TRANSITION FINANCE HOW-TO GUIDE SERIES

How To Design Transition Finance Approaches

June 2024

Table of Contents

Introduction

Transition finance is emerging as a core concept for financial institutions seeking to align their portfolios and business strategies with net-zero goals. This guide offers financial institutions critical information for deciding how to design a transition finance approach that meets their needs. It outlines key design questions and summarizes the advantages and trade-offs of different approaches currently seen in the market. Relevant resources and examples are included to help provide additional context and support financial institutions seeking to build on existing guidance.

How to use this guide

AUDIENCE

This guide is primarily for sustainability and strategy teams within banks. However, it offers introductions to core concepts that could be useful across a variety of functions and organizations that are exploring different approaches to transition finance, including other types of financial institutions as well as nongovernmental organizations (NGOs), regulators, and policymakers.

CONTEXT

Transition finance approaches should be designed with a firm's regulatory context and portfolio in mind. Transition finance can be seen as an enabler of change in the real economy, and transition finance approaches provide stakeholders with a better understanding of what type of projects the capital is flowing to in a specific financial institution. However, the success of the real-economy transition and, thus, financial institutions' ability to finance the transition, will also be dependent on appropriate economic conditions and policy incentives.

STRATEGY

This guidance is not exhaustive. Each financial institution will need to adapt it based on a number of factors, including its strategic goals for undertaking work on transition finance, portfolio exposures, stakeholder expectations, existing policies and practices, internal governance, and operational structures.

INTEROPERABILITY

This guide can be used in conjunction with other guidance and frameworks on transition finance and related topics, such as transition planning, target setting, and reporting standards.

Why Design a Transition Finance Approach

When an organization begins designing a transition finance approach, one of the first things to clarify is *why*. Internal alignment on the goals will make the design choices easier and quicker, and a unifying motive should help post-design communication and implementation. Alignment on the *why* can also inform when and how transition finance is seen as part of an organization's net zero journey, from strategy design to implementation and reporting.[i]

A financial institution might choose to develop its own approach to transition finance for several reasons. The list of reasons below offers a starting point to guide internal discussions on goals and motives for designing a transition finance approach, but each firm will likely have its own variation and additions. Moreover, this list is not exhaustive, and motives are not mutually exclusive. The impetus for clarifying an approach to transition finance will likely come from multiple internal and external demands.

Finance real-economy decarbonization where it is needed most.

Ultimately, a transition finance approach can help a firm finance real-economy decarbonization through capital allocation to transition projects. By assessing and prioritizing the credibility of activities, these approaches can help the firm identify impactful opportunities and allocate capital where it is needed most as well as where there is significant commercial opportunity to finance the low-carbon transition. This can help reduce risks and maximize opportunities from the global transition.

Help meet net-zero targets.

A transition finance approach can help a firm meet its net-zero targets. Financing counterparties' transitions in line with credible net-zero transition plans and pathways may accelerate the real-economy transition and support portfolio alignment over

i For more guidance on the steps in a net-zero journey, see RMI's *Getting Down to Business: Enabling Action and Enhancing Credibility in Net-Zero Banking Using a Portfolio-Led Approach*, **https://rmi.org/wp-content/uploads/dlm_uploads/2022/12/getting_down_to_business.pdf**.

time. Transition finance is therefore likely to be one part of a firm's overall strategy for pursuing net-zero targets, and having a clear transition finance approach can drive progress toward these goals.

Reduce systemic risk and mitigate financial instability.

If the real economy remains misaligned with the goals of the Paris Agreement, unmitigated climate change could create instability within the entire financial system. In light of the above two reasons, then, transition finance's contribution to net zero can help reduce systemic risk within a portfolio.

Reduce exposure to regulatory risk.

Regulators in the United States, the European Union, and elsewhere are increasingly looking at financial institutions' preparedness to withstand climate-related shocks and at the credibility of their climate-related activities. Having a clear approach and strategy to shift portfolios toward transition finance and away from business-as-usual approaches could help reduce reputational risk and act as a buffer against future transition-planning expectations, capital requirements, and regulatory obligations.

