

Transition Finance Market Review

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

We agree there continues to be a lack of clarity on the definitions for transition finance approaches and standards in the UK and across other jurisdictions. We would very much support more harmonised definitions and best practice to develop further over time for transition finance approaches and standards, transition finance instruments, and importantly policy tools (e.g. transition plans, taxonomies, climate benchmarks) that can assist financial market participations in this evolving market.

Policymakers will have a supportive role to play in many of these areas, including continuing to promote international harmonisation across countries of transition plan disclosures, taxonomies, broader corporate sustainability disclosures, and other transition finance policy tools.¹ A core priority for policymakers, both in the UK and other jurisdictions, is providing clearer policy signals and policy certainty relating to countries and individual sectors' decarbonisation pathways, with appropriate policy incentives in place for sectors that can promote flows of transition finance across the economy.

As our collective understanding of transition finance develops, there is a prominent leadership role for the UK government to work closely with the private finance industry, businesses, and a wide range of actors to highlight best-practice and consider how coalescence can be encouraged around a set of broad definitional principles and frameworks for transition finance, both in the UK and for different regions. Consideration should be given to enhancing standards and the market credibility of a range of transition finance instruments and financial products that can support decarbonisation.

In regards to definitional principles and frameworks, this work to harmonise should draw on existing finance industry initiatives, such as the Glasgow Financial Alliance for Net Zero (GFANZ) financial sector and real economy guidance on transition financing strategies, the International Capital Market Association's (ICMA's) Climate Transition Finance Handbook, and other industry initiatives identified by the Review, as well as policymaker recommendations.² In relation to the latter, this includes the European Commission's 'Recommendations on Transition Finance' which are valuable in identifying existing tools in the EU's sustainable finance framework that can support transition targets.³

More harmonised approaches would be welcome in relation to instrument-specific frameworks, corporate disclosure standards, taxonomies, and sector-specific guidance and tools. We hope the Transition Finance Market Review can play an important part, alongside government, the finance and investment industry, and other actors in promoting the emerging discourse on transition finance and crucially best in class transition finance approaches in the coming years.

¹In time, we believe that transition plan should be mandatory for large listed and unlisted companies, and we would expect this to be the direction of travel, especially in light of transition plan requirements under the European Union's Corporate Sustainability Due Diligence Directive (CSDDD).

²GFANZ (2022) 'Expectations for Real-economy Transition Plans': <https://assets.bbhub.io/company/sites/63/2022/09/Expectations-for-Real-economy-Transition-PlansSeptember-2022.pdf> and 'Recommendations and Guidance on Financial Institution Net-zero Transition Plans': <https://assets.bbhub.io/company/sites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf>; ICMA, Climate Transition Finance Handbook 2023, <https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/climate-transition-finance-handbook/>, June 2023.

³European Commission Recommendation 2023/1425 of 27 June 2023 on facilitating finance for the transition to a sustainable economy <https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32023H1425>, July 2023.

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

We identify clear barriers for many of our members- which includes 300+ financial institutions and investors managing more than £19trn in global assets under management (AUM)- in deploying transition finance in the economy. A number of these should be addressed by policymakers as quickly as possible alongside industry.

In the UK, these barriers include the following (and these are relevant to other countries): a lack of clarity on the scope of transition finance; insufficient clarity from government on the country's decarbonisation pathway and individual sectors' decarbonisation pathways that impacts investors' ability to allocate capital efficiently to sectors (particularly challenging in hard to abate industries); 'greenwashing' concerns in transition finance; and the need for delivery on existing transition finance tools in the UK that can assist financial market participants, such as a science-based 'green taxonomy' and transition plans.

Government and regulators have an instrumental role in supporting existing tools that are already available to financial market participants. We agree with the Commission's Recommendations on Transition Finance that the existing tools in the EU's sustainable finance framework (e.g. the EU taxonomy and EU climate benchmarks) can be used to support transition targets and to articulate transition finance needs at the company level.⁴

Clearer policy signals from government on various sectors' transition pathways, especially where these pathways appear less clear and transition risks are most apparent, continues to be required urgently and this would go some way to support the integrity of transition finance. A lack of clarity on various sectors' pathways will make it more difficult to get companies on board and prepared to transition their activities.

