Interim report of the Asia Transition Finance Study Group

April 25, 2022

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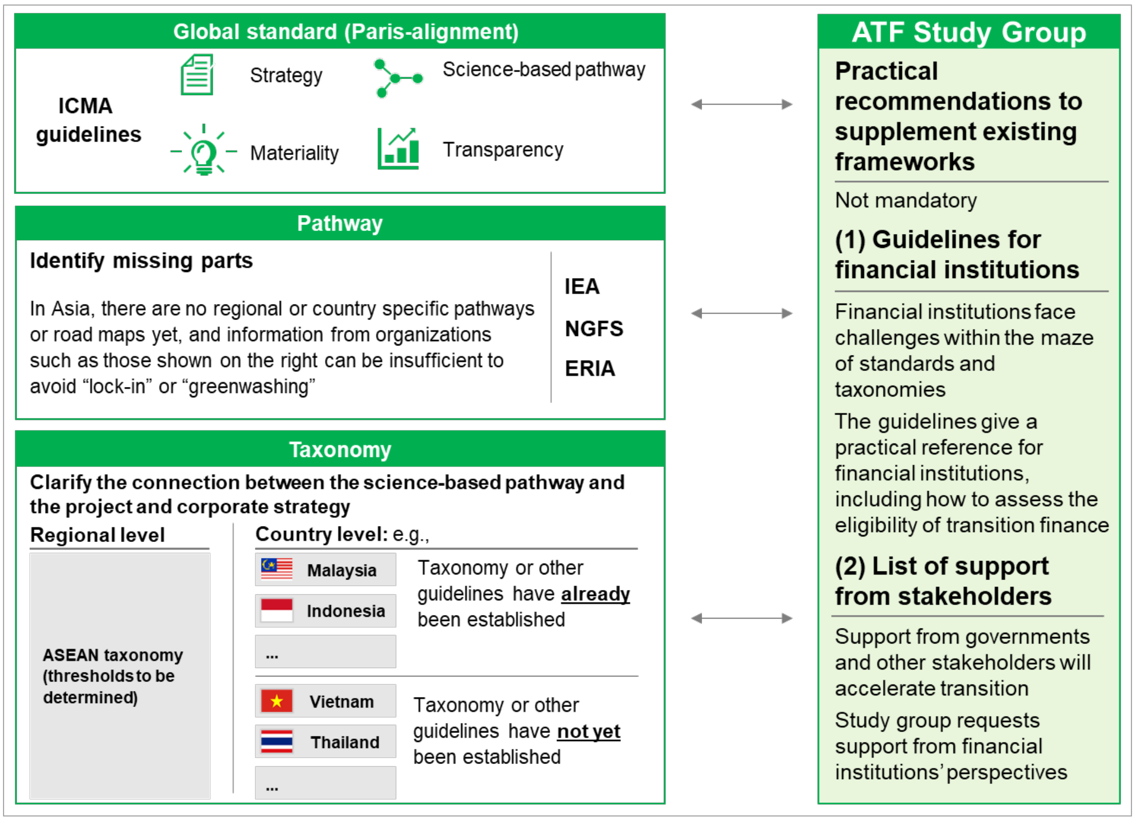
1 Context and objectives

The Asia Transition Finance (ATF) Study Group is a private led initiative with a core membership composed of Asian and global banks. It aims to create practical recommendations to supplement existing frameworks, including global standards and taxonomies. These recommendations will be in the form of (1) practical transition finance[1] guidelines for financial institutions and (2) a list of support requested from governments and other stakeholders.

Exhibit 1: Objectives of the ATF Study Group



* *This paper is an interim report of the ATF Study Group and is subject to change. The paper intends to provide a concept for eligibility for transition finance, information on how to determine eligibility and what may be considered an eligible practice with given references and tools for financing transition activities. The contents of this document are not mandatory rules or procedures, and the study group participants are not obliged to adhere to the proposals, but financial institutions can refer to them as needed.*

The need and urgency for decarbonization is globally recognized, but there remains significant uncertainty on how the transition to a low-carbon society will occur. However, it is clear that financial institutions will play a role in financing activities that support transition along Paris Agreement-compliant pathways. There are many opportunities to decarbonize in Asia, but not all of these opportunities are easy to capture, given Asia's growing demand for energy and industrialization, and varying natural resource endowments for renewable

