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Transition finance's role in decarbonisation

What is transition finance?

Transition finance refers to financing provided to emissions-intensive industries to fund their green transition, which plays an importance role in addressing climate change and accelerating global decarbonisation. Emissions-intensive industries include hard-to-abate sectors like energy and chemicals, steel, cement, and construction.

Transition finance emerged as the industry realised that effective decarbonisation of the global economy would require more than green and sustainable finance. Compared to green and sustainable finance that have largely focused on channelling funds to green and environmentally-friendly projects, transition finance aims to mobilise funds for the transition of emissions-intensive brown sectors to be greener. Decarbonising emissions-intensive industries through transition finance is therefore critical for the journey towards net-zero.

Transition finance in Asian economies

To move the needle on decarbonisation, transition strategies to green the brown sectors are important for Asia – a region that continues to industrialise and continues to be heavily reliant on coal for power generation.

Developing transition finance taxonomies

1. China

China's pledge to peak carbon emissions by 2030 and reach net-zero by 2060 will be no easy feat for the largest global greenhouse gas emitter. The majority of China's greenhouse gas emissions are from hard-to-abate sectors e.g. almost 50% of emissions are from steel (17%), chemicals (13%), cement and concrete (13%) companies. China has done much work in green finance by mobilising funds towards renewables such as wind and solar energy.

Under its green finance scheme, the opportunities for financial institutions to invest in or make loans to companies in emissions-intensive sectors are limited. This prevents such sectors from implementing emissions-reduction measures that usually require high upfront capital costs.

In Nov 2022, the G20 Sustainable Finance Working Group (SFWG) approved and launched a Transition Finance Framework in Bali to support emissions-intensive sectors in better accessing bank loans and capital markets while minimising greenwashing. China has made some progress in this area, such as The People's Bank of China developing a national transition finance framework with a focus on four sectors: coal and thermal power, construction material, cement and agriculture.

2. Singapore

The Monetary Authority of Singapore (MAS) is supporting the development of an industry-led green and transition taxonomy through the Green Finance Industry Taskforce (GFIT) for eight focus sectors.

According to the MAS, these focus sectors account for approximately 90% of ASEAN greenhouse gas emissions, namely (i) Agriculture and Forestry/Land Use, (ii) Real Estate, (iii) Transportation, (iv) Energy, (v) Industrial, (vi) Information and Communications Technology, (vii) Waste/Circular Economy and (viii) Carbon Capture and Sequestration. The proposed criteria for the taxonomy are green (sustainable activities), amber (transition activities) and red (harmful activities incompatible with the net-zero transition). When the finalised full taxonomy is published this year, there may be greater clarity for the industry on the definitions of green and transition activities to safeguard against greenwashing.

Can transition bonds gain traction?

Transition bonds are picking up in China and Japan recently, with strong support from the respective governments. To supplement green bonds, China announced in Jun 2022 the roll-out of low-carbon transition bonds under a pilot scheme to accelerate its green efforts. The proceeds from the transition bonds will be channelled to fund green efforts in emissions-intensive companies. Japan's Ministry of Finance is also considering issuing 1.6 trillion yen (~S$16 billion) of green transition bonds in the second half of the next fiscal year from April.

However, transition bonds may fall short of being the preferred financial instrument for the low-carbon transition because of its use-of-proceeds structure. Comparatively, sustainability-linked bonds (SLBs) may be viewed as a simpler and more attractive instrument that does not limit issuers to channel the proceeds to pre-defined sustainable projects. SLBs provide greater flexibility to use the funds for all purposes, while meeting sustainable KPIs within a specified timeframe at the issuer level. Therefore, SLBs are easier for issuers with established climate strategies and targets. As some SLBs were found to be tied to weak or irrelevant climate targets, greenwashing risks remain a concern. There needs to be greater scrutiny on the climate targets to strengthen the credibility of SLBs as an effective instrument for transition finance.

Conclusion

On top of sustainable and green finance, transition finance can accelerate the transition of emissions-intensive brown sectors towards a low-carbon future. The development of transition taxonomies is a step in the right direction, so that there are clear definitions of what transition activities are comprised of to minimise greenwashing.

To support transition finance, there is a need to build capabilities for companies to understand the standards and innovative financing solutions to deploy decarbonisation strategies. Collaborating with stakeholders to identify and implement transition technologies with the necessary financial and strong policy support will be crucial to the decarbonisation journey.

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