Clarify how the firm will support counterparty transition.

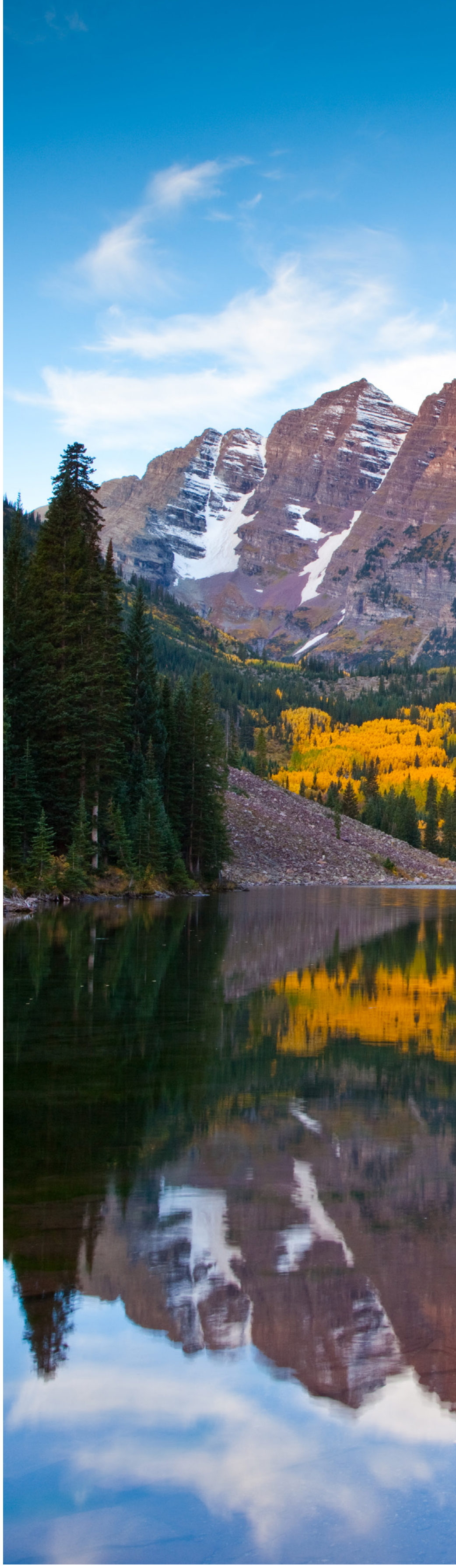
A clear transition finance approach can help define boundaries for and facilitate communication of how a bank will support clients' transition activities. This can include enhanced clarity on existing approaches as well as presenting opportunities for new financial products and services. Having a transparent approach can also reduce reputational risks from accusations of greenwashing.

Accelerate decision-making.

Standardized and centralized transition finance approaches across an organization can help accelerate decision-making by clarifying processes, responsibilities, and expectations for employees. Depending on its format, a transition finance approach could simplify and accelerate assessment, engagement, and approval processes both internally and externally where relevant. This can reduce resource burdens and potentially increase the amount and speed of capital allocated to transition finance.

Translate transition planning into capital deployment.

As financial institutions publish transition plans to meet net-zero commitments, they will need ways to translate these plans into capital allocation. A transition finance approach can be a central part of this translation, turning plans into the policies,



expectations, processes, products, and services that will allow front-office bankers across the firm to allocate funds in a standardized and measurable way. This can support internal alignment as well as stakeholder communication as to how the transition plan will be implemented.

Support balance sheet prioritization.

As a financial institution adapts its business practices in light of climate goals, it needs to assess its portfolio and identify areas where it wants to expand or reduce exposure. Designing common approaches and tools can help employees prioritize action and innovation in parts of the balance sheet that can most effectively support the net-zero transition in the real economy at different times. Focusing on where the firm has exposure and potential influence in transition-enabling activities can ensure that organizational resources and financial capital are deployed efficiently and effectively.