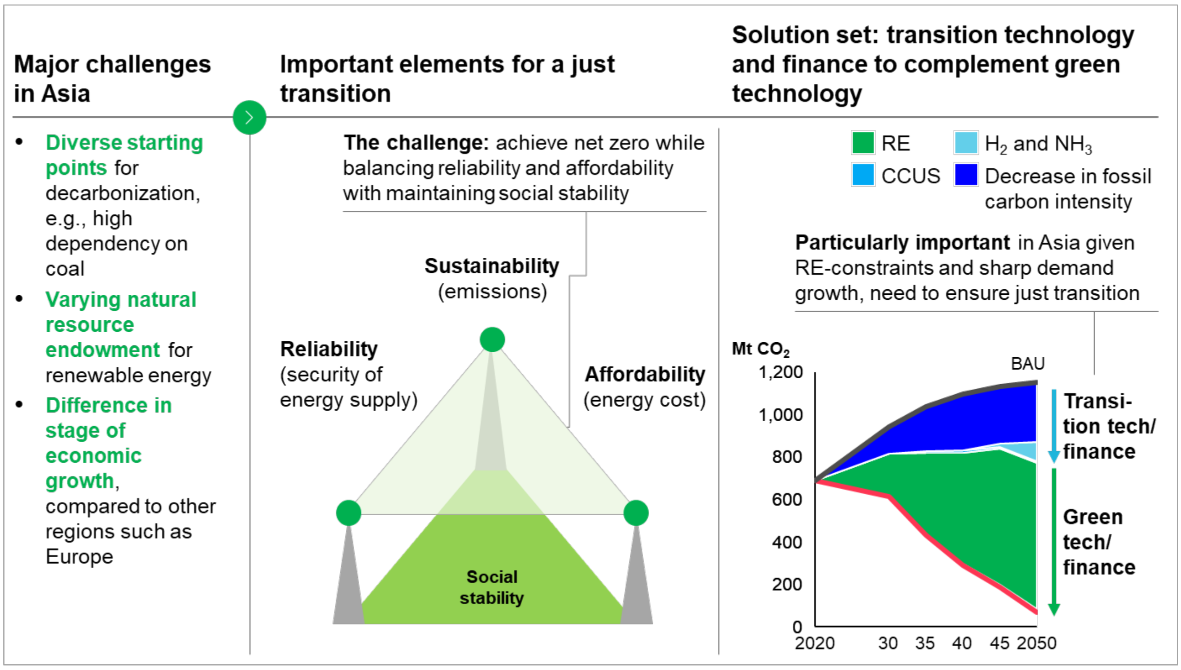
[1] In this study group, we assume green technology to be technologies which emit zero carbon emission through operation and enablers of those (for example, solar related technology), and "transition" technology as other emissions-reducing activities.

energy. While green technologies will certainly contribute to the decarbonization of Asia, there is a need for transition technologies that will enable decarbonization in line with the Paris Agreement and ensure a just and orderly transition. That is to say, transition activities should consider not only climate sustainability, but also reliability of energy supply, affordability of energy, and social stability in order to accelerate decarbonization and ensure energy security while avoiding abrupt dislocations. The Asia Transition Study Group recognizes the importance of a just and orderly transition and intends to further the discussion on how financial institutions may support such a transition by considering case studies, where they exist.

While there is broad recognition of the need for transition technologies and financing to support these activities, existing green taxonomies typically focus on defining eligible activities as those with no carbon emissions, resulting in a binary and static approach to what is considered sustainable. This potentially excludes activities that may support the broader objective of decarbonization. Though there is growing consensus around the need to support activities, technologies and entities that are part of the transition guidelines regarding transition finance are nascent.

The ATF Study Group aims to supplement existing guidelines on transition finance to help financial institutions implement transition finance. Both private and public funds will be critical in achieving the transition. To support the mobilization of private capital, clear guidelines and approaches to transition finance must be defined. In this interim report, all types of finance such as loans, bonds and equity, will be included as tools of transition finance.

Exhibit 2: Challenges and the concept of transition in Asia



2 Challenges for transition finance

The ATF Study Group has identified four main challenges in implementing transition finance today:

I. **Differing standards.** There are a number of different standards and taxonomies for practitioners to navigate, each with their own requirements. For example, the International Capital Market Association handbook provides recommendations for transition bonds and requires additional explanation when applying its contents to transition loans and equity investment. Additionally, it is unclear how certification under one standard can be transferred to certification under other taxonomies; that is, there is uncertainty regarding the interoperability of the International Capital Market Association standard, the Association of Southeast Asian Nations (ASEAN) taxonomy, and other taxonomies developed or under development by individual countries.

