

Briefing · October 2024

Reforming climate finance: Asia leads in transition finance

Key points:

- The definition of transition finance is widely contested. While it is sometimes given a broader meaning, as any investment going towards the energy transition, this briefing will focus specifically on finance for high-emitting sectors to decarbonise.
- Many emerging and developing economies (EMDEs) struggle to meet the strict criteria in existing sustainable finance regulation and face barriers in attracting private finance. Transition finance could fill this gap and help EMDEs access the finance needed to decarbonise their economies.
- In Asia, a region that contributes to around half of global carbon dioxide emissions, decarbonising high emitting sectors is crucial as many countries continue to develop.
- There is a growing acceptance of transition finance among investors and markets in Asia. Several countries, including Hong Kong, Singapore and Japan, have released taxonomies or guidelines for transition finance.
- However, criticisms have been raised over the potential for ‘transition-washing’ and the lack of quantitative emissions reduction targets in these taxonomies.
- To mitigate this, Asian transition taxonomies could introduce several guardrails to build investor confidence. These could include screening criteria, transition plans benchmarked against regional emission reduction pathways, and retirement dates for technologies not meeting emissions targets.

Finance will be key at COP29 and biodiversity COP16

Climate finance is set to be a central topic at the United Nations Biodiversity Conference (COP16) and the UN Climate Change Conference (COP29) this year, with countries in the Global South seeking accountability in financial pledges and access to finance on equitable terms.

This series of reports, titled ‘Reforming climate finance’, illustrates the influence of global financial institutions on high debt burdens and limited access to climate finance in the Global South. The reports examine the financial tools and institutional changes being discussed in international forums to address these challenges.

The series includes briefings on [debt-for-nature swaps in Latin America and the Caribbean](#), the impact of [sovereign credit ratings on highly indebted countries](#), the inconsistencies between the International Monetary Fund’s climate policies and conditionalities imposed on debtor countries, and transition finance in Asia.

Defining transition finance

The sustainability debt market has grown in recent years, with labels such as green, social, sustainable, sustainability-linked, and more recently, transition – which [was in the spotlight at COP28](#).¹ Despite efforts by governments and financial coalitions, there is no [widely-accepted definition](#) of transition finance and the activities it covers. Instead, there are [at least three overlapping interpretations](#) currently in use, according to ICMA.

The broadest definition is the ‘economy-wide transition’ to meet Paris Agreement goals and wider sustainability targets. Narrowing down, the ‘climate transition’ emphasises specific sectors, particularly energy and high-emitting industries to achieve Paris goals. Finally, there is the ‘hard to abate’ transition, which addresses the specific challenges of reducing emissions for high-emitting sectors that are currently difficult to decarbonise, known as hard-to abate sectors. This briefing looks specifically at transition finance for the decarbonisation of these sectors.

What is hard to abate?

According to the IEA, [hard-to-abate sectors](#) are sectors “where cutting emissions substantially is likely to prove particularly difficult because technological solutions do not yet exist or are relatively costly.” However, the term can create confusion for investors as there is no universal agreement on which sectors are hard to abate. [Cement, chemicals, shipping and aviation](#) are often cited as examples. The list of industries included in ‘hard to abate’ also changes as technology advances and becomes cheaper. For instance, [long-distance trucking](#) and [steel](#) are often not considered hard to abate anymore. Liebrich, founder of BloombergNEF said “[there are no longer any so-called hard-to-abate sectors](#) ... only some sectors in which clean solutions are not projected to undercut their fossil-based alternatives”. In view of the confusion around ‘hard to abate’, this briefing instead refers to ‘high-emitting sectors’ that are currently difficult to decarbonise.

Challenges that transition finance could address

Transition finance emerged from the recognition that investment is needed for the shift from a high-carbon to a low-carbon economy, especially in low-income countries that are burdened by high public debt and face barriers in accessing global financial markets.