Further clarity can be provided by development of credible 'net-zero investment roadmaps' which government has already committed to. However, the existing roadmaps do not provide sufficient granularity for investors, including the specific regulatory and long-term financing mechanisms in place to incentivise financial flows into decarbonising sectors.

These roadmaps should clearly identify investment gaps facing sectors, while we continue to back the adoption of an over-arching UK 'Net-Zero Investment Plan' to analyse, on an ongoing basis, private and public net-zero financial flows to help determine how the investment required for the UK to reach its emissions reductions targets can be met.⁵ Finally, policymakers should consider a range of other incentives to support transition finance in the UK, such as strategic use of subsidies to incentivise investment by companies in low-carbon technologies and solutions and tax grants.

⁵Credible sector roadmaps are needed underpinned by the near-term policies, actions and milestones needed to shift financial flows towards net-zero and help crowd in private capital, and should consider the following: a long-term financing framework to lower the cost of capital; a cross-party based (ideally) policy framework to tackle risks of future changes to regulation; facilitating an investible pipeline of projects including through effective project preparation; binding decarbonisation pathways, among other areas.

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

Alongside many of our members, we believe that transition finance has much potential to assist many sectors and companies' decarbonisation pathways, and help promote a whole of economy approach to the transition. It can and should extend to the credible transition of all sectors in the economy.

More finance continues to be urgently required for companies in hard to abate sectors (e.g. agriculture, steel, shipping, aviation, cement, chemicals) that may have ambitions to become more sustainable over time (e.g. with science-based net-zero targets and transition plans in place) and are vital to supporting economic development, though that cannot today, and immediately, shift their operations to climate-neutral practices for a number of reasons. These include the lack of availability and readiness of the right low-carbon technologies for these industries in some instances.

Priority should be given by policymakers and industry predominantly to the decarbonisation and tackling the financing gaps for those transitional and most hard to abate areas of the economy.

In many of these areas, this is where transition risks are most apparent for investors and where policy clarity may be particularly lacking in the UK. As part of this, clear minimum safeguards are essential to ensure transition finance does not unnecessarily prolong the life cycle of the most high-polluting legacy assets, such as coal power plants. In the UK context, the Review alongside policymakers could consider new guidance to support development of these minimum safeguards to maintain the integrity of transition finance going forward.

More finance is needed in those new technologies that can support emissions reduction in 'browner' sectors and can assist sectors to decarbonise their existing operations.

The EU estimates that the current transition finance gap for its Green Deal stands at more than €620bn every year until 2030, while the World Economic Forum has stated the additional capital expenditure needed for decarbonisation of steel, cement, aviation, shipping, trucking, aluminium, and ammonia (for fertilizers and as a clean fuel) is \$370bn each year between 2024 and 2050.

There will be investment opportunities for our members and the wider economy in helping to transition 'browner' companies towards a more sustainable pathway, and the role of policymakers will be paramount in supporting this. More broadly, there needs to be greater public recognition over the role that transition finance, and transitional economic activities and technologies can play in supporting the UK's and global 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?

We broadly agree with this recommended initial prioritisation, while we have the view that attempts by policymakers (or the private finance industry) to prescriptively define a common, exhaustive list of transitional activities and sectors in the UK- and their respective transition stages- may not be feasible, especially in the immediate term. This includes defining a 'transitional' or 'extended' taxonomy framework in the UK, building off the existing green taxonomy.

Uncertainty over policy incentives from government for decarbonising many hard to abate industries in the UK has been an important factor impeding private investment flows. For example, in our recent *Financing the Future: Transport* report we highlighted a lack of clarity on the freight sector's decarbonisation pathway, including the expected fuels of choice and technological solutions for heavy goods vehicles (HGVs) and trucks.

These hard to abate sectors should not be excluded from policymaker and industry approaches and frameworks on transition finance; not only in terms of assisting the decarbonisation of the economy, but also to facilitate a just transition for those employees and other stakeholders operating in these sectors. There will be economic opportunities we expect; for example, analysis from the Aldersgate Group has found that industrial sectors and wider supply chains contribute around £152 billion in gross value added to the economy and support over 1.4 million jobs.⁶ These sectors will need to experience significant decarbonisation, including through new technologies and energy efficiency.