II. **Unclear eligibility requirements.** Currently, there is no globally recognized, practical approach to transition finance that addresses the various challenges in assessing a project's eligibility for transition finance, such as the following:

   — Transition finance projects are more complex to evaluate than green projects. In the case of transition finance, targets or thresholds are subject to a science based decarbonization trajectory which is relative to the starting point and life cycle of a project across countries and sectors, whereas green projects have clearly defined targets.

   — Projects are often executed using special-purpose vehicles with multiple stakeholders, and it is often difficult to identify which stakeholders' strategies should be assessed.

   — Corporate level sustainability strategies are not yet standard for companies (large corporations and small and medium enterprises) – it is impossible to assess a strategy that does not exist.

III. **Localized references.** Transition solutions are context specific, meaning that localized references are critical for evaluation. Asia lacks national and sectoral pathways that are aligned with the Paris Agreement. Furthermore, the importance of a "just and orderly" transition is not fully recognized or incorporated into policies.

IV. **Limited case history.** There are limited case examples for financial institutions to use as reference points when trying to finance transition projects.

Addressing these challenges will take time. It is critical that interim approaches are developed and accepted by stakeholders to ensure timely implementation of transition finance activities.

Exhibit 3: Challenges of transition finance in Asia

Challenges	Resolution: I. Guidelines	Resolution: II. List of support requested from stakeholders
Maze of standards and taxonomies	Explanation of existing standards and taxonomies, e.g., ICMA guidelines, ATB, and common ground taxonomy	Clarify rules on interoperability (to be discussed from April onwards)
Absence of well-defined practical approach to transition finance, • Transition finance projects are more complex to evaluate than green projects	Key concept of **eligibility of transition finance** **Checklist** of disclosure / info needs for transition finance assessments	N/A
• Project finance: SPC established by various corporations	Guidelines on **whose strategies** need to be examined for transition finance assessment	N/A
• Many companies in ASEAN without decarbonization strategies	Guidelines for use-of-proceeds financing **when sponsors do not have decarbonization strategies**	N/A
Absence of well-established localized reference points for transition finance assessments • Lack of applicable Paris-aligned benchmark	N/A	Creation of **sector/country-level decarbonization pathways and technology road maps** for ASEAN
• Limited recognition of just and orderly transition	N/A	Consideration of a **just and orderly transition** in accelerating decarbonization
• Need time to create endorsed reference	Guidelines on the **interim approach** when countries do not have pathways/ road maps e.g., use of existing regional pathways and third-party verification	N/A
Limited case history	N/A	**Financing or stakeholder involvement support** for several pilot cases with transition finance in Asia

3 Proposal

I. Practical guidelines for transition finance

A) Key concept of eligibility for transition finance

Projects or corporations whose plans and strategies can be regarded as aligned with the Paris Agreement through considering use-of-proceeds-level and corporate-level elements should be eligible for transition finance. Specifically, the target level of decarbonization and target year need to be aligned with Paris Agreement-compliant pathways. The use-of-proceeds also needs to be feasible, aligned with publicly recognized sources such as national technology road maps.

Exhibit 4: Concept of eligibility for transition finance

Key concept of eligibility for transition finance

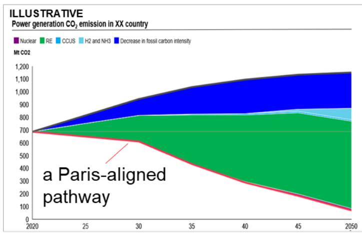
Project or corporation whose strategy can be regarded as **Paris-aligned** is a **transition finance eligible** with the combination of X) and Y)

- **Target level: Net-Zero commitment by country or a long-term Paris-aligned target**
- **Target year: Set by governments for Net-Zero commitment or by globally recognized scenarios**
- **Feasibility of projects: Alignment with publicly recognized sources**

X) Use-of-proceeds level

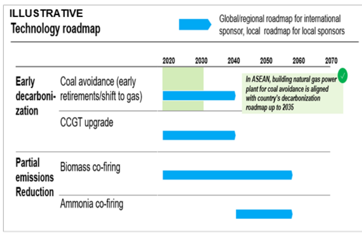
X1) **The targeted project** has a **long-term decarbonization plan** including a medium-term target, aligned with

- **Science-based, Paris Agreement-compliant country and/or sector pathway**
- **Corporate strategy**[1]



X2) **The technology in a targeted project** can be assumed as eligible with publicly recognized sources, e.g.

