzhou City	2022.01	Huzhou Transition Finance Endorsed Catalogue (2022 version)
Taxonomy	China	China Construction Bank	2021.04	China Construction Bank Transition Bond Framework
Both principles and taxonomy	UK	Standard Chartered	2021	Standard Chartered's Transition Finance Framework
Taxonomy	South Korea	Ministry of Environment	2021.12	K-Taxonomy Guideline
Taxonomy	ASEAN	ASEAN Taxonomy Board (ATB)	2021.11	ASEAN Taxonomy for Sustainable Finance-version 1
Taxonomy	Singapore	Green Finance Industry Taskforce (comprising representatives of Singapore-based financial institutions and is convened by the Monetary Authority of Singapore)	2021.01	Identifying a Green Taxonomy and Relevant Standards for Singapore and ASEAN
Taxonomy	UK	HM Treasury	Taxonomy NA / 2021.10	Greening Finance: A Roadmap to Sustainable Investing
Taxonomy	Indonesia	Financial Services Authority (OJK)	2022.01	Indonesia Green Taxonomy

Identification of Transition Activities: Emerging Principles

These approaches should:

help reduce the cost
and transition-
washing risk;

help identify
transition activities
both at project and
entity levels;

be flexible and
dynamic;

timebound emission
reduction targets
should be key
identifiers of
transition activities;

targets be
consistent with the
Paris Agreement;

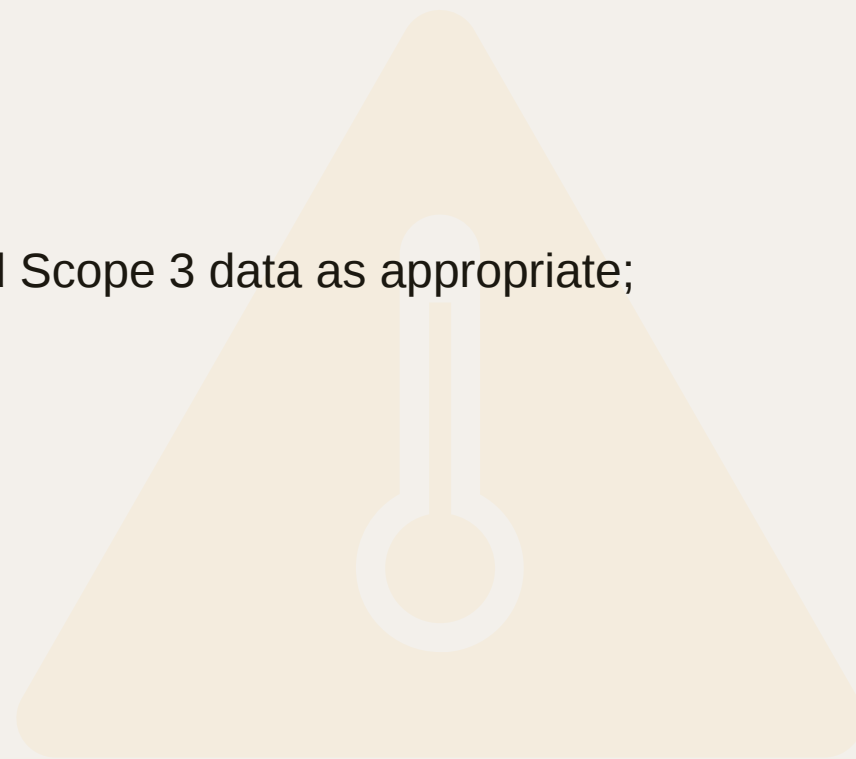
safeguard
measures/“not do
significant harms”;
and

independent
verification if
appropriate.