1. Regulatory hurdles

Emerging markets and developing economies (EMDEs) sometimes struggle to meet the strict criteria in international regulations for sustainable finance, which are often designed with more mature markets in mind.

MSCI found that the EU’s Sustainable Finance Disclosure Regulation (SFDR) sets stringent criteria for sustainable investments, which has [unintended negative effects on emerging markets](#). The SFDRs focus on “principal adverse impact (PAIs)” indicators and the principle of “do no significant harm” set a high bar to increase transparency in sustainable investment decisions. However, many emerging-market firms fail to meet the required

¹ Green finance covers activities that are already green/ sustainable.

thresholds and often lack necessary data.² [Only 39% of companies in a key emerging markets index](#) disclose Scope 1 and 2 emissions, compared to 98% percent in a global infrastructure sustainability benchmark, where Europe, the US and Oceania lead, according to analysis by Global Real Estate Sustainability Benchmark.

2. Barriers to attracting capital

EMDEs need scaled-up finance for their climate transition, with the private sector playing a key role. [By 2030, private finance must cover about 80% of climate mitigation investment needs in EMDEs](#), and this figure rises to 90% when China is excluded, according to the IMF. However, [only 60% of emerging markets and 8% of developing economies have an investment-grade sovereign credit rating](#). This makes sovereign bonds and corporates from these countries too risky for many investors, who limit their portfolios to investment-grade assets.

[High-risk perceptions also lead to higher borrowing costs for many EMDEs](#), often forcing them to borrow in “hard currencies” like US dollars, euros or Japanese yen. This exposes EMDEs to additional risk – if their local currency depreciates, repaying the debt becomes even more expensive. Higher borrowing costs also apply to sustainable investments such as renewables: the cost of capital for utility-scale solar projects [is two to three times higher in key emerging economies than in advanced ones or China](#), according to the IEA.³

Transition finance and decarbonisation in Asia

With standards for green activities becoming more stringent, transition finance offers an opportunity for developing countries reliant on heavy industry to decarbonise their processes. Many Asian countries, which are reliant on high-emitting sectors, are seeking to [lead this distinct decarbonisation approach](#) to ensure that [projected economic growth and industrialisation](#) in the region is in line with achieving net zero.

Developing Asia represented around [half of global carbon dioxide emissions](#) in 2023, and Asian countries could lose almost [a quarter of GDP by 2100](#) compared to a scenario without climate change. Meeting climate mitigation and adaptation needs in emerging and developing Asia have been shown to require at least [USD 1.1 trillion](#) in investments annually. As it stands, investment lags behind by around [USD 800 billion per year](#). Transition finance could help to bridge this climate funding gap.

High emitting sectors in Asia

[Heavy industry is integral to Asia’s economy](#), in particular [cement, steel, aluminium and petrochemicals](#).⁴ Over the last two decades, total global emissions from heavy industries have increased [two to three times](#).⁵ In 2022, these industries (plus iron) accounted for [24% of global carbon dioxide emissions](#).

Asia produced about [73% of the world’s steel](#) in 2022. The global steel sector is responsible for [8% of total energy system emissions](#), and is the [largest contributor to industrial emissions](#) globally. Transition finance could be used to fund demonstration or

² PAIs are sustainability factors that fund managers or financial advisors need to collect and disclose for their investments. There are currently [14 mandatory PAIs under the SFDR](#), covering data connected to climate and environment and social and governance.

³ Utility scale solar together with wind projects covers a quarter of EMDE’s total clean energy investment needs in the next 10 years according to the IEA’s 1.5°C aligned pathway

⁴ Zero Carbon Analytics analysis, BNEF (2023) BNEF Talk: Decarbonizing Heavy Industries: Pathways for the World and China, available via BNEF platform, accessed on September 23, 2024.

⁵ Ibid.

commercialisation projects in Asia such as the [direct electrification of steel production](#). For example, in October 2023, the Bank of China (Luxembourg branch) issued a [EUR 300 million three year transition bond](#) to finance four steel production and recycling projects in China's Hebei Province.