> **Transition finance frameworks and taxonomies help move the transition conversation away from subjective viewpoints and definition-based qualitative discussion, towards data-driven decision-making. They do this by providing definitional clarity and enabling financial institutions to measure, manage and benchmark the rate of progress towards company and sector-based net zero targets.**
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> **Transition frameworks and taxonomies can also facilitate coordinated capital allocation towards technologies, activities or organisations that are aligned with credible, science-based transition pathways, or to engage those that need to accelerate their transition pathway.** — **Investor Leadership Network,** 2023[1]

Top 10 Guiding Questions

to Inform Transition Finance Approaches

As a firm embarks on creating its approach to transition finance, it will have to grapple with several thorny questions, many of which do not have clear answers or best practices today. Regardless, reaching internal alignment on each firm's own opinions will be critical to unlocking design choices and the feasibility and credibility of the final approach. However, given the rapidly evolving nature of transition finance, the firm should remain open to new guidance and solutions as they emerge, and build in opportunities to revisit its assumptions and answers to these questions when designing internal guidance and governance.

Following are the top 10 questions that a firm will likely need to consider in designing a transition finance approach. The order of the questions represents how discussions could evolve internally. However, depending on how the firm is structured, governed, and already thinking about these topics, these questions might emerge at different times during the process, and firms may already have answers to some but not others. This list can serve as a guide for those beginning their design process or as a review for those with established approaches to check if their documentation and processes can answer all of the questions for both internal and external stakeholders.

Tips from Bankers

We asked some of our partners for words of advice based on their experience designing transition finance approaches:

"It's fine to **start small and build**. It's fine to not have the perfect answer day one."

"The first step is to **involve the business side** in this work. Sustainability teams cannot do everything."

"Make sure you've got the resources and support from the **executive level**."

"Recognize that **it takes investment** to develop systems for implementation."

"**Learn from others**. You are not alone!"

1 Definitions

How does the firm define transition finance? How does its definition compare with and build on aspects of other organizations' methodologies, definitions, and guidance?

2 Use Case

What does the transition finance approach need to achieve? How do the use cases differ between internal and external stakeholders?

3 Instrument Scope

Are any financial products, services, or business lines out of scope? Are different requirements needed for dedicated versus general purpose finance? Which instruments should be prioritized to deploy transition finance?

4 Strategy and Targets

Are new targets for transition finance needed? If yes, what form should they take (e.g., capital allocated, financing ratios, portfolio emissions)? How is the firm considering transition finance in relation to existing firm-wide business and sustainability strategies, targets, and priorities?

5 Lens

Is transition finance being explored from sectoral, asset, portfolio, technology, and/or regional perspectives?

6 Assessment Process

What criteria and processes are being used to assess potential transition finance deals? Are they predicated on transition planning? How can these processes ensure credibility and reduce risk of greenwashing accusations? What is being assessed: the activity, counterparty, or potential financial instrument?

7 Metrics and Measurement

How will transition finance be measured, monitored, and reported? How will this be incorporated into existing reporting processes?

8 Governance

How will transition finance be built into existing governance structures to ensure clear lines of responsibility and oversight?

9 Implementation

How will the transition finance approach be rolled out across sectors, geographies, asset classes, and business units? How will the firm integrate the approach into the client experience so that it becomes business as usual? How will the firm resource and train employees to implement the transition finance approach? Are there third-party providers that can support transition finance activities?