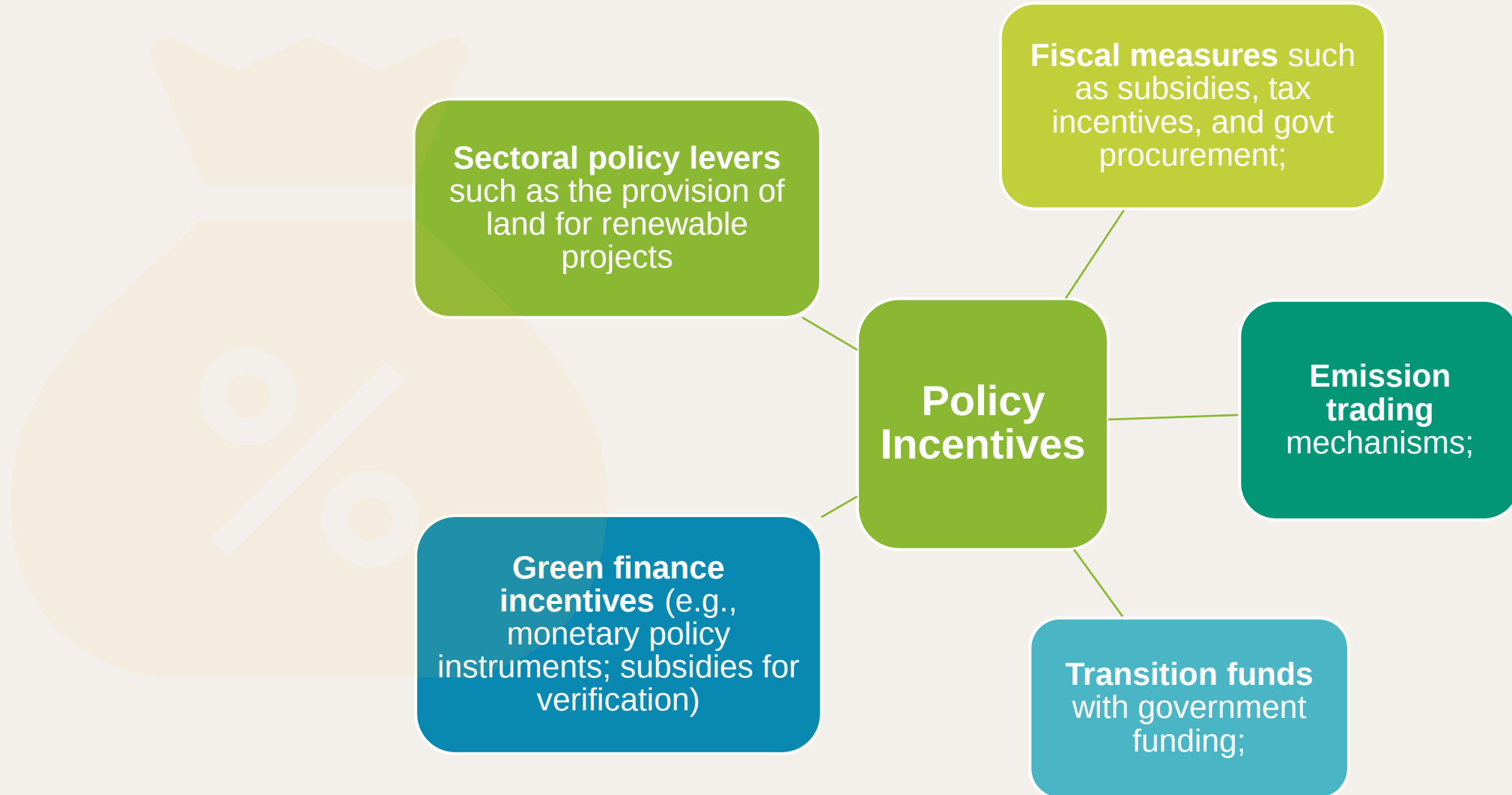
2. Reporting of Transition Activities

There is an emerging consensus that the reporting framework could cover the following elements:

- ❑ Robust transition strategies, goals and timelines;
- ❑ Goals be set as science-based targets;
- ❑ Historical Scope 1 and Scope 2 GHG emissions data, and Scope 3 data as appropriate;
- ❑ Corporate governance to ensure implementation;
- ❑ Progress reporting;
- ❑ Use of proceeds; and
- ❑ Implementation of safeguard measures.



3. Policy incentives



4. Financial Instruments for Transition Activities

Debt instruments - transition and sustainability-linked loans and bonds:

- With clearly specified transition targets;
- Incentives and penalties for outperformance/underperformance against targets, disclosure requirements, use of proceeds requirement, etc.