- **Science-based, Paris Agreement-compliant country technology road map**
- **Corporate strategy**



Y) Corporate level

Y1) **The targeted company** has a **long-term decarbonization plan** including a medium-term target and KPIs, aligned with a **science-based, Paris Agreement-compliant country and/or sector pathway**

Remarks

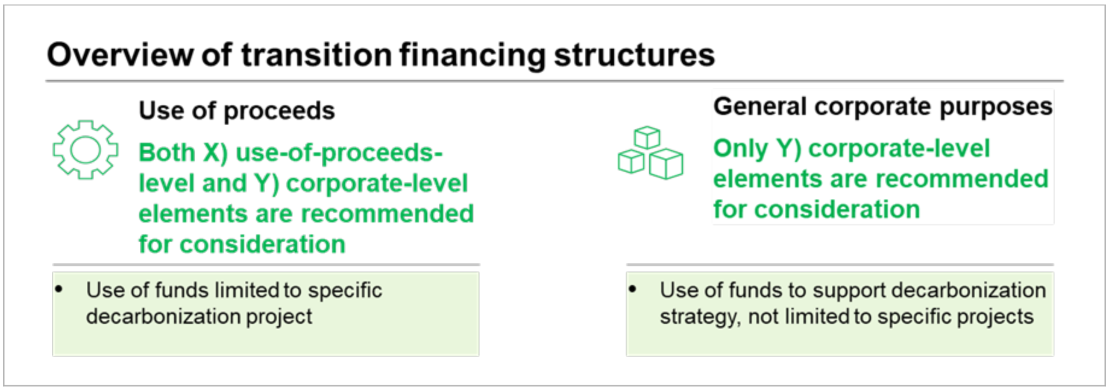
- **Interim approaches can be applied with a proxy which satisfies the concept of transition finance above** (e.g., regional pathways, relevant taxonomy) until the Paris aligned country road map or pathway is created
- **Type/timing of eligible technology can vary by countries** based on the concept above, including future technologies

1. Even if both project plan and corporate strategy are aligned with a Paris-compliant pathway, the project plan may not be aligned with the corporate strategy

B) Considerations for transition finance

There are two types of financing structures: use of proceeds financing and general corporate purposes financing. Use-of-proceeds financing, where the use of funds is limited to specific projects, is recommended to consider both use-of-proceeds and corporate-level elements, while financing for general corporate purposes financing is recommended to exclusively consider corporate-level elements. These elements are not required to be considered for all cases and required consideration points will be decided on a case-by-case basis. Further discussion on this topic will be conducted in future study group meeting.

Exhibit 5: Overview of transition financing structures



<u>Use-of-proceeds-level considerations</u>

For a use-of-proceeds-level consideration, it is recommended that the following conditions (among others) are met:

› The targeted project's long-term decarbonization plan, including a medium-term target, is aligned with a science-based Paris Agreement-compliant country and/or sector pathway and with corporate strategy.

› The technology in a targeted project is consistent with publicly recognized sources such as a science-based Paris Agreement-compliant country's technology road map, and the corporate strategy.

<u>Corporate-level consideration</u>

For a corporate-level consideration, it is recommended that the following conditions (among others) are met:

› The long-term decarbonization plan, including a medium-term target, of the targeted company is aligned with a science-based Paris Agreement-compliant country and/or sector pathway.

