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Recent Developments in Transition Finance

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For financial institutions, retaining high-carbon emission companies on their books poses risks. However, the achievement of net-zero carbon emissions by 2050 is dependent on decarbonization of the entire global economy, and transition finance will be crucial for decarbonizing high-emitting sectors. Transition finance refers to finance provided to support companies in transitioning to low-emission pathways to help achieve societal decarbonization. It is focused on the funding of activities and technologies that support the greenhouse gas emission reductions of companies in high-emitting and "hard-to-abate" sectors. The last few months have seen a number of new developments in the transition finance field.

On January 25th, HSBC Bank announced its first Net Zero Transition Plan. In the plan, HSBC outlines pathways to reducing financed emissions, and presents the changes needed for the decarbonization of high-emitting sectors. The plan spans 101 pages and has sections titled "Vision and strategic approach", "Sector transitions", and "Implementation plan".

The "Sector transitions" section covers energy supply; transport (automotive, aviation, and shipping); heavy industry (cement; chemicals; iron, steel, and aluminum; and mining); real estate; and food, forests, and other land use. For each sector, pathways to net zero, technology feasibility and timelines, and estimated capital expenditure requirements are presented as sector transition overview. As HSBC's sector approach, HSBC also provides targets and its action plan.

The "Implementation plan" section covers 'supporting the customers,' 'embedding net zero into the way HSBC operates,' and 'partnering for systemic change.' HSBC selected the International Energy Agency Net Zero Emissions by 2050 (IEA NZE) 2021 scenario for the reference scenario. Since the scenario cannot be broken down by region, HSBC is employing a global pathway for key sectors, but plans to continue monitoring scenarios that allow regional breakdowns.

On February 9th, Barclays Bank announced its Transition Finance Framework, which outlines criteria for transition finance transactions. In doing so, Barclays became one of the first major banks to define

transition finance. While the framework is only 20 pages long, it includes a transition activity list targeting 11 high emitting and hard-to-abate sectors: agriculture, cement, chemicals, energy, power and utility, real estate, metals, mining, aviation, ground transport, and shipping. Eligible transition activities and activity exclusions are specified for each sector/activity. For instance, in the power and utility sector, gas-fired power generation for non-OECD countries for coal-to-gas switching is deemed an eligible transition activity, whereas ammonia co-firing with coal for power generation, or CCUS (carbon capture, use, and storage) paired with coal-based new power generation facilities, are excluded. Barclays states that although version 1.0 of the framework has a narrow scope, areas they will likely be focusing on in future iterations include managed phaseout of carbon intensive assets.

Actual steps towards implementing transition financing began to emerge in March. HSBC, Standard Chartered Bank, and others were reported to be considering a couple of approaches to accelerate the retirement of coal-fired power plants. One involves the creation of “transition credits”, where the difference between emissions, if a coal-fired power plant would have continued operating versus the lower emissions levels achieved through the plant’s early retirement, is monetized and traded on the carbon offset market. The other approach involves compensating investors for losses due to the early retirement of coal-fired power plants, with financial institutions lending the required funds. In such cases, the public financial institutions would participate in reducing the debt. If such financing mechanisms are successfully established, they could potentially serve as precedents for other applications.

These transition finance-related developments are still in the early stages, and it remains unclear just how the transitions will take shape. Transitions will need to be defined for each sector and region. With regard to transitions in Asia in particular, the efforts of the Asia Transition Finance Study Group and the “Technology List and Perspectives for Transition Finance in Asia” of the Economic Research Institute for ASEAN and East Asia (ERIA) need to be widely promoted to a global audience.

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