Equity-related instruments:

- including investments by transition funds, PE/VC funds, buyout funds, and mezzanine financing, that are suitable for companies adopting new technologies, highly indebted companies, and/or SMEs;

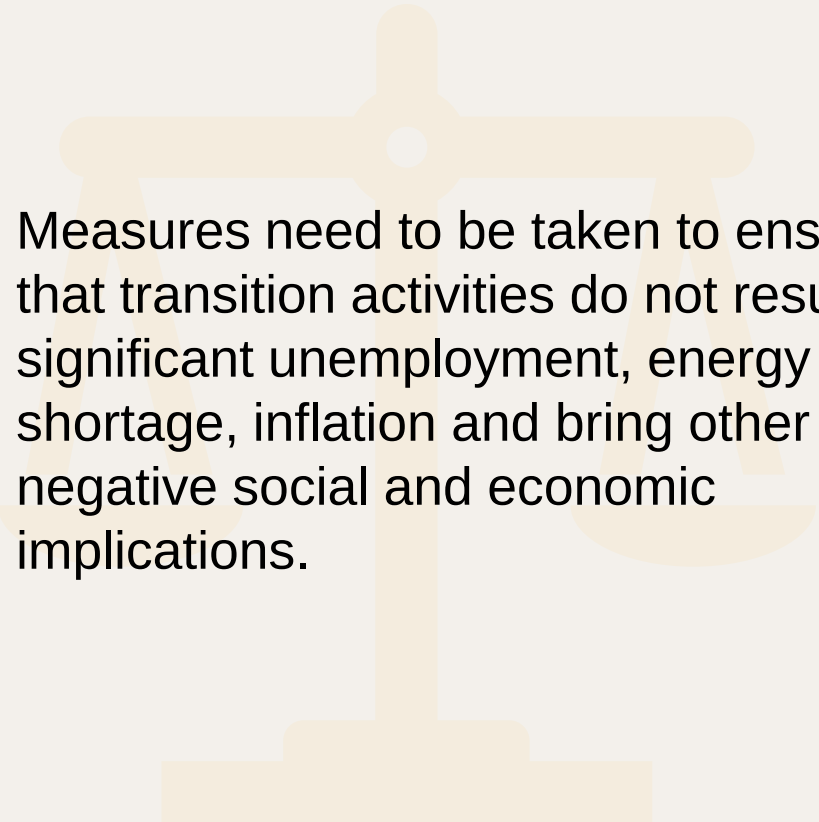
Risk-mitigation products and others.

Sustainability-linked bonds show solid growth in 2021, Transition bonds slower

Climate Bonds



5. Identifying and Mitigating Negative Social Impact



Measures need to be taken to ensure that transition activities do not result in significant unemployment, energy shortage, inflation and bring other negative social and economic implications.

Possible measures to integrate “just” element into transition finance:

- Include an assessment of employment implications in fundraiser’s transition plan;
- Include mitigation measures (e.g., training and reskilling programs) in transition plan;
- Disclosure the employment related information and mitigate measures;
- Consider including employment performance measures in KPI design of SL products.

Part 2

China Initiatives

In China, the PBOC is leading the development of national-level transition finance framework

- The People's Bank of China is developing a policy framework (including taxonomy, disclosure, products, and incentives) for transition finance
- ✓ **PBOC's current work concentrates on developing four industries' transition finance taxonomy**

Coal and thermal
power

Construction
material

Cement

Agriculture

- China's current green finance taxonomy already covers some project-based transition activities (about 1/4 of the 86 climate mitigation activities in green taxonomy could be viewed as "transitional").
- Transition taxonomy will include both project- and entity-based activities that are aligned to the country's carbon peaking and carbon neutrality goals.

NDRC and sectoral ministries have outlined technical pathways

- The National Development and Reform Commission (NDRC) and other ministries in charge of sectoral developments have already developed at least a dozen guidelines on technical pathways for decarbonization for carbon-intensive industries.