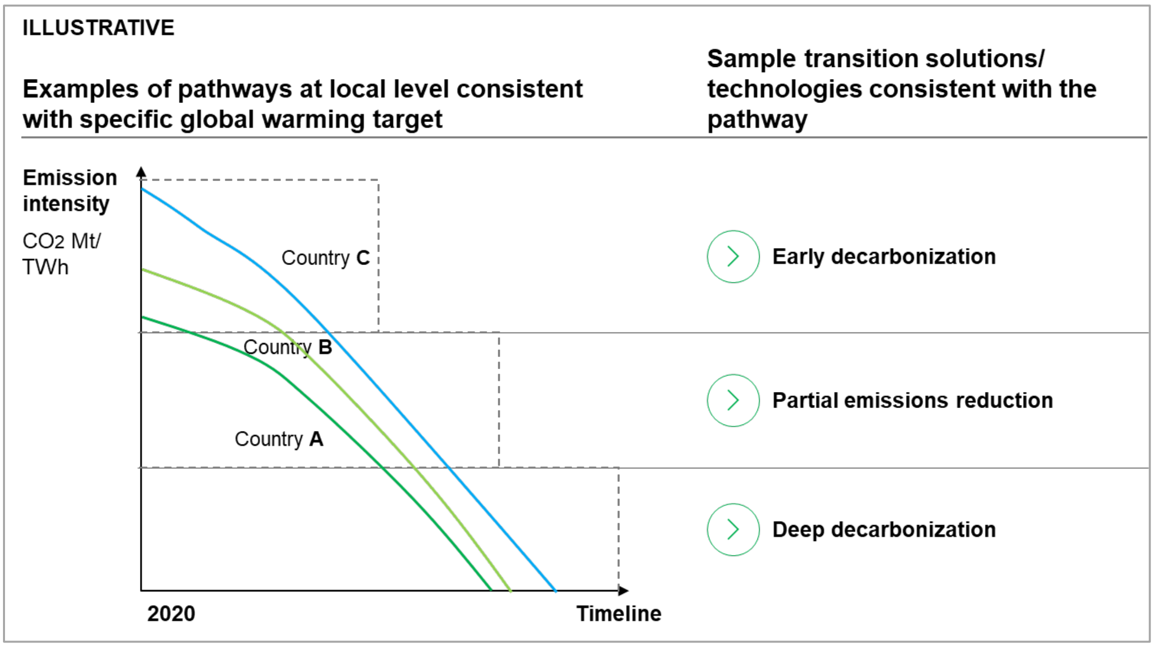
› The associated KPIs to the financing for general corporate purposes (for example, SLB, SLL) are assumed to be ambitious based on a science-based Paris Agreement-compliant country and/or sector pathway.

C) Concept of transition technologies

Admissibility of transition technologies is tied to pathways and is therefore time bound. Countries at different stages of decarbonization need different types of decarbonization technologies. For example, countries that currently have higher emissions intensity, such as Country C in Exhibit 6, could be decarbonized using early decarbonization technologies for a longer period of time than other countries. On the other hand, countries that currently have lower emissions intensity, such as Country A, should soon switch to partial emissions reduction technologies for further decarbonization. There may be a case where Country C could move quickly to deep decarbonization due to technology development and intensive public and private financial support.

A list of potential transition technologies within each decarbonization stage will be a useful initial reference to build upon.

Exhibit 6: Concept of transition technologies



D) Guidelines on the interim approach, assuming that countries or regions need time to create pathways and road maps if they do not already have them (to be further discussed)

› Financial institutions can consider leveraging references, such as:

» Benchmarking the carbon emissions forecast of a project with existing regional pathways to validate the Paris Agreement alignment of the project.

» Using relevant taxonomies as indicative benchmarks, where applicable.

» Extracting transition technologies with timelines from existing pathways and using them to validate the Paris Agreement alignment of the project; analyzing each technology's contribution to carbon emissions reduction, with a timeline, and clarifying which technologies are eligible in a certain period.

» Referencing list of potential transition technologies applicable to Asia, created by credible source

» Utilizing credible industry standards regarding transition pathways where these exist.

› Independent reviews may be of particular help while governments develop localized pathways, and these are likely to be part of an ongoing audit of financial firms' performance in any case.

E) Content expected to be included in the final guidelines:

› Checklist of disclosure and informational needs for transition finance assessments

› Guidelines on which strategies need to be examined for transition finance assessments and how to encourage corporations to create them

› Guidelines for use-of-proceeds financing when sponsors do not have decarbonization strategies

II. List of support requested from governments and other stakeholders:

Interim suggestions on supporting activities that would help underpin the supply of transition finance at scale will be shared. These suggestions are targeted towards, for example, guidelines provided by governments, international and regional organizations, and other international efforts by policymakers. These should include the following:

A) **Creation of sector-level or country-level decarbonization pathways and technology road maps for ASEAN**. This should include the support of international organizations or other countries. Financial institutions require sector-level or country-level decarbonization pathways and technology road maps to assess if projects are compliant with the Paris Agreement, in order to be deemed credible. It is critical that these sector-level or country-level decarbonization pathways and technology road maps are created with the following key features:

› Global recognition, linked to Paris Agreement aligned decarbonization scenarios with science-based targets

› Sufficient granularity (down to the sector, country, or technology level), capturing different starting points

› Feasibility, in alignment with a decarbonization story grounded in national economic and development policies, and endorsed by the government

The above-mentioned list of potential transition technologies may be used to assist the development of country-level or sector-level decarbonization pathways and technology roadmaps by providing a reference point.

