Transition Finance Market Review

Response to Call for Evidence

9 May 2024

The Association for Financial Markets in Europe (AFME) welcomes the opportunity to respond to the Transition Finance Market Review (TFMR or the Review) Call for Evidence. AFME welcomes the Review and the focus on facilitating transition finance and addressing barriers to the provision of transition finance.

In November 2023, AFME published a report "Sustainable Finance in the EU: Priorities to unlock financing and investment"[1]. While primarily focused on the EU regulatory framework, the report included a chapter on transition finance (see section 2) which discusses the role and importance of transition finance, barriers to the provision of transition finance and makes a number of recommendations for policymakers.

We have set our answers to the questions raised in the Call for Evidence below.

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?

- Strongly agree
- → Agree
- No view
- Disagree
- Strongly disagree

Discussions around transition finance illustrate that currently, there is a lot of confusion around the scope of this term. For example, Organisation for Economic Co-operation and Development (OECD) refers to there being "neither a consensus definition of transition finance, nor a set of technical criteria or qualifying sectors or technologies that are commonly agreed upon" (see, OECD Guidance on Transition Finance). Perhaps one of the reasons why there is actually no perfect framework is because transition finance will almost always be sector-, geography-, context-specific and principles-based. Any definition of Transition Finance therefore needs to provide sufficient flexibility to be adapted to specific regional conditions or technological changes, to be also usable for financing activities in emerging markets, for example. AFME notes that a definition of transition finance already exists in the EU Commission Recommendation (EU) 2023/1425[2]. As the Review is intended to take a globally applicable approach and take into account implications for emerging markets, an approach to transition finance needs to be developed which can have global application, while aligning, to the extent possible, with existing definitions.

Given the diversity of approaches in relation to defining transition finance initiatives and as inevitably what specifically falls within the concept will evolve over time, it is unlikely that there will be complete harmonisation of definitions when the term is used for a variety of purposes. There is, however, a general lack of alignment and consensus on what those efforts are ultimately seeking to achieve and how best to achieve those objectives. In AFME's view, it would be helpful to receive signalling from the UK government and/ or

[1] https://www.afme.eu/Portals/0/DispatchFeaturedImages/AFME_SusFinFramework_03-1.pdf
[2] Available here

regulators in relation to a minimum baseline for transition finance, through their communications (for example, Dear CEO letters, good / bad practice guidelines). Clarity and consistency in the UK's approach to transition finance across relevant initiatives would also be helpful. This would assist AFME members, and the market in general in enhancing their understanding of and deployment of transition finance.

However, whilst clarity and consistency in the UK's approach to transition finance would of course be helpful, the more significant issue holding back transition finance is the lack of clarity and policy stability from the government and from the public sector in ensuring favourable economic conditions to make transition finance commercially viable at scale in all relevant activities. Therefore, the work to define and measure transition finance should be done with the ultimate goal of providing more insight into how financing is supporting the transition, not from the premise that classifying and measuring transition finance will drive real economy decarbonisation.

For completeness, AFME's view is not to have the UK government introduce a prescriptive regulation on transition finance because, considering the variety of stakeholders and institutions involved, a one-size fits all approach would not work in this context. As discussed further in our response to Q12, AFME also notes that there are a significant number of initiatives and to the extent that it is deemed necessary to further define transition finance, we strongly encourage the government to work with international bodies and standard-setting market initiatives (e.g. Glasgow Financial Alliance for Net Zero (GFANZ), International Capital Markets Association (ICMA), Climate Bonds Initiative) and partner countries to provide interoperability and avoid introducing an additional definition.

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

- ○ Strongly agree
- → ○ Agree
- ○ No view
- ○ Disagree
- ○ Strongly disagree

AFME acknowledges that there is an element of reputational risk involved in deployment of transition finance, in the absence of a uniform definition or regulatory reference. As noted above in response to Q1, clarity as to what it means in practice by the UK government and/or the regulators and outcomes that transition finance is aimed at, would be beneficial. A more consistent understanding would help the banks and the corporates in:

1) raising more awareness for the need to invest; and
2) emphasising their role and relevance in the transformation that transition finance would entail.

For AFME members, the main challenge is the economic viability of given transition finance activities. Where economic viability is already clear without government support, or it has been supported by governments, financing is available for the relevant activities regardless of how they are "badged". This is perhaps most clearly seen in the power market where the existence of the "contracts for difference" scheme for renewable energy products allowing a guaranteed price for electricity ensures commercial viability and facilitates the deployment of finance.