Example 1

NDRC Action Plan for Carbon Peaking and Carbon Reduction of Steel Sector

- Energy efficiency retrofit
- Hydrogen smelting
- Process optimization: scrap resources recycle, raw material mix, renewable energy
- Circular economy industrial chain: solid waste utilization, steel and chemical combine production

Example 2

Ministry of Housing and Urban-Rural Development (MOHURD) Building Energy Conservation and Green Building Development Plan for the 14th Five-year Plan Period

- Building electrification
- Green construction materials
- Renewable energy application
- Energy conservation renovation for existing buildings

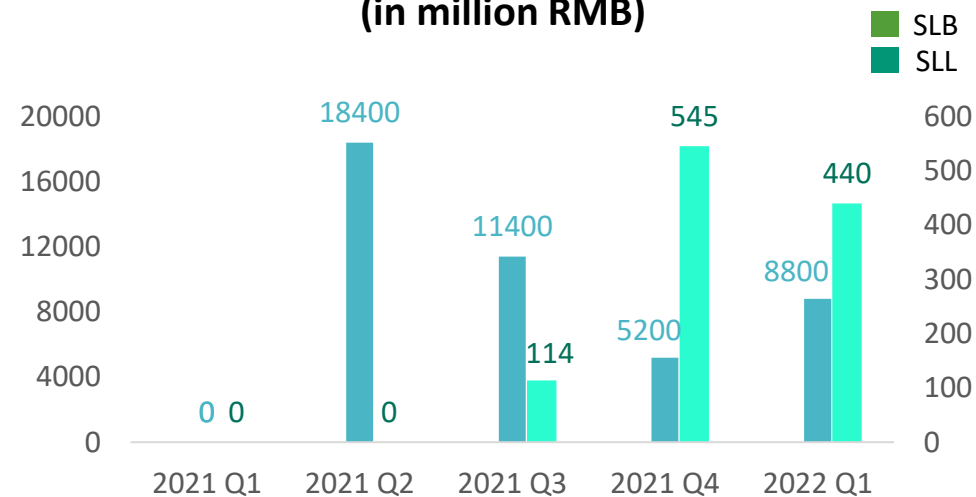
Issuance of transition finance products grew rapidly

Transition finance products have been developed since 2021, including issuance of sustainability-linked loans and bonds, with interest rates linking to issuers' sustainability KPIs such as carbon emission, energy efficiency, and other green performance indicators.

Recent examples of SLLs and SLBs:

- China Construction Bank (CCB) 's SLL to support green building projects
- Postal Savings Bank's SLL to support decarbonization of power companies
- GD power's SLB to support wind power capacity expansion
- State Grid International Leasing's SLB to support financial leasing of renewable energy equipment

Number of SLB and SLL products supporting transition
(in million RMB)



Chinese banks' initiatives in developing transition framework

Bank of China (BOC) and CCB have taken a lead in issuing their own transition bond frameworks

- Align with ICMA's Climate Transition Finance Handbook (2020) on issuers' transition activities and the four pillars of relevant ICMA Sustainable Finance Principles including on use of proceeds and transparency;
- Transition strategies to include Science-based Targets and pathways;
- Transition activities in line with pathways to carbon neutrality goals and strategies of the countries or regions the projects are located in;
- Apply "Do No Significant Harm" principles.

Example: Transition activities for cement industry in BOC Transition Taxonomy – Cement sector

Eligibility criteria

- Reduction of clinker-to-cement ratio
- Furnace heating using natural gas
- Improvement of energy efficiency of clinker production
- Recovery and utilization of waste heat energy
- CCS

Quantitative indicator		Eligibility threshold
Projects located in China	▪ Clinker-to-cement %	0.64
	▪ Energy consumption of cement clinker production	≤ 105 kg coal/ton
Projects located in the EU	▪ CO ₂ emission of clinker production	0.766 tons of CO ₂ e ton/cement clinker

Part 3

Implications for Asia

Implications for Asia and the Pacific Region



Standards:

Developing a clear definition of transition activities, e.g., a transition taxonomy



Demo Projects:

Initiate a few demonstration projects in carbon intensive sectors, such as coal-fired power, steel, cement, and petrochem, with a focus on helping develop benchmark transition pathways



Launch Transition Funds:

The lack of equity investment instruments is a key bottleneck in transition finance. These transition funds, set up by govts and/or ADB, can crowd-in more debt financing

Thank you!