Asia's coal fleets present another opportunity to use transition finance, for early coal retirement in the 'coal to clean' shift. A study by IEEFA showed that [coal power plants as young as 15 years old can be profitably retired](#) under the right policy conditions through power purchase agreements. A report by Climate Smart Ventures lays out conditions under which [transition finance could drive coal plant retirement in Asia](#). These include partially transferring the future value of the coal plants to the present to make retirement financially viable, and generating financing at competitive rates for diversifying into clean technologies. According to the World Economic Forum, each deal should assess a [realistic retirement date](#) to avoid financing technologies that prolong the life of coal plants, like ammonia co-firing, which was [criticised by the UK and Canada at the G7](#) in 2023.

Using transition finance to retire coal plants early could help Asia meet the IPCC's phase-out targets of [2030 in OECD countries and 2040 in non-OECD countries](#).

Which transition debt instruments are already being used?

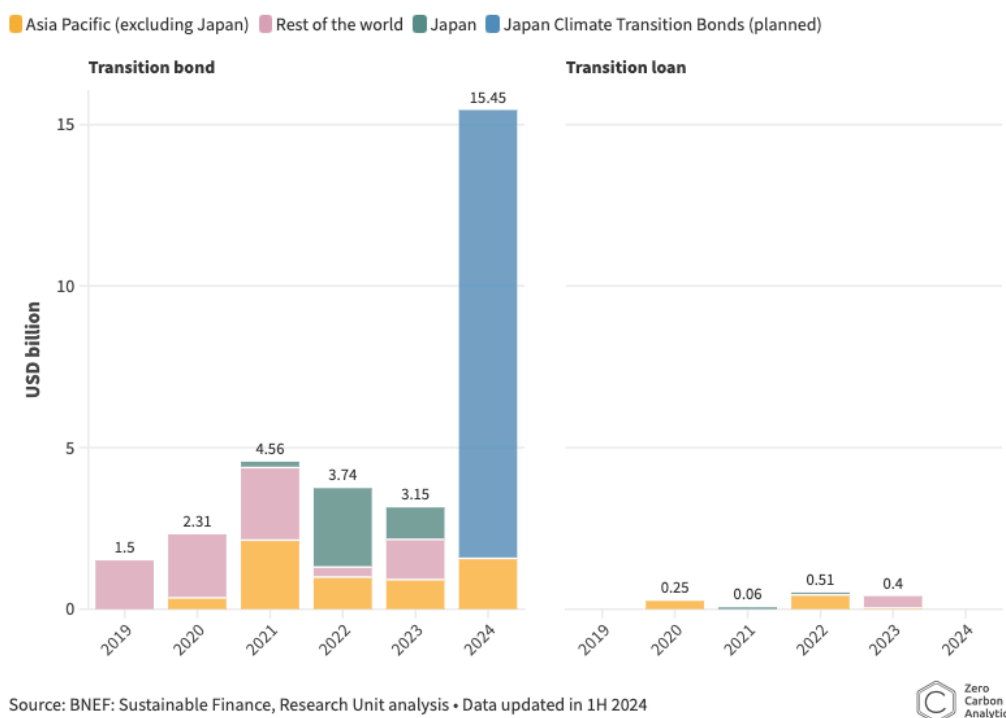
A [power company in Hong Kong issued the first transition bond](#) in 2017, and since then, the transition debt market has experienced bumpy growth. Global transition bond issuance since 2019 currently stands at around [USD 34 billion](#).⁶ In 2023, total issuance for transition bonds was just USD 3.1 billion, [about 0.2% of total sustainable debt issuances](#).⁷ For transition finance to take off, a wider range of issuers is needed.⁸

Fig. 1: Global issuance of transition bond and loans (2019-2024)

⁶ Zero Carbon Analytics analysis, BNEF (2024) Sustainable finance database, available via BNEF platform, accessed on September 23, 2024.

⁷ Ibid.