In AFME's view, a clear understanding of transition finance combined with commercial incentives would facilitate transition finance. The zero-emission vehicle mandate, introduced by the UK earlier this year, is a good example in this regard. This regulation introduces a clear transition pathway along with improvements in commercial viability (both with and without government support), which have in turn, allowed the deployment of finance at scale.

AFME members also acknowledge the government's inclination to promote transition finance through legislative measures, for example, UK SDR transition. AFME notes that clearer boundaries around greenwashing would also help to give assurance to transition finance providers.

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.

- ○ Strongly agree
- ○ Agree
- ○ No view
- ○ Disagree
- ○ Strongly disagree

Yes. Transition finance should include all sectors of the economy. Further, alongside financing activities and entities that are "green" or "sustainable", it is essential that financing is available to companies that do not currently meet the criteria for assessment as "green" or "sustainable", for example under the EU Taxonomy. To achieve the goals of the Paris Agreement, it is necessary to not only scale up zero or near-zero emitting technologies and businesses, but also to support emissions reductions in high-emitting and hard-to-abate sectors.

As stated by the G20 Sustainable finance Working Group, "*An excessively narrow interpretation of "green" or "sustainable" finance could limit the flow of capital towards activities and investments that are needed to support the climate transition. For example, it may entail the risk that some GHG-intensive firms be penalized despite having credible transition plans, thus increasing the cost of capital to firms in need of investment to realize their green transition goals.*''

It is therefore essential to ensure that the policy framework avoids such a narrow interpretation of transition finance and supports the provision of finance and investment to real economy corporates at different stages of their transition journey. Financial institutions will need to provide finance to all parts of the economy, including high-emitting and hard-to-abate sectors, throughout the transition.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME agrees with net zero transition in hard to abate and high emitting areas of the economy being the primary focus of transition finance, whilst noting that transition finance should not be reserved for these sectors only. For example, an activity which is part of a credible transition plan to be aligned with net zero by 2060 (if in line with regional targets) may not be considered "credible'' in a region which has a regional net zero target of 2050.

Further, AFME notes that the term "credible" should be broadly defined and interpreted in its geographical context. Relying exclusively on UK's understanding of the term "credible" might pose an issue with respect to cross-jurisdiction transactions. Where the counterparties will be positioned is very jurisdiction and resource specific.

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.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME agrees with transition finance having a broad scope, including all types of economic activity that are compatible with a credible net zero transition. However, the focus for policymakers should be predominantly on carbon intensive sectors, covering both green and transition activities. Additionally, as noted in our response to Q4, AFME believes that the term "credible" should not be too prescriptively defined, and interpreted in its geographical context, in case of economic activities as well. There cannot be one gold standard for credibility that would apply to all geographies and all activities.

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

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME agrees that providing a prescriptive distinction in this regard would be difficult and hence the broad approach proposed as a starting point by the Review is sensible.

In general, AFME believes that some investors may want to understand to what extent the activities that they are investing in are already aligned with "green finance" economic activities in distinction to transition finance economic activities (which could be in hard-to-abate sectors which could exclude them from certain "green" labelling). There is some sort of demarcation, in certain existing regulatory and reporting obligations such as the EU Taxonomy. However, the EU Taxonomy also contains references to transitional and enabling activities, which blur the distinction between these and 'green' activities. The FCA's sustainability disclosure requirements have also avoided a clear distinction by foreseeing labels for 'sustainable focus' and 'sustainability improvers' as well as a label for funds with a mixed goal. Similarly, the ICMA Transition finance handbook does not demarcate between the two.

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.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME agrees that transition finance should include all types of financial products and services that support a credible net zero transition. It is important that all types of financing are included to ensure that companies have access to the appropriate type of financing for their particular needs. AFME notes that if transition finance were to be limited to specific or complex financial products, that could potentially restrict access to funding for certain segments / sectors of the economy that do not have access to those products.

Q8) Please describe any concerns you have with the application of transition finance through certain types of financial products or services?

As per our answer to Q7, we do not have concerns with the application of transition finance to all types of financial products or services. However, certain types of financing such as equity or general-purpose debt involve additional considerations to specific purpose lending. General-purpose lending does have a role to play in transition finance, but will require more mature climate disclosure, transition planning or commitments from borrowers. These requirements could be paradoxical as SMEs are likely to require general purpose financing but may find it challenging to produce detailed climate disclosures. Banks would have to engage in ongoing monitoring to ensure the integrity of general-purpose lending for transition finance, given the use of proceeds is not ring-fenced. Therefore, while all products and services should be included within the scope of transition finance, it may be necessary to separately consider how transition finance should be applied to them, to ensure scalability and decarbonisation.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME acknowledges the importance of observing non-emissions-based and non-climate-based considerations and agrees with including these considerations in the scope of transition finance. Nature and social considerations are intrinsic aspects of the net zero transition; the Green Finance Strategy states that "there is no pathway to net zero without protecting and restoring nature." As such, we are of the view that financing for biodiversity and nature protection (such as a debt-for-nature swap) should be linked to transition finance and fall within the scope of transition finance. However, the focus of transition finance should continue to be on "emissions reduction" and these considerations should not override the climate-based considerations. Additionally, financing should not be *required* to factor in biodiversity and other non-climate-based considerations to qualify as transition finance. AFME members are aware that unlike the case of GHG emissions, there has not been broad international agreement on the definition of a "social" or "just" transition.