Just transition considerations should feature very prominently in the Review's activities in the coming months and industry's transition finance frameworks. In some cases, we would expect that companies will not- at any point in time- be able to transition successfully and the Review should further consider how the decarbonisation potential and pathway of this more limited group of companies could be addressed, including potentially through the role of climate 'bad banks'.

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.

We broadly support the definition outlined by the Department for Energy Security and Net Zero (DESNZ) and HM Treasury (HMT) setting out the Review's terms of reference: *'Transition finance' refers to financial products and services that support higher emitting companies and activities to decarbonise over time. These instruments are generally used by companies seeking to reduce greenhouse gas emissions and should be part of a credible decarbonisation pathway that is consistent with global climate and nature goals.*

We would expect that government's definition of transition finance reflect the following: the UK's own short-term and long-term climate objectives, including its carbon budgets required under the Climate Change Act, which will be more ambitious than many other countries; consideration of a fair and just transition; and the pressing need to support the decarbonisation of higher-emitting sectors as quickly as is possible, rather than referring to a longer time period with action deferred until the very end stages as we approach 2050.

This focus can help maximise policymaker and industry action on those sectors that may particularly require significant pools of capital to quickly transition and can support real-world decarbonisation of the economy. As part of this focus, the role of climate solutions and enabling technologies should be recognised in supporting the decarbonisation of hard to abate industries, not only the role of transition technologies per se.

For investors specifically, this is a recommended focus for their stewardship and engagement activities which remains a critical and unique lever for investors to drive the transition. Properly utilised and resourced by firms, active stewardship with all companies, particularly those in

⁶Aldersgate Group, [Economic benefits of industrial decarbonisation. A low carbon industrial future for the UK](#), August 2023.

hard to abate sectors such as manufacturing, steel and cement, can speed up the transition journey of the whole economy. This is more effective when coupled with consistent government policy measures and signals outlining a clearer direction of travel for the economy.

This is why, among other reasons, we continue to emphasise delivery of the UK's taxonomy and transition plans across the economy, which over time can better support our members in navigating the UK's transition finance market.

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

Transition finance products and services will require particularly close oversight from regulatory authorities to guard against 'greenwashing' risks for clients and customers.

'Greenwashing' risks will help to damage integrity and confidence in the transition finance market, undermining its long-term growth. This includes intentional or unintentional 'greenwashing' by firms, the latter of which may be heightened by the lack of universal definitions and approaches to transition finance in the marketplace today.

Given 'greenwashing' concerns, we expect there will continue to be some caution from some financial institutions and investors in developing new transition finance products, as well as referring directly to transition finance in products, policies, communications and marketing materials, and documentation with clients (i.e. 'transition finance hushing').

As clearer and more rigorous definitions and industry approaches continue to emerge, we hope this will help minimise 'greenwashing' risks and enhance investors' understanding of different transition finance frameworks that may be used by firms to inform their investment processes. In time, more financial services firms may choose to be more explicit in highlighting their approaches to transition finance.

We would like to see robust and transparent disclosures detailing the investment approaches and strategies taken by firms' transition finance products and strategies. This includes an upfront explanation of the intended investment objectives (whether financial or non-financial), appropriate benchmarking, disclosure of key indicators, such as transition plan disclosures and/or taxonomy-alignment, and a justification for a particular approach adopted, and any foreseen risks for clients or mismatch in their expectations.

The FCA's Sustainability Disclosure Requirements (SDR) and investment labels regime, we believe, is a positive regulatory model for other countries for setting out transparency and appropriate guardrails for investors in regards to transitioning or 'improving' investment funds, and this could be drawn on for other types of financial instruments (e.g. private markets instruments). Further details on the FCA's SDR regime and its treatment of transitioning funds and underlying assets can be found in our response to Q.30 to the Review.

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?

Wider sustainability considerations should certainly be included in the Review's scope of transition finance in the UK, including biodiversity, nature, ecosystem services, climate adaptation and resilience, a just transition, and other social factors such as human rights and modern slavery.

This is vital in light of the considerable (and growing) interdependencies between many of these issues, and collective recognition of the necessity to address these factors in tandem in order to achieve progress towards the Paris Agreement goals and the Sustainable Development Goals (SDGs). Along with many of our members, we continue to emphasise the importance of the global transition being viewed from a holistic sustainability perspective, not only through a carbon emissions only lens; therefore, any industry approaches and definitional frameworks for transition finance should be clear in recognising wider sustainability challenges and not shifting our collective focus away from these issues that continue to require prioritisation.