⁸ The sustainable debt market also remains a small part of the total debt market– making up just 2.4% of total debt issuances in June 2024.



Japan has led in transition finance in recent years, with Japanese bonds making up [34% of global issuance in 2023](#) and [around 99% of issuances in 2024 so far](#), driven by strong government support.⁹ In February 2024, Japan [issued its first sovereign transition bond](#). Although this bond was initially certified by the Climate Bond Initiative for its sustainable focus, [future certifications were withheld](#) due to a lack of clarity over the use of proceeds. Fears of transition-washing could have also led to the [lacklustre international investor appetite](#).

Transition-washing

[Transition-washing](#) occurs when transition finance is used to support activities or companies that do not have credible plans to align with the decarbonisation pathways needed to achieve global climate goals, such as limiting warming to 1.5 degrees celsius (°C). [Similar to greenwashing](#), which involves misleading claims about environmental benefits, transition-washing involves providing finance to projects or companies that continue high-emission activities while claiming to transition to greener practices.

To prevent transition-washing, it's crucial that companies issuing transition finance instruments have a [credible transition plan](#) that outlines how they will reduce their emissions in line with global climate goals.

Transition finance frameworks

Transition finance frameworks are [crucial for avoiding carbon lock-ins](#) as they enhance the credibility of investments and address potential loopholes that could otherwise allow for prolonged high-carbon practices. Common definitions across jurisdictions can provide clarity for issuers and investors and boost market confidence.

⁹ Zero Carbon Analytics analysis, BNEF (2024) Sustainable finance database, available via BNEF platform, accessed on September 23, 2024.

Taxonomies in Asia

The [IMF recommended taking actions to improve investor trust in transition finance](#) to unlock finance for climate transition in EMDEs. An example of such an action is developing transition taxonomies to align financial flows with low-carbon activities. Some progress has been made towards this, and a number of Asian countries have developed taxonomies or guidelines on transition finance, in order to provide investors with more certainty on which activities are covered by transition finance and to alleviate risks around transition-washing.

Hong Kong

Hong Kong's banking regulator released a [taxonomy for sustainable finance](#) in May 2024 for adoption in the local market. The taxonomy covers 12 economic activities under four sectors: power generation, transportation, construction, and water and waste management. The regulator plans to expand the taxonomy to more sectors and transition activities in the future.

Japan

Japan's financial regulator, environment ministry and economy ministry released the [Basic Guidelines on Climate Transition Finance](#) in May 2021, as opposed to a transition finance taxonomy. The guidelines were based on the Climate Transition Finance Handbook by ICMA, which has become an [international standard setter](#). The guidelines were accompanied by an annex of [technology roadmaps](#) for high-emission sectors eligible for transition finance, including iron and steel, chemicals, power, gas, oil, pulp and paper, cement, automobiles, shipping and aviation and marine transport.

In addition, the Japanese cabinet approved the Green Transformation (GX) plan in February 2023. The plan aims to promote transition finance through the issuing of [JPY 20 trillion](#) (USD 144 billion) GX Economy Transition Bonds over the next 10 years.

Critics of the Japanese roadmaps have pointed out that the guidelines [lack quantitative emissions reduction trajectories](#), with sunset dates for technologies not meeting targets that strictly align with science-based [1.5°C pathways](#).

Singapore

Singapore's central bank launched the [Singapore-Asia Taxonomy](#) at COP28 in 2023. The taxonomy uses a "traffic light system" to categorise companies from eight sectors as green (near zero emissions), amber (transition), and red (ineligible). The amber category represents transition activities with a defined timeframe or a fixed sunset date of around 2030. In 2030, an amber activity either gets upgraded to green or downgraded to red depending on whether emissions targets are met.

The Singapore Taxonomy is the most established taxonomy in Asia. Singapore's central bank and People's Bank of China (PBC) are currently collaborating on aligning the taxonomy with the International Platform on Sustainable Finance's Common Ground Taxonomy, expected to be completed by the end of 2024.¹⁰

However, Singapore's inclusion of [natural gas and nascent and expensive technologies such as carbon capture and storage in the taxonomy has been criticised](#).