For completeness, AFME notes that the integrated approach would also raise certain concerns, which the UK Government should be aware of, which are as follows:

- non-emissions-based and non- climate-based considerations are not widely included in current sectoral and national pathways based on emissions and climate change;
- this approach would narrow the scope of transition finance mostly for SMEs, who would be the least able to demonstrate compliance with non-emissions-based factors to access transition finance;
- all financial institutions are not well situated to evaluate whether their financing will facilitate these considerations; and
- extension of these considerations to all financial services that transition finance would apply to would be impractical, as there would be a significant number of services for which these considerations would be irrelevant.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Yes. Credible comparable transition plans can be a valuable tool for financial institutions to understand their clients' decarbonisation trajectories and engage with clients to understand plans, constraints and potential opportunities for financing. AFME members note that they would support a market-based approach to selection of decarbonisation pathways to assess against in a transition plan. Financial institutions and investors need to understand companies' transition strategy and how transition financing will be used to support this. In particular, AFME members have highlighted that:

- There are potential use cases for their clients' transition plans – for example, their clients' transition plans will give banks helpful information to assess where they are relative to the AFME members' portfolio trajectories and assess risks in severe transition scenarios. Client transition plans can also be helpful for investors as a collation of all transition-related information in one place. Assessing clients' decarbonization plans also creates an opportunity for AFME members to engage with their clients, understand their views, plans and constraints, and to understand the guidance and capital needed. However, a client publishing a transition plan does not in and of itself ensure that the client will be able to deliver on that plan; and

- If a client does not have the ability to deliver on its transition plan – i.e., the client does not have commercially viable opportunities to transition – then there is no transition activity for the bank to finance, and no "transition companies" for asset managers to market. This has been recently demonstrated by the fact that more than 200 companies - including the likes of Microsoft, Eurostar, Asda, Twitter, Diageo, P&G, and Unilever - had their short-term emissions goals or net zero commitments "removed" from the list of targets endorsed by the Science-Based Targets initiative (SBTi). The companies noted that this was because the government had not created the policy frameworks needed to achieve the emissions reductions, making it difficult for them to move as fast as they had originally thought. However, this could have not been prevented by the preparation of better climate plans as setting a long-term decarbonisation strategy based on, often, wishful policy thinking is "too abstract". As demonstrated by the SBTi story, the existence of a net zero target – or a transition plan in another form - is not a proxy for credibility because it must still be interrogated and assessed over time to determine whether it is fit for purpose.

AFME members also note that the barriers around transition finance are not solely due to a lack of transition plans (e.g. Transition Plan Taskforce (TPT)), or broader net zero targets (e.g. SBTi). While plans and targets can be helpful, the fundamental failures are often linked to unfavourable investment conditions in the economy and governments not setting the policy agenda to make the transition commercially viable. Moreover, transition finance is already occurring as policy and market drivers spur real economy transition activity, which banks can then finance.

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.

AFME members recommend a principles-based approach to transition plans disclosures to acknowledge that, as a business strategy document, transition plans will vary widely across companies, industries, sectors, and economies. AFME's expectation is that the UK government will be able to leverage the standards published by the International Sustainability Standards Board (ISSB) and the guidance published by TPT. Companies should disclose information that is at the core of their transition strategy, in accordance with the ISSB materiality principles. This approach would assist companies in leveraging the TPT for any ISSB aligned transition plan disclosure and providing material and decision-useful information to their investors. This includes the possibility for banks to determine which of their core activities should be captured in transition plans. There should be safe harbours for disclosing forward-looking information and flexibility for any disclosures on financial planning, engagement strategy and governance arrangements.

Our view is that when ensuring both the credibility and integrity of transition finance, it is important to consider whether the activity considerably contributes to decarbonisation in a specific sector, whether it is aligned to a credible strategy including (e.g. CapEx plans), and whether the activity can be demonstrated to help the client decarbonise according to a science-based benchmark or trajectory, accepting that it may occur at different speeds in different geographies.