10 Engagement

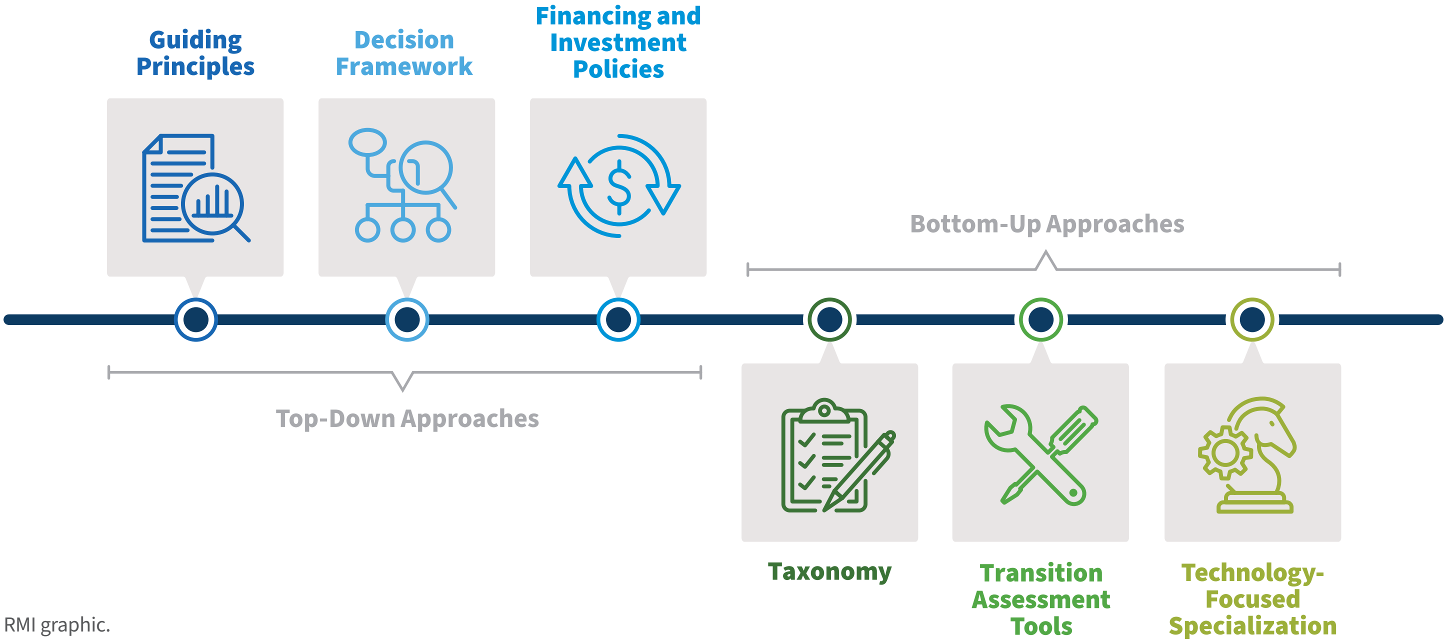
How will the firm engage on transition finance topics, such as with clients, the finance sector (including peer as well as multilateral and public finance organizations), regulators and policymakers, NGOs, and standard setters?

For help getting started on answering some of these questions, see **Additional Guidance and Resources** at the end of this guide.

Pros and Cons of Design Options

This section identifies and explores six different design options that are available based on existing practices in the market. A description of each approach is provided, along with high-level pros and cons and examples to help firms assess where and when the approach might be beneficial. Exhibit 1 identifies the six approaches and highlights that firms can choose from both top-down and bottom-up approaches to transition finance depending on their needs.

Exhibit 1 **Summary of Top-Down and Bottom-Up Transition Finance Approaches**



RMI graphic.

The design and implementation of the approach are key to ensuring its integrity, credibility, and ultimate impact. Regardless of the conceptual benefits, if the design lacks rigor or is not tailored to an organization's existing structures, it will likely not deliver expected outcomes. Separate guidance is available on how to build internal capacity for transition finance,[2] which can help facilitate implementation. These approaches do not happen in a vacuum, and the financial institution will likely need to select and invest in enabling inputs, such as the underlying data, sectoral and/or regional pathways, engagement, and financing strategies.

Transition finance approaches do not need to be designed from scratch. A firm interested in pursuing transition finance should first take stock of how its approach can fit within existing frameworks, policies, and practices. A firm should also build on available market standards and best practices to support harmonization and comparability across the financial sector.

Exhibit 2 presents a visual summary of the relative advantages of each option. This shows that there is no single approach that can provide all the answers: Each financial institution needs to identify the approach (or approaches) that most suit its goals, resources, and existing structures.