There are opportunities also for transition finance to play a supportive role in promoting initiatives relating to wider material sustainability factors, such as biodiversity and nature loss, the circular economy, responsible business conduct, among other areas. Broadly speaking, we want to see transition finance encompass a range of ESG factors in order to advance the transition to a more sustainable financial system and economy.

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?

High quality and decision-useful transition plans are central to the effective allocation of transition finance in the economy. Effective transition plans from corporates are well-placed to provide clarity for investors in channelling capital to companies whose business models will remain most relevant in a net-zero world.

We welcome the Review's focus on how high-quality transition plans can be a key lever to support the growth of transition finance, and we would support consideration by the Review team on how all businesses (regardless of size) can be incentivised to put in place, in time, a transition plan.

The continued absence of credible transition plans from many businesses makes it more complex for investors to navigate investment risks and opportunities. A survey from the asset manager Ninety One, in 2022, of global asset owners and advisers highlighted that 60% of respondents cited the lack of companies with "credible and feasible" transition plans as a barrier to transition finance.

Transition plans remain a crucial tool for companies in communicating to the market their commitment to decarbonising their operations, while managing the risks and opportunities of the transition.⁷ These plans can help attract capital from global investors who, more and more, value good-quality disclosures from their investee companies when allocating capital.⁸

To support this lever, greater progress is needed in the international harmonisation of transition plan disclosure standards. This includes in relation to standards that have been published by: the UK's Transition Plan Taskforce (TPT), the International Sustainability Standards Board (ISSB), GFANZ, EU, and OECD.

In terms of the UK's TPT, there is potential we see for the TPT's disclosure framework to, in time, become an internationally leading 'gold standard' for transition plan disclosures that is adopted in the UK and other jurisdictions, and that can be drawn on- as far as possible- by emerging

⁷For companies, transition plans will help them in shaping their business strategies, building confidence in their efforts to transition among their shareholders and stakeholders, and in the process helping to attract investor capital.

⁸They can also assist investors' stewardship activities, helping them hold companies accountable in meeting their transition plans and targets.

economies in their approaches.⁹ Its high bar and its enhanced interoperability with other global and industry standards, such as the transition plan aspects of the ISSB's IFRS S2 and GFANZ, is positive and should help encourage global harmonisation.

Finally, we continue to recommend to the UK government that climate transition plans are introduced on a mandatory, sequenced basis across the wider economy, including for large privately-owned businesses, fulfilling one of the UK's core pledges made at COP26 in Glasgow. Government's consultation on transition plans for large companies in the economy, including unlisted companies, should progress quickly without further delay.¹⁰

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.

Each of the principles and policy tools can play a crucial part in assessing the integrity of transition finance. In regards to transition plans, the decision-useful and forward-looking data provided by these plans can support financial markets participants' capital allocation, stewardship, and ability to more accurately price risks in investments.

Should transition plans be implemented across the UK and global economy on a mandatory basis- through a staged approach- we expect they will help unlock investors' capital. This data for investors is important in light of continued reluctance from many companies to publish good-quality low-carbon transition plans. According to a report by CDP in 2023, only 81 of 4,100 global companies reported sufficient detail to all 21 key indicators in CDP's climate change questionnaire that aligns with a credible transition plan.¹¹

For privately-owned companies, transition plan requirements are necessary to help avoid risks of 'regulatory arbitrage' and minimise the scenario of financing for high-emitting companies to be channelled elsewhere within the finance sector.¹²

In terms of companies' capital allocation plans and capital expenditures (capex), these metrics can provide a powerful tool for investors to assess how companies' future investment plans are aligned with the transition. Capex can be valuable- particularly when considered alongside more qualitative disclosures from companies- by showing companies' investments aimed at transforming their business models, though there are challenges in assessing capex data from companies, including a lack of a common methodology to assess capex alignment.

Greater transparency over companies' capex plans can incentivise investments by companies in green solutions. Policymakers should encourage these disclosures and other indicators of low-carbon investments that can facilitate a supportive environment for transition finance. Companies' scope 3 emissions are an additional indicator to ensure credibility of a transition plan. Many companies often omit the most material sources of Scope 3 emissions, focusing on

⁹In relation to the ISSB's approach, we continue to see the ISSB's IFRS S1 and S2 disclosure standards and guidance for transition plans as a minimum 'baseline' for the UK to build on top of its future approach to sustainability disclosures and transition plans.