A more prescriptive approach to the core transition principles would restrict the development of transition finance and the broader market. The factors that make up a credible transition plan are highly dependent on the reporting company's stakeholders and business strategy. A company's business strategy around climate and net zero will be strongly dependent on the individual company's circumstances, and variation across transition plans is likely. While credibility factors may vary, there are certain principles of a credible transition plan that may apply consistently across sectors, and those should be integrated accordingly. Please see our response to Q12 on guidance re approach to transition finance. Beyond these high-level principles, transition plan disclosure will vary, and stakeholders and policymakers should avoid setting specific expectations on reporting targets. However, disclosures should at the very least contain progress reporting against the short, medium and long-term targets as well as investments spent.

Q12) Which standards, frameworks, guidance or tools are you using to guide your approach to transition finance and why? If your approach varies between jurisdictions, please explain why.

AFME notes that the following resources could be used to guide the approach to transition finance:

- **IEA Net Zero Emissions targets scenarios**
- Transition Plan framework for corporates:
    a. **Glasgow Financial Alliance for Net Zero's (GFANZ)** Financial Institution Net-zero Transition Plans[3]
    b. UK **Transition Plan Taskforce**'s (TPT) framework
    c. **Net Zero Banking Alliance** (NZBA)[4]

- **UNEP FI Guidelines for Climate Target Setting for Banks**
- **The Climate Transition Finance Handbook**
- **The Transition Pathway Initiative (TPI)**
- **The Equator Principles:** A risk management framework adopted by financial institutions for determining, assessing and managing environmental and social risk in projects, often used in project finance for industrial and infrastructure projects.

- Other regional and national Sustainable Finance Taxonomies, which reflect different specific geographical conditions and starting points.

Q13) Do you consider current guidance for transition finance to have credibility and demonstrate integrity from an economic, environmental and a broader sustainability perspective? Why / Why not?

Please see response to Q1.

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.

[3] GFANZ, Supplement to the 2022 Net-zero Transition Plans report – Available here.
[4] NZBA, NZBA Transition Finance Guide – Available here.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Yes, there is an important role for regional or national pathways given the need to provide finance in developing economies. The low-carbon transition is unique to each country's socio-economic context and domestic context. These differences should, therefore, translate to varied approaches in different jurisdictions, albeit with the end-goal of supporting net zero transition.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME suggests that a formal ''transition finance'' taxonomy is not necessary, but existing taxonomies can be useful reference points. The existing taxonomies can be a useful tool to help define and classify when economic activities might be contributing to the transition to net zero and aligned with a net zero trajectory. They can also facilitate comparisons between activities and jurisdictions.

AFME notes that "A Compendium of Market Practices" (Compendium) published by EU Platform on Sustainable Finance (PSF) in January 2024 provides helpful guidance as to how EU Taxonomy has been integrated into credit institutions' processes for provision of sustainable finance. The Compendium provides examples where banks have complemented their loan origination framework with EU Taxonomy criteria to help identify environmentally sustainable loans.

Both the EU Green Bond Standard and the EBA December 2023 report on green loans and mortgages contemplate the existence of a two-tiered approach for ''green'' use of proceeds debt to allow for ''dedicated transition purpose" financing activities which are set to become Taxonomy-aligned within a fixed 5-10-year period. We would stress that the approach to defining transition finance which must become aligned with a taxonomy within a set period of years does not provide enough flexibility to the market.

AFME also notes that this response is subject to the following limitations:

- taxonomies used would need to be science-based and account for regional context. There continues to be debate on what activities should be included in taxonomies, particularly in terms of activities that are important for the transition to net zero; and
- the taxonomies themselves will not be the key driver in shifting financial flows towards real economy decarbonisation and the transition to net zero. This will depend on whether the policy incentives and economic conditions are in place to enable the real economy to transition, thereby creating opportunities for finance and investment to support real economy transition activities.

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

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

As discussed in response to Q14, we believe that it is important that transition finance acknowledges that different jurisdictions have different transition pathways and facilitates financing not only in the UK but in across other jurisdictions as well.

Q18) What principles, considerations and common approaches are needed to ensure both flexibility and environmental credibility and integrity across diverse jurisdictions and sectors with varying transition pathways, ensuring global coherence and effectiveness?

