Concept Paper on Climate Transition Finance Principles

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Study Group on Environmental Innovation Finance in Japan

1. Background

- In order to solve the urgent challenge of climate change, it is important to create a proper environment for adopting measures against climate change, as the Paris Agreement enters into the implementation phase this year. Japan, having reduced its GHG (Green House Gases) emissions for five consecutive years and by 12% compared to the level in FY2013, needs to reduce emissions even further.
- As a tremendous amount of green investments is required globally to achieve the Paris Agreement goals, especially in emerging countries including those in Asia, it is critically important to promote such investment flows. In addition to accelerating current measures such as promoting green bonds, the following perspectives are important to reduce GHG emissions globally:
  - Facilitating investments into a wider range of areas (including energy, components, raw material, and service) which can contribute to a low-carbon economy, considering the high demand for investment.
  - As international trade is expanding and division of labor is deepening, there have been cases that countries that expand the ratio of service sector are reducing GHG emissions domestically but instead have been importing products that embed CO2 emissions from other countries, thus not necessarily ensuring a reduction of GHG emissions at the global level. Therefore, in order to actually reduce GHG emissions worldwide, it is necessary to aim at low-carbonizing all industries and sectors globally in an inclusive way, not leaving out GHG emitting industries and sectors (i.e., industries and sectors for which de-carbonization is technologically or economically insoluble in the foreseeable future).
  - With respect to GHG emitting industries and sectors, it is vital to promote finance in areas where proper measures are adopted or improvements are made towards lowering emissions.
  - Promoting long-term research and development (R&D) towards low/de-carbonization.
  - Accelerating the reduction of GHG emissions throughout the entire global value chain and the life cycle of a product.*

    * The former refers to GHG emission reduction by providing materials, products and services with excellent environmental performance to global markets. The latter refers to GHG emission reduction through the entire life cycle of products and services including from raw material procurement to manufacturing, distribution, use, disposal and recycling, rather than just a part of the life cycle such as the use phase.

- Accordingly, it is imperative to promote financing for these areas (including by transition bond, transition loan etc.) by developing a new set of standards for climate transition towards the Paris Agreement goals.

2. Concept

- In addition to promoting financing for an already de/low-carbonized activity, for instance in the area of renewable energies, it is important to promote financing for transition actions towards the de/low-carbonization of GHG emitting industries and sectors as well, as a part of climate finance contributing to the mitigation of climate change.
- Climate transition finance should be defined as financing (initial investment or refinancing) for businesses on a transition path towards achieving the ambition of the Paris Agreement and the reduction target of each country based on the Paris Agreement.
- While green investments expand across borders worldwide, transition pathways aligned with the Paris Agreement may differ from region to region and from country to country, depending on its industrial structure, and/or the role it plays in the overall global value chain.
- Therefore, we propose that, in developing the concept of "financing for a transition", (1) international principles should adopt an inclusive and flexible approach that can be applied to various circumstances of countries and regions without excluding specific sectors/industries or technologies from its scope, and (2) further details should be considered by each country or region based on its respective circumstances.

3. Proposal for international principles

- Based on the ideas described in 1. and 2. above, we propose the following as a basis for drafting international principles on transition finance that can be applied flexibly. Since the following only covers the contents of our proposed general principles, further details for practical use should be discussed by respective countries or regions.

(Standard for alignment with the Paris Agreement)

- It should be finance for a transition towards achieving the Paris Agreement goals and the reduction target of each country based on the Paris Agreement.

(Standards for business entities)

- It should be finance for a business entity that is proactively pursuing a transition towards achieving the Paris Agreement goals and the reduction target of each country, including for example by providing a mid- to long-term vision or an action plan, taking into account long-term environmental impacts (it is preferable if an entity has been working on concrete measures such as R&D aiming at low- and/or de-carbonization).
- It should be finance for an entity that has a mid-term target for reducing GHG emissions

towards the reduction target of each country based on the Paris Agreement and that has been achieving its target or has been making an effort to achieve it in the future.

(Standards for Projects)

- It should be finance for a project in a GHG emitting industry or sector that achieves or implements the level of best performance of low GHG emissions in line with a reputable global or regional standard for such a sector or industry.

  E.g., investment towards a BAT(Best Available Technology) project, capital investment to significantly improve energy efficiency and decrease the CO2 emissions of existing facilities, investment in a new business to decrease the CO2 emissions of a whole supply chain or cities, and capital investment in installing cutting-edge high- efficiency power generators

or

- It should be finance for a project relating to or contributing to products with the level of best performance of low GHG emissions in line with a reputable global or regional standard for such a sector or industry.

  E.g., production of highly efficient automobiles and projects related with its value chain and production of items regarded as "top-runner" in terms of efficiency, etc.

Whether the standards for business entities and the standards for projects should be both satisfied depends on asset classes or designs of each financial instrument. Considering the fact that the intent of business entities plays a vital role in a transition, it is important to take into consideration business entities' proactive stance or action to pursuing a transition (for example by providing a medium to long term vision or action plan).

(Other points which can be taken into account)

- Contribution to a global reduction of GHG emissions where a business operates in the global value chain.
- Contribution to GHG reduction throughout the life cycle of a product.
- Contribution to or influence on other SDGs or other environmental objectives.