¹⁰For listed companies specifically, we look forward to seeing the FCA's consultation released shortly on updating its disclosure framework for these companies to reference the ISSB's disclosure standards, while we would like to see clarity outlined on the extent to which the TPT's disclosure framework will be incorporated in its approach.

¹¹A separate report by EY found that although over 80% of FTSE 100 constituent firms have made a net-zero commitment, 78% of firms disclosed only partial transition plans with key elements, such as strategy and execution plan, missing.

¹²This extended coverage for transition plans is a particularly important consideration given the requirements we have seen for UK asset managers, asset owners and listed companies to publish transition plans on a 'comply or explain' basis.

‘easier to report’ emissions. More work is required to ensure they are more accurately disclosed by companies to inform our members’ investment processes and reporting.¹³

Science-based decarbonisation targets are another core indicator, and it is critical these are in line with the Paris goals. External validation and assurance is important to promote integrity of decarbonisation targets among stakeholders, with progress by companies against their targets disclosed each year. Finally, taxonomies are another metric, with mandatory requirements important for companies to disclose the proportion of their capex that is taxonomy-eligible and taxonomy-aligned, alongside disclosures of turnover and operating expenditure.¹⁴

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.

Our members will draw on a number of the standards and tools that are highlighted in the Review (Table 3.2), and as previously highlighted we are hopeful of seeing over time further consolidation of industry’s use of these tools.

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?

To realise this potential more quickly, as previously highlighted greater standardisation of industry approaches to transition finance and transition finance instruments and products will be needed. As part of this, ‘greenwashing’ risks will need to very closely monitored by policymakers to ensure confidence in this market.

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 see a prominent role for ‘green taxonomies’ in supporting the provision of transition finance in the UK’s and global market, building off their existing role in enhancing transparency over sustainable economic activities and investments and helping tackle ‘greenwashing’ risks. Above all, the UK government should provide long-awaited clarity on its approach to the taxonomy following a series of lengthy delays to the consultation.

In the UK’s upcoming approach to the taxonomy, the role played by ‘enabling’ activities and technologies should be clearly recognised within the taxonomy. Enabling activities include services and technologies that are enablers of climate solutions, such as electrical equipment or industrial automation, that will be needed to promote a renewable energy system, and they will continue to play a vital role in the net-zero transition.

The EU taxonomy has set overly complex technical screening criteria (TSC) for companies reporting against the taxonomy to meet on efficiency levels for the ‘manufacture of low carbon technologies’, resulting in a reduction of the taxonomy’s utility with companies that are making relatively little use of the taxonomy’s provision on ‘enabling’ activities.¹⁵ The UK can learn

¹³More details on challenges relating to Scope 3 emissions can be found here- [Scope for improvement: Solving the Scope 3 conundrum | LSEG](#)

¹⁴We would note the difficulties in calculating opex in the experience of the EU’s taxonomy and it has generally been a less decision-useful indicator for corporate reporting against the taxonomy.

¹⁵ABB Group has published a report highlighting the lack of guidance in the EU taxonomy in regards to enabling technologies, which has helped to reduce the utility of the taxonomy as companies have made little use of the taxonomy’s provision under the ‘Manufacture of low carbon technologies’ which covers ‘key components that result in substantial GHG emission reductions in other sectors of the economy’.

lessons here from the EU taxonomy's approach, which has led to poor understanding by financial market participants.

This has meant that investment opportunities have, potentially, been discouraged in the EU in vital 'enabling' activities that can be harder to assess in companies' supply chains, but that can help generate positive sustainability outcomes. We would recommend the UK adopt a tailored approach that recognises more explicitly the role these technologies and the wider activities within companies' supply and value chains can play. Better reflection of these activities could ensure more effective implementation of the UK's taxonomy in the coming years, while crucially supporting the growth of transition finance in the UK and the reduction of carbon emissions across different sectors.