The UK government should promote global discussion and interoperability, by flagging guidance and best practice and obtaining comfort from industry bodies and regulators as to how they will be apprising transition finance. The issues to consider are:

- Keeping pace with international frameworks – jurisdictions should not front-run international frameworks in relation to transition finance or goldplate them. The UK government should engage with international / global groups looking to develop frameworks that are relevant to finance, and also adhere to the frameworks that have already been made such as the ISSB standards.
- Ensuring that SMEs are not left behind – the issue is that although transition plans are critical from a corporate standpoint, such a framework would not be appropriate for retail or small and medium-sized enterprise applications. SMEs have limited resources and often do not have staff dedicated to sustainability. Ensuring that any transition plan guidance is simple, easy to understand, and provides specific actions that SMEs could take would be helpful. As many SMEs are early on in their sustainability journey (and are unlikely to have readily available data), the framework should seek to close this knowledge gap. Please also see our response to Q28.
- Solving data issues, in the context of targets and KPIs for transition finance. Please also see our response to Q25.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

No. We should however ensure that initiatives aimed at scaling up transition finance in the UK do not disproportionately favour the adoption of technologies that have not proven to be scalable, effective or in demand. Measures should remain technology-neutral and science-based to avoid that UK businesses become reliant on technologies that prove ineffective or soon become obsolete.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

While the importance of mainstreaming transition finance is increasingly recognised by policymakers, and banks and investors are keen to scale the provision of transition finance, financial institutions face several challenges which are holding back the potential of transition finance.

By far the most significant factor is a lack of commercial viability for transition finance investments. As noted in our response to Q2, where either private market conditions or government intervention allows for the commercial viability of transition finance investments, there has been a deployment of finance at scale in these areas. In contrast, where the commercial viability of transition finance is not clear, this inevitably holds back financing.

Other barriers to transition finance include:

- Concerns regarding reputational and legal risk arising from potential accusations of greenwashing;
- Lack of rigor around sustainability-linked products, both sustainability-linked loans and sustainability linked bonds;
- A lack of a common interpretation/understanding of transition finance;
- Concerns that pressure on financial institutions to reduce their financed emissions and KPIs for financial sector disclosures will disincentivise financing for high-emitting sectors or activities most in need of support for transition;
- Ability to assess expected emissions reductions when granting long-term financing;
- Ability to robustly and consistently assess customers' transition plan credibility;
- Credit risk issues where technologies are fairly nascent and may not have significant income history;
- Limited view on domestic/regional pathways for hard to abate sectors, which make the investments too risky;

- Underdeveloped infrastructure and value chains; and
- Low demand and willingness to pay premium for decarbonisation of less profitable sectors.

Please also see our response to Q30.

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

Please refer to our response in Q20.

It is also important to ensure that regulation is appropriately facilitating, and not disincentivising, the provision of transition finance. Some disclosure requirements for banks in some jurisdictions, such as the Green Asset Ratio and Pillar 3 disclosures in the EU do not reflect banks' contributions to the transition of the economy through the provision of transition finance. It is important that transition planning frameworks for banks provide a broader perspective, allowing banks to explain their broader contribution. It is also important that supervisors and regulators focus on their mandates to supervise risk and do not attempt to use financial sector regulation to actively steer the transition of the real economy. It is also important to ensure that the supervisory approach to addressing greenwashing does not stifle innovation or the willingness of financial institutions to engage with companies that may be earlier in their decarbonization journey, as this will include areas where financing and investment is most needed. Finally, changes in regulation should encourage, rather than hinder or cut across the desire to increase transition financing. By way of example, the current proposals for the implementation of Basel 3.1 in the UK could make it more costly for UK banks to provide sustainable project financing, particularly at the construction phase, versus EU banks under Capital Requirements Regulation. This has two effects: (1) it could create less competitive conditions for UK banks; and (2) it could hinder the acceleration of energy transition in the UK and the ability of UK banks to finance the transition. Acknowledging this is not an issue that the Review seeks to address, AFME notes that it should be used as an example to remember that the UK government's recommendations should facilitate competitiveness of the UK as a jurisdiction for transition finance, and that will be integral to its effectiveness as a global hub as well as the UK's ability to meet its net zero ambitions.

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?

In AFME's view, examples of finance being deployed effectively to support a credible net zero transition are as follows:

- The European Investment Bank (EIB): In 2020, the EIB announced that it would align all its financing activities with the goals of the Paris Agreement by the end of 2020 and aim to support €1 trillion of investments in climate action and environmental sustainability from 2021 to 2030.
- UNEP FI Net Zero Banking Alliance: many banks have joined the Net Zero Banking Alliance, committing to align their lending and investment portfolios with net-zero emissions by 2050.
- In the public sector, the Japanese government issued its first tranche of Climate Transition Bonds in February 2024. The proceeds from these bonds will be used to fund Japan's Green Transformation (GX) programme, in particular in funding emerging technologies which will help to decarbonise and

enhance industrial competitiveness, such as hydrogen technology. This issuance was received well in the market, and it is possible that other Asian countries may look to replicate a similar programme.