Exhibit 2 Summary of Relative Advantages of Transition Finance Approaches

Approach	Transparency	Ease of design	Flexibility
Guiding Principles	MODERATE	HIGH	HIGH
Decision Framework	HIGH	MODERATE	MODERATE
Financing and Investment Policies	HIGH	MODERATE	LOW
Taxonomy	HIGH	LOW	LOW
Transition Assessment Tools	MODERATE	LOW	MODERATE
Technology-Focused Specialization	MODERATE	HIGH	HIGH

RMI graphic.

Guiding Principles

Guiding principles can provide guardrails for decision-making. Often seen as one of the foundations of creating a multilayered transition finance approach, guiding principles are generally a short list of high-level considerations that prioritize critical transition finance parameters.

Pros

Flexibility. High-level principles can be shaped by the firm to reflect the organization's own needs and priorities. They are widely applicable to different parts of a firm. They are also easy to implement in tandem with other approaches.

Simple to understand. Clear principles can be a useful communication tool to align employees on transition finance priorities.

Cons

Open to interpretation. Because they are often high level, how and when principles should be used is not always clear.

Comparability. It may be difficult for external stakeholders to compare different financial institutions' approaches and implementation of the principles.

Insufficient alone. Given they are high level, guiding principles often need to be combined with other approaches to provide employees with sufficient guidance and detail to inform decisions.

Examples

SMBC's Transition Finance Playbook outlines four principles:[3]

Do no significant harm: No investment should lead to significant harm. This principle has been included in most of the taxonomies and regulations related to the green transition.

No carbon lock-in: Carbon lock-in occurs when fossil fuel–intensive systems perpetuate, delay, or prevent the transition to low-carbon alternatives. Avoiding carbon lock-in is a key principle of transition finance.

Best available technology: Best available technology is the technology approved by legislators, regulators, or the industry for meeting output standards for a particular process.

Just transition: A just transition means greening the economy in a way that is as fair and inclusive as possible to everyone concerned, creating decent work opportunities, and leaving no one behind. In the context of the Playbook, the just transition principle means that the investment should maximize social and economic opportunities through consultations with impacted groups.

Standard Chartered's Transition Finance Framework outlines three principles.[4] Assets and activities that qualify for labeling as "transition" will:

- Be compatible with a 1.5°C trajectory, established by science
- Not hamper the development and deployment of low-carbon alternatives or lead to a lock-in of carbon-intensive assets
- Meet the minimum safeguards as defined in Standard Chartered's Environmental and Social Risk Management Framework

Decision Framework

A basic structure that can underpin and guide decision-making, a transition finance decision framework could take multiple forms. For example, this could be a decision matrix for different categories of transitional and non-transitional activities, a decision tree with guiding transition-related questions, and/or an internal governance structure. To be effective, it should define transition finance for the firm and outline a core decision-making process. It should also include guidance about whether and how different financial products and business lines are included in the transition finance approach. This framework could become the organizational compass for navigating the topic.

Pros

Transparent. A published framework can provide clarity to employees and to the market as to how the firm is defining and implementing transition finance. This can help reduce risks from the appearance of greenwashing.

Comprehensive. A framework can cover multiple approaches and angles of transition finance and highlight connections among concepts. Compared with principles or taxonomies, it can offer a more in-depth explanation of why the firm is taking certain actions and how the governance structures and processes will underpin future decision-making.

Flexibility. A framework can be particularly useful in filling gaps in existing market guidance, for example in covering regions and sectors with no established taxonomies.

Cons

Open to interpretation. Because these are often high level, how and when they should be used is not always clear. A framework is also open to interpretation.

Less standardized. Groups such as the Glasgow Financial Alliance for Net Zero (GFANZ), the International Capital Markets Association (ICMA), and the Climate Bonds Initiative (CBI) have developed guidance that could be used as building blocks for decision frameworks.[ii] However, these are implemented in different ways by financial institutions based on their needs. It is hard to compare across firms and could lead to heterogenous approaches to transition finance in the market.

Insufficient alone. Frameworks often compile and build on other approaches as inputs. Approaches such as taxonomies and transition assessment tools can offer more direction to inform decisions.