In the first instance, we would support consideration of an enhanced approach to the incorporation of 'enabling' activities within the UK's taxonomy ahead of exploration by of a 'transitional' or 'extended taxonomy'. We support the Green Technical Advisory Group's (GTAG's) recommendations released last year on a 'transitional taxonomy', highlighting that the UK *first* prioritise implementation of a 'green taxonomy' to clearly define green economic activities and is a credible, science-based, and usable tool for the market, ahead of consideration of developing an extended framework.

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?

As mentioned previously in our response, a key challenge in ensuring the integrity of transition finance includes the continued lack of high-quality and consistent climate and sustainability-related data for the financial sector and investors.

Corporate data is still not sufficiently robust and decision-useful to meaningfully inform investors' investment decisions and accurately price assets in markets. For example, research from one of our members, FTSE Russell (an LSEG business), shows that of the 4,000 large and mid-size constituents in the FTSE All World index, only 58% disclose both their Scope 1 and 2 carbon emissions.¹⁶ It indicates that many companies are still over reliant on inaccurate data estimates, and finds that there is a material disclosure gap, and considerable variation in reporting on sustainability issues according to company size, region, and sector. There is a particular disclosure gap in relation to forward-looking sustainability and climate data.

In regards to transition plans, a 2022 OECD Industry Survey on Transition Finance highlighted that 79% of financial market participants surveyed noted that a lack of corporate information on their climate transition plans was a "relevant" or "very relevant" barrier to transition finance.¹⁷

Other challenges included in this study were: a lack of consensus and common guidance on what constitutes a Paris-aligned country-level sectoral transition pathway, a lack of definitions for transition activities, issues in assessing the ambition of companies' net-zero targets and plans, and a lack of commercially viable projects and companies.

¹⁶FTSE Russell Indices, Insights & Data | LSEG

¹⁷2022 OECD Industry Survey on Transition Finance.

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

Different countries will naturally define their approaches to transition finance differently according to the needs of their economy and climate transition journey.

It very important for tailored approaches to transition finance to be developed and promoted in emerging and developing countries, recognising the unique challenges facing these countries and the different stages of their transition journey. Regulatory authorities will need to guard against certain regulations and disclosure requirements, such as transition plan disclosures, having unintended consequences in terms of helping impede the flow of transition finance to emerging economies, with a staged, flexible approach for rules needed.

There may be a case for the UK and/or existing international institutions and standard-setters, such as the International Platform on Sustainable Finance, or IOSCO, to contribute to new transition finance approaches for developing economies. Work at the international level should initially aim to unify and bring together the multiple different initiatives in the marketplace and prioritise, where possible, minimising regulatory authorities and industry's duplicative efforts in transition finance approaches, many of which the Review has identified.¹⁸

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?

As previously highlighted, as transition finance products scale up in the UK and other jurisdictions, we have strong concerns over 'greenwashing' risks in this market- whether intentional or unintentional 'greenwashing'.

Very differing conceptions and subjective views by firms, and their clients and customers, over what should constitute a 'transitioning' fund and instrument for example are very likely. This includes the extent to which these funds are invested or linked to certain high-emitting companies and assets, that may all have very different degrees of transition potential, or where determining the transition potential may be complex (e.g. due to lack of good-quality forward-looking data).

In our response to Q.30, we outline our views for mitigating potential risks for labelled transition finance funds and instruments, which from our views includes as clear as possible, transparent, and decision-useful disclosure requirements for these funds. Greater clarity and certainty over what constitutes transition financing and transition funds can help minimise greenwashing risks in the market. We want institutional and retail investors and companies to be able to better identify, and compare, how funds and economic activities respectively are transitioning and aligned with the Paris goals.

¹⁸These initiatives include the International Monetary Fund's (IMF's) publication, 'Activating Alignment: Applying the G-20 Principles for Sustainable Finance Alignment with a Focus on Climate Change Mitigation', which aims to contribute to the design of a transition finance framework in a constructive way for emerging market and developing economies, attempting to finding the balance between interoperability and the local context.

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?

In terms of barriers impeding private capital flows towards transition finance and transitioning activities in the UK, as mentioned previously these include regulatory barriers, among other issues such as a lack of government support to de-risk transition finance.

A clearer regulatory framework for sustainable finance can help address barriers that are slowing the mobilisation of private capital into transition activities, and this means delivering on commitments made in the 'Green Finance Strategy'. We have called on policymakers for some time to provide implementation timeframes on the UK's 'green taxonomy', transition plans, and the broader sustainability disclosures regime.