- The Monetary Authority of Singapore announced the launch of the Transition Credits Coalition in December 2023, aiming to facilitate the early retirement of coal-fired power plants throughout Asia through the issuance of carbon credits.
- In Asia, this has come up in the context of Energy Transition Mechanism (ETM), which is a pilot initiated by the Asian Development Bank. ETM is a scalable, collaborative initiative developed in partnership with developing member countries that will leverage a market-based approach to accelerate the transition from fossil fuels to clean energy.
- In the UK, the government has introduced a zero-emission vehicle mandate. The new laws will help households make the switch to electric, supporting growth of EV sales in the second-hand market and incentivising charging to roll out more widely across the country.

Q23) 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.

- ○ Strongly agree
- ○ Agree
- ○ No view
- ○ Disagree
- ○ Strongly disagree

Naturally, risk is a major barrier to accessing and deploying capital or financial services, as is the case with all financing decisions.

AFME notes that one of the most prevalent risks associated with deploying capital and financial services is the lack of certainty around legislative and policy measures, which makes companies susceptible to reputational and financial risks. Generally, liquidity in financing has not been an impediment to companies securing transition financing and, once policies are in place, the financial sector are often adept at adapting to what is required from them. However, in the absence of clear and timely government policy, some financial institutions have been more hesitant to commit to an uncertain risk level.

Private investors face a significant degree of unknown risks when investing in technologies needed for transition. Investors need certainty regarding commercial viability before they put money behind longer-term, capital-intensive projects. Whilst in some areas of transition finance, commercial viability is clear and hence financing is readily available, in other areas that certainty is often lacking, which makes projects needed for transition commercially unviable. As noted in our previous responses, this is the biggest barrier to the deployment of transition finance.

This is where public capital can come in and make the risk-reward profile sufficiently attractive for private investors. Public guarantees and instruments, such as contracts for differences in the renewable power market, can play a key role in liberating more capital for the transition. Where such government-led price stabilisation is not available, companies become increasingly reliant on financial support from private entities.

These private markets are often not sufficiently developed to deal with large-scale projects, which can provide significant uncertainty and can make the projects very high-risk to finance.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Yes. AFME notes that focus on the improvement of data will be vital for the models to function, as well as the consistency of the data utilised across the industry. This is particularly relevant given the lack of consistency regarding the timing and frequency of climate data publication. In addition, the audit industry needs to not make it punitively expensive for third party verification, which is needed throughout the system.

Taking the analogue of the historical development of green and sustainability linked finance (loans and bonds), there have been capacity issues in the provision of expert legal drafting services as the market developed, as well as limitations in the availability of cost-effective independent verification services for KPIs (these assurance services have increased materially in cost for users of sustainable financing, somewhat discouraging its use). Any legal and assurance requirements for transition plans etc may be subject to similar risks of ancillary services availability and cost inflation.

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.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Yes. We do consider the availability and cost of developing viable projects is an issue for the deployment of transition finance. The cost of capital for nascent technologies (e.g. hydrogen, CCUS) needed for transition of specific companies is more expensive than for tested technologies where the risk is significantly lower. In this economic environment, there's far less capital being raised in general, and investors are even more wary about investing in unproven capital-intensive projects today compared to higher risk appetite in 2021 and 2022. If such a project is being developed by a small or medium size business, for example a CCUS or hydrogen start up, the small size of the company and a typical lack of collateral value only increases the risk of investment.

Public-private financing solutions have worked well for nascent technologies, particularly those developed by smaller and/or less established companies. A good recent domestic example is the ZeroAvia funding round backed by the UK Infrastructure Bank (UKIB). ZeroAvia is a leader in zero-emission aviation, focused on hydrogen-electric aviation and it is a great example of UKIB supporting a first of its kind technology to enable private investment.

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.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Yes. Please see our response to Q18 and Q28 for specific issues faced by SMEs in relation to access and deployment of transition finance, and steps that can be taken to address those.

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 types of financial instruments for the provision of transition finance that are already available in the market are similar to those available for other forms of sustainable finance. These include use of proceeds bonds, sustainability-linked bonds, general purpose lending, sustainability-linked lending, and equity investment. Market standards for bond and loan products are available, for example under ICMA Green Bond Principles and Loan Market Association (LMA) Green Loan Principles. All the financing products are therefore available for transition finance.

In relation to SMEs in particular, AFME notes that to effectively support the transition to a net zero economy, additional practices such as the following might be required:

1. **Policy Incentives:** Tax incentives, subsidies, or rebates for green investments can make it more financially viable for SMEs to initiate such projects.