Exhibit 7: Key features for pathways and technology road maps

Key features	Key points	Why it is important for financial institutions
Global recognition and alignment	• Endorsed by international institutions and using global recognized metrics • Linked to global Paris-aligned scenarios • used by global financial institutions and third-party verifiers, e.g., SBTi • Reviewed by global peer review	• Mitigate reputational risk • Avoid the risk of green washing and lock-in • Ensure interoperability with other standards and taxonomies
Granularity	Has below granularity • Regional/country-level granularity • Sector-level granularity • Technology-level granularity	• Demonstrate alignment with Paris Agreement at sector/local level • Identify technologies/pathways to support transition finance while mitigating the risk of lock-in of fossil fuels
Feasibility	• Has accurate modeling of local condition • Has stated or pledged policies and targets • Has policies and targets endorsed by local policymaker • Is flexible and can quickly incorporate the changes in assumptions into the scenarios/pathways	• Mitigate policy risk • Facilitate co-financing from other financial institutions and local governments • Mitigate market and technology risk – e.g., overestimating/ underestimating the needs of certain technologies or investing in not feasible/viable technologies/projects • Reflect the change in technology advances and policy updates

B) **Consideration of a just and orderly transition in accelerating decarbonization.** Green technologies alone are simply not sufficient for promoting an orderly transition, especially in developing parts of Asia (for example, those with a high dependency on coal and growing demand). It is important to recognize that a mix of green and transition technologies is most likely to optimize overall costs and avoid abrupt dislocations. It is also important to balance the pace of transition with respect to other legitimate concerns, such as impact on employment prospects and standard of living.

C) **Financing or stakeholder involvement support for several pilot cases with transition finance in Asia.** Success stories can be used as a reference for subsequent projects, which will scale up transition finance. It is important for stakeholders to support the transition consistently to create a reference case through provision of, for example:

› Support or incentives for both large corporations and small and medium enterprises to create decarbonization strategies

› Proof-of-concept transition projects supported by the government or led by government entities

› Alignment of developmental finance institutes' strategies

› Public financing support such as concessional finance, equity injection, ECA finance, financial incentives and broader risk-sharing (blended finance)

› Incentives for corporations and financial institutions (such as warranty periods and de-risking for financial institutions, carbon credits for corporation)

› A database or digital platform for successful decarbonization projects

4 Conclusion

Transition finance will play a critical role to accelerate a just and orderly transition aligned with the Paris Agreement in Asia. On the other hand, Asia is facing challenges including differing standards, unclear eligibility requirements, lack of localized references and shortage of successful case references. In order to address these challenges, financial institutions need guidelines for transition finance and support from governments and other stakeholders. The study group will continue to meet to further discuss the contents of these guidelines and the support requested from governments and other stakeholders. It aims to continue to refine its proposal for an interim approach that assumes that countries or regions need time to create pathways and road maps, and interoperability with other taxonomies among other topics.

Exhibit 8: Study group participants

Category		Participants			
Core members	**Commercial banks (19)**	• MUFG Bank • Mizuho Bank • Sumitomo Mitsui Banking Corporation • Sumitomo Mitsui Trust Bank	• Bank Mandiri • Bank Danamon • Maybank • BDO Unibank • Security Bank • United Overseas Bank • Bank of Ayudhya	• Kasikornbank • VietinBank	• Macquarie • Barclays Bank • Standard Chartered Bank • HSBC • UBS • Citibank
Observers	**Development banks, ECAs, and others (6)**	**(Multilateral)** • International Finance Corporation	**(State-affiliated)** • Development Bank of Japan • Japan Bank for International Cooperation	• Export-Import Bank of Thailand • Nippon Export and Investment Insurance	**(Commercial)** • DBS Bank
	Public agencies and finance associations (12)	• ASEAN Taxonomy Board • Sustainable Finance Institute Asia • Australian Government	• Ministry of Energy and Mineral Resources, Indonesia • Ministry of Finance, Indonesia • Ministry of Finance, Japan	• Financial Services Agency, Japan • Ministry of Economy, Trade and Industry, Japan • Economic Planning Unit, Malaysia	• Department of Energy, Republic of the Philippines • Ministry of Energy, Thailand • Japanese Bankers Association