The policy gaps that exist in these areas will help constrain the growth of transition finance, by for example making it more difficult for investors to identify and invest in the 'transition leaders' among companies, and to channel investments to those companies committed to improving their sustainability performance over time.

In the longer term, we would like to see policymakers consider consulting with industry on new instruments, such as climate transition bonds. With appropriate policy support, transition bonds may have potential to better assist higher-carbon intensive companies in their preparations to become greener over time; for example, with funds raised from these bonds helping companies to invest in climate technologies or make changes to existing energy-intensive activities.

In light of Japan's issuance of the world's first sovereign climate transition bonds, we would welcome consideration from UK policymakers on how UK climate transition bonds could assist UK companies in their transition efforts away from carbon-intensive practices.

Policymakers would need to ensure a UK transition bond would meet rigorous market standards and certification, e.g. being fully compliant with ICMA's green bond principles and climate transition finance guidelines or the Climate Bonds Initiative's (CBI's) standards; be updated over time in line with achieving the UK's emissions targets, include sufficient subsidy allocations for green activities and R&D projects, and a small flexibility pocket consistent with the flexibility pocket introduced in the EU's Green Bond Standard. Rigour will need to be maintained in this market, and clearer standards for transition bonds may continue to emerge in time.

Given the nascency of transition bonds, we would expect that total issuance and take-up to remain low for some time while this market continues to evolve, for example as transition bond principles continue to develop with which companies can align their frameworks.

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?

We would like to see the Review, alongside policymakers and other actors, give consideration to how support for new financing models for decommissioning and phasing down the most environmentally harmful activities and projects could be enhanced, including for those projects that may not have a viable transition pathway. This work should draw on existing initiatives, such as the work of GFANZ to encourage the financing of high-emitting assets with the specific objective of facilitating the 'early retirement' of these assets.

We do not want to see carbon emissions simply passed onto other companies' balance sheets, nor investors only prioritising the decarbonisation of their portfolios (i.e. 'artificial decarbonisation') through divestment of high-emitting companies and assets as a first resort, rather than practicing active stewardship with investee companies.

We would welcome the Review acknowledging the prominent role of investor stewardship in supporting a positive evolution of the transition finance market in the UK and globally, and considering how stewardship expectations could, and should, evolve to more effectively encourage the most high-emitting companies to wind down and retire their operations, including in a 'just' manner for their employees and stakeholders. Stewardship approaches from investors to promote the responsible retirement of assets should include some of the following elements: a clear 'escalation strategy' with companies should sufficient progress not be made by companies; relevant metrics and KPIs agreed with companies; and clear disclosures outlined by companies on their progress and other relevant information, such as its policy advocacy activities with governments.

In terms of divestment, we would like to see investors take steps to ensure that when high-polluting assets are sold off, that this is done in as responsible a way possible that minimises the scenario of investors with potentially fewer incentives to reduce emissions taking on polluting assets- specifically solely to maximise returns and not manage these assets responsibly. We would like to see greater discussion on this issue of 'responsible divestment' and the Review could seek to highlight this discourse more prominently as part of its activities, pointing to emerging approaches.

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?

To safeguard against 'greenwashing' risks in the market, robust and decision-useful disclosure requirements will be vital for 'labelled' transition finance instruments and products.

The approach in the FCA's SDR regime to 'transitioning' investment funds offers a model for jurisdictions' approaches to regulation and disclosures for transition finance products, including new instruments that may emerge over the coming years. There is a role for new, clear product labels from regulatory authorities to assist clients in comparing transition finance products that suit their particular needs and investment objectives. We would welcome a renewed focus from international policymakers to dedicated labels for these products, working closely with industry as part of this.

The FCA's 'Sustainability Improvers' category under the SDR learns an important lesson from the EU's Sustainable Finance Disclosure Regulation (SFDR), by recognising those investment strategies that have a specific objective and ambitions to support the transition towards a more sustainable future.