2. **Capacity Building:** Providing SMEs with the knowledge, skills, and tools needed to identify and implement green projects can help them access and deploy financing more effectively.

3. **Sustainable Supply Chain Financing:** Offering favourable financing terms to SMEs that are part of a sustainable supply chain could encourage wider adoption of sustainable practices.

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?

Please see response to Q28.

Additionally, in introducing new financing strategies, market tool, practices or products, the UK government should ensure that these put UK at a level playing field with other jurisdictions. As noted above in response to Q21, the current proposals for the implementation of Basel 3.1 in the UK could make it more costly for UK banks to provide sustainable project financing, particularly at the construction phase, versus EU banks under Capital Requirements Regulation. This is a good example of legislation that could make UK less competitive versus EU, in relation to sustainable project financing. The UK government should ensure that in facilitating transition finance, it is also facilitating competitiveness of the UK as a jurisdiction for 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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

For the reasons set out in Q1, AFME is not of the view that a transition finance labelling regime is necessary. Instead, AFME would encourage an industry-led approach which points to best practices and recommendations around transition finance. At times, as there might be uncertainty around the quality of output of those voluntary approaches, so signalling by the regulators in this regard, in their communications (for example, Dear CEO letters) as to what might / might not be considered as greenwashing will also be very helpful. Finally, as noted in Q21, it is also important to ensure that the supervisory approach to addressing greenwashing does not stifle innovation or the willingness of financial institutions to engage with companies that may be earlier in their decarbonization journey, as this will include areas where financing and investment is most needed.

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.

It is important to recognise that the provision of transition finance or other financial services, in itself, will not drive the real economy transition. The financial sector's ability to support the transition will depend on whether the policy incentives and economic conditions are in place to enable the real economy to transition, thereby creating opportunities for finance and investment to support real economy transition activities. The ability of corporates to successfully transition, and for financial institutions to facilitate and finance these transitions, is dependent on whether firms have economically viable opportunities to decarbonise their businesses – which may be affected by economy-wide policies, sectoral incentives, supply and demand dynamics, and connectivity across value chains.

As mentioned under the responses to Q1 and Q23, AFME does not generally note an absence of liquidity in the market, but rather an absence of favourable economic conditions in which financial institutions are prepared to offer financing. AFME believes that the government is best positioned to focus on improving the regulatory regime, by providing a clear strategy for transition finance and favourable economic conditions for private finance. In doing so, public finance institutions can assist the UK government, by playing a valuable role in providing financing and support for certain projects where it may not otherwise be possible to make projects commercially viable, but there remains significant public interest in proceeding with the projects.

It would be beneficial for public bodies to prioritise industrial policy that creates favourable economic conditions to facilitate companies' transition. Policies such as incentives or subsidies to support jobs and investment in the transition have the potential to send strong signals to companies in the real economy and stimulate long-term investment. Public/private partnerships also play an important role in mitigating the risks faced by financial institutions and, from companies' perspective, in reducing the cost of capital. This kind policy support has the potential to facilitate the application of financial tools for investments in both proven and emerging technologies (e.g., green hydrogen, sustainable aviation fuel and carbon capture). The benefits of clear communication should not be underestimated, and public bodies should consider showcasing concrete successes and encouraging market participants to share best practices.

Finally, we also encourage the Review and government to collaborate with relevant standard-setters and industry initiatives such as work at PCAF to measure transition finance activities when calculating financed emissions.

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

- In the US, the President's Inflation Reduction Act (IRA) of 2022, is playing a key role in attracting large investors to the US. The IRA includes a combination of loans, grants and other incentives to facilitate the deployment of transition finance. This includes investments in deploying clean energy, expanding the electricity grid, developing domestic clean technology manufacturing, incentivising uptake of electric vehicles, reducing methane emissions, increasing the efficiency of buildings, improving the climate resilience of communities, and other areas.
- Another example is the EU's InvestEU Programme, which aims to trigger more than €372 billion in additional investment across Europe until 2027, including in new technologies. It has already unlocked investments in several public-private investments that would have not been possible without the support of public capital. For example, in March 2024 the European Investment Bank (EIB) teamed up with private investors to support the development of innovative electrolysis technologies needed for Europe`s green transition. The EIB has agreed to support Germany-based Sunfire's solid oxide electrolysers toward first commercial production with up to €100 million in venture debt, of which €70 million has been signed with the help of InvestEU finance. In addition, Sunfire secured additional €215 million in a Series E equity financing round. The agreement will support Sunfire develop electrolysers to produce green hydrogen more energy- and cost-effectively for industry processes, replacing the use of fossil fuels in high energy consuming sectors like chemicals and steel.
- Partial credit guarantee – in 2023, the African Development Bank approved a partial credit guarantee of EUR 400 million to Senegal to facilitate the mobilization of the country's inaugural sustainable financing to be exclusively allocated to green and social investments, in line with Senegal's Sustainable