¹⁰ The International Platform on Sustainable Finance (IPSF) on November 4 released the [Common Ground Taxonomy](#), a green investment classification system built on the green taxonomies of the EU and China.

ASEAN

The Association of Southeast Asian Nations (ASEAN) [released the ASEAN taxonomy on sustainable finance in November 2021](#), and last [updated the taxonomy in April 2024](#). The taxonomy aims to define sustainable activities and attract investment for economic transition in the ASEAN region. The taxonomy is meant to serve as a [regional classification standard](#) for ASEAN member states – which can overlay it with their own, localised standards. Similar to Singapore’s approach, it incorporates a traffic light system that classifies activities into green (aligned), amber (in transition but do not yet meet the highest technical standards), and red (not aligned).

At the moment the taxonomy provides technical screening criteria for six sectors. While the investment community shows interest due to its flexible approach some say [this approach is complex](#). In addition, [under specific conditions, the Tier 3 of the amber classification allows for new coal plants to be built and operate until 2028](#), which [may put off international investors](#).

Paris-aligned transition finance frameworks

Several of the taxonomies in Asia have been criticised for allowing investments in coal and gas and for not setting quantitative [emissions reduction](#) targets that align with [1.5°C pathways](#). To address these criticisms, Asian transition taxonomies could introduce several guardrails. According to ClientEarth, [credible transition finance frameworks should include the following](#):

- **Clear definitions and meaningful ambition:** The transition finance framework needs to establish clear definitions and boundaries, specifying which activities or companies can use transition finance labels. It should also ensure that only firms committed to a meaningful reduction of their emissions (across the whole value chain) are eligible. To ensure compliance and maintain the integrity of the market the framework needs to include enforceable and clear penalties.
- **Robust classification standards:** The activities and technologies financed must meet rigorous classification standards that mitigate risks like carbon lock-in. These standards should clearly define which carbon-intensive activities are eligible for transition finance and outline the required emissions reduction trajectories for these activities.

Defining the sectors included and excluded in transition finance, instead of relying on ‘hard to abate’ as an umbrella term, could also help address investor uncertainty and reduce the risk of transition-washing. An example is Standard Chartered’s [exclusion of natural gas projects from its transition finance label](#). Exclusion criteria may also differ depending on the development stage of the country in question – with more developed economies having more stringent criteria.

Company transition plans

Companies should [clearly disclose whether they have credible transition plans for decarbonisation](#) to improve transparency and guide investments toward sustainability, according to the International Capital Market Association (ICMA). The company should provide detailed information on planned changes to its business model, operations and investments, ensuring these actions align with its transition strategy. ClientEarth said any corporate transition plan should be benchmarked against national or regional emissions reduction pathways that are consistent with limiting global warming to 1.5°C. According to ICMA, a company issuing transition-focused instruments [should also set and disclose science-based targets](#) for reducing its own greenhouse gas emissions. This includes setting

clear short-, medium- and long-term goals and reporting both absolute and intensity-based metrics. The company's [transition strategy should be directly connected to environmentally significant aspects of its business model](#) and focus on areas with the greatest environmental impact, ICMA said.

ClientEarth has called for [transition plans to be validated by independent, external verifiers](#) capable of assessing the alignment of the company's overall strategy with Paris Agreement goals, according to ClientEarth. This includes verifying the transition strategy's scientific integrity and ensuring that the financed activities contribute to meaningful decarbonisation. ICMA [highlighted that disclosures may not remain voluntary in the future](#), with several regulators developing transition plan requirements. These regulations, along with market initiatives promoting the adoption of transition plans, may turn the plans into “a ‘de-facto’ requirement for most corporates issuing in the international debt markets,” even among companies who are not required by law to do so, according to ICMA. This would help investors understand where their money is going and help to shift more capital to businesses actively reducing their carbon footprint.