The SDR approach in requiring fund managers to disclose clear, objective qualifying criteria, including in relation to investor stewardship activities, for 'Improver' funds seeking to qualify under the 'Sustainability Improvers' label category is largely positive. This offers sufficient flexibility to reflect future innovation in the market, while maintaining a high bar for what assets

and companies can be included for 'Improver' funds. The market-driven, disclosures-focused approach from the regulator is broadly welcome.¹⁹

Given the prospect for mismatch in clients' expectations over the sustainability profile of 'transitioning' funds, policymakers need to be attuned to 'greenwashing' for labelled transition finance instruments. Over time, we could see the SDR 'Improvers' category encouraging the creation of new dedicated transition investment strategies in the UK's market, across ESG investment themes, that could meet the needs of a wide group of investors while supporting capital towards decarbonising transitioning assets.

As the SDR regime beds into the UK, we would encourage policymakers to reflect on the experience of the 'Sustainability Improvers' category, and assess how its framework, principles, and criteria could apply to other types of financial products and services in time.²⁰

Globally, we would like to see the European Commission consider the creation of a transitioning labelling category drawing on the UK's SDR, alongside other markets, such as the U.S. In the coming years, we expect interest among investors to continue to grow in transition finance themed funds and services, and regulatory guardrails will be essential to support this market and safeguard clients' interests.

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?

The UK should seek to build on its considerable existing strengths in financial services and related professional services to support the growth of transition finance, while we continue to see a prominent role of the City of London and other financial centres across the UK in helping to finance the UK's and global transition to net-zero.

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 UK Infrastructure Bank (UKIB) and other existing financing models and institutions could be utilised further by government to support a variety of blended finance approaches to help de-risk transition finance. This may include revisiting institutions' risk appetite and capitalisation over time.

The Environmental Audit Committee's recommendations- set out in its report on the financial sector's role in the net-zero transition in 2023- for government to publish in one document all of its different blended finance models and assessing how these are currently addressing particular investment gaps in the wider economy could be explored further by the Review and government.²¹ In our response to Q.35 below, we highlight views on the UKIB's potential role here.

¹⁹For example, the label does not overly prescribe the precise KPIs and sustainability criteria that firms would be mandated to disclose to measure the extent to which a fund is 'improving', while necessitating these criteria are "credible", evidence-based, and justifiable to clients.

²⁰The FCA's 'anti-greenwashing' rule should, we hope, further guard against 'greenwashing' risks for investors invested in 'improving' funds, by making clear that all regulated financial services firms should ensure that any sustainability references within their products and services are "fair, clear, not misleading, and proportionate to their sustainability profile."

²¹House of Commons Environmental Audit Committee, The financial sector and the UK's net zero transition <https://committees.parliament.uk/publications/42316/documents/210501/default/>, November 2023.

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?

The UK government may want to review, in time, the role of the UK Infrastructure Bank (UKIB) in helping to de-risk and scale up transition finance, though we believe any changes or clarification to UKIB's investment mandate should be a longer-term consideration from government. This is important given the nascency of the UKIB that has only been established and the need we see for its existing mandate to be given sufficient time to bed in.

The UKIB could consider in future an initial discussion paper or formal consultation with stakeholders on an envisaged future role in promoting transition finance in the UK, including how this new emphasis would be consistent with its existing investment principles, including: supporting regional growth and action on climate change, prioritising investments in clean energy, transport, water and waste, and digital technology, delivering financial returns, and crowding in pools of private capital over time. Given the clear financing gaps that exist in regards to many transitioning activities and industries, there may be a role for a focus on transition finance to help the UKIB more effectively deliver on, and to demonstrate, its existing approach to additionality for all its infrastructure projects and deals, though as alluded to this would first require careful consultation. One foreseen risk that would need to be avoided as far as possible is the UKIB or other public finance institutions inadvertently helping prolong the life cycle of high-polluting projects or assets.

Separately, the UK government- working with industry- could further consider the role that climate 'bad banks' could play, both in the UK and globally, to promote managed phaseouts of the most high-emitting businesses and assets, facilitating companies' efforts to channel more investment towards clean technologies and solutions and reducing the risks of stranded assets.

With approaches to 'bad banks' relatively nascent, there is an opportunity for the UK to contribute to new thinking and models which we expect would have some interest from financial institutions. For example, Prudential and HSBC have been involved with the Energy Transition Mechanism introduced by the Asian Development Bank, which seeks to acquire coal power plants with the aim of winding them down earlier than their typical life expectancy. Some of these derisking solutions will carry risks and will need further consideration from policymakers to promote their effectiveness, and we would welcome the Review highlighting the opportunities of 'bad banks' in its upcoming work.