Financing Framework. The financing by the Republic of Senegal will be in the form of a sustainable loan or loans for an amount of up to EUR 500 million. The Bank's guarantee enables financial establishments that are considering financing the operation to be protected against losses resulting from Senegal's failure to pay principal and interest on this loan up to EUR 400 million.
- First loss guarantee – in 2021, the U.S. International Development Finance Corporation (DFC) signed a credit guaranty on a portfolio of loans arranged by Trine AB expanding access to off-grid renewable power and lighting solutions.
- Green Finance Strategy – in this Strategy (introduced in 2019), the UK government sets out the measures it plans to take to achieve its green finance objectives. Central to this Strategy is the focus on the pathway to domestic and global net zero objectives as well as the need to take action to prepare for the physical impacts of the changing climate, seeking to align finance flows with a climate resilient economy and increasing investment in adaptation.

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.

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Blended finance is going to be a fundamental element of the UK's transition to net zero. The UK Infrastructure Bank (UKIB), alongside other public finance institutions, is going to be key in catalysing investment for nascent technologies. Its capitalisation needs to be reflective of the scale of the transition. Please see our response to Q31 as well on the role that public finance institutions can play in general to scale up transition finance.
Broader recommendations for blended finance include:

- Reduce complexity. There is a broad need to move away from bespoke solutions and products in the case of blended finance. Solutions cannot be over-structured. Products that are well understood by the market (e.g. loans/bonds, guarantees) are more suitable for private actors.
- Prioritise the deployment of guarantees and other de-risking instruments, such as first loss or subordinated traches. We think guarantees are also critical, especially in the current, more risk-averse market.
- Public institutions need to assist in creating bankable projects. This includes technical assistance and work with domestic public bodies to increase pipeline of investible projects.
- Prioritise efficiency. One of the issues with blended finance identified by investors is the length that it takes for public finance institutions to move on with specific projects. While we appreciate the need for careful consideration of investments, the pace and uncertainty of the process can pose an additional hurdle for private investors and does not reflect the urgency of deploying capital to projects critical for transition.

There has been a growing focus on blended finance as a tool to mitigate risk and facilitate climate finance, particularly in emerging markets. In our view, key opportunities for scaling blended finance internationally include (i) scaling the transactions that the private sector already does well together with the Multilateral

Development Banks (e.g., leveraging the MIGA guarantee product) and (ii) putting resources into project preparation.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

Please see our response to Q23. The role of private investors is identifying attractive investment opportunities with clear financial returns which, as outlined in the previous questions, is more challenging in the case of nascent technologies needed for the transition. Accordingly, the role of public finance is to help manage risks associated with these investments and, thus, make them workable. Governments can deploy a range of investment models, including Regulated Asset Base (RAB), Cap and Floor, and contracts for differences and, as demonstrated on the example of the offshore wind industry, their existence can be one of the most effective policy catalysts for nascent technologies needed for transition.

The UK Infrastructure Bank could play an enhanced role to deploy capital or guarantees to the more challenging areas such as nascent technologies or the more challenging infrastructure projects working in partnership with private finance. Examples that it could draw lessons from include:

- KfW in Germany which has a joint venture with the German government to deploy capital.
- Banque publique d'investissement (BPI) in France which plays a significant role, with respect to supporting the SMEs decarbonisation pathways with capital and awareness raising.
- GFANZ, a global coalition of financiers and funds launched as part of a campaign to mobilise private capital for the net zero transition, which continues to assist in amplifying government action.

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?

- Strongly agree
- Agree
- No view
- Disagree
- Strongly disagree

AFME's view is that UK could play a key role development of global thought leadership on transition finance, by facilitating global discussions / dialogues and working closely with other jurisdictions to avoid a fragmented approach. However, in doing so, the UK government should align its approach with the international frameworks as well, as any deviation from or gold-plating of such frameworks, would undermine UK's perception as a global hub.

About AFME

AFME represents a broad array of European and global participants in the wholesale financial markets. Its members comprise pan-European and global banks as well as key regional banks, brokers, law firms, investors and other financial market participants. We advocate stable, competitive, sustainable European financial markets that support economic growth and benefit society.

AFME is the European member of the Global Financial Markets Association (GFMA) a global alliance with the Securities Industry and Financial Markets Association (SIFMA) in the US, and the Asia Securities Industry and Financial Markets Association (ASIFMA) in Asia.

AFME is registered on the EU Transparency Register, registration number 65110063986-76.

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