Examples

First Abu Dhabi Bank's (FAB) Sustainable Finance Framework provides a decision tree for identifying which activities can be labeled as transition finance.[5] The logic process allows for classifying transactions as sustainable or transition finance. Under this framework, any financing (including but not limited to debt and equity capital markets, corporate lending, consumer lending, and Islamic finance) can be classified as sustainable or transition finance.

SMBC's Transition Finance Playbook provides a series of definitions and decision trees to support the categorization of transactions in the power and oil and gas sectors (split by type of financial products: project finance, general corporate purpose, and corporate finance use of proceeds) into green, yellow (transition), and red (non-transition).[6]

Standard Chartered's Transition Finance Framework outlines a decision tree for asset-based financing that differentiates green, social, and sustainable eligibility and highlights the approval process for financing to be labeled as a transition transaction.[7]

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ii See Additional Guidance and Resources at the end of this guide for reference to these and other available market guidance and resources that could inform design of transition finance approaches.

Financing and Investment Policies

These policies provide clarity about the firm's stance on the provision of finance and investment for particular activities, sectors, and regions. The policies can both guide internal decision-making and signal to stakeholders and clients what can be expected from the firm. Policies can create helpful guardrails for credibility, but may also include exclusionary mandates. Designing transition-related policies could include the review and amendment of existing policies or the drafting and implementation of new ones. Although each firm is likely to have different policies in place, transition finance could be integrated into:

- Sector or activity financing policies (e.g., fossil fuel financing policies)
- Environmental and/or social responsibility policies
- Risk policies and appetites
- Climate change position statements
- Client engagement policies
- Climate transition plans

Pros

Transparent. A published policy can tell employees and the market how the firm defines and implements transition finance.

Financing and investment linked. Designed to directly inform financing and investment decisions, these can show where there is significant commercial opportunity to finance the low-carbon transition.

Offers internal standards. A policy can form what is and is not acceptable within a firm, potentially accelerating decision-making through clarity.

Familiar. Already widely used in the financial sector for sustainability and ethics issues, employees are used to reading and implementing them.

Con

Restrictive. A policy can be interpreted as a strict binary decision tool. Depending on the content, this can limit the potential pipeline of projects, particularly if the policy is not regularly updated and revised to reflect changes in market opportunities and innovation. They are often less flexible than other approaches outlined in this guide.

Example

ING updated its financing policies following COP28,[8] announcing that it would phase out upstream oil and gas financing by 2040 and aim to triple new financing for renewable energy by 2025. ING noted that this would move policies in line with the International Energy Agency's (IEA) net-zero emissions scenario for advanced economies.[9]

Taxonomy

A taxonomy is a list or classification of which real-economy activities the firm considers as transition-related. This can be used to categorize, report, and/or label products and services. Taxonomies can be designed with different levels of granularity, often at the sector, asset, or technology level. They can also be binary (e.g., what is included or excluded from transition finance) or tiered (e.g., include activities considered green, transition, and/or not sustainable). Firms could choose to use external signals to inform design choices, including existing regional taxonomies (e.g., the EU taxonomy or the Singapore-Asia Taxonomy), proxy policies (e.g., the Inflation Reduction Act), and transition pathways (e.g., the IEA's net-zero pathways, Mission Possible Partnership roadmaps).

Pros

Offers internal standards. A taxonomy can form what the firm does and does not consider transition activity, potentially accelerating decision-making through the clarity.

Simple to understand. This can be a useful communication tool to get employees and stakeholders aligned on priorities.

Transparent. A published taxonomy can provide clarity to the market as to what the firm includes in transition activities, which can help reduce the risk of greenwashing accusations.

Verifiable. Decisions as to what fits within the taxonomy can be assessed by third parties to provide verification of the credibility and integrity of the activities.

Contextual. A taxonomy can incorporate greater nuance and flexibility to account for sectoral and geographical context and technological maturity.

Cons

Restrictive. Depending on how it is designed and used, a taxonomy can be less flexible than other approaches. A taxonomy could be a strict binary in-out decision tool. This could limit the potential pipeline of projects, particularly if the taxonomy is not updated and revised regularly to reflect changes in market opportunities and innovation.

Complex to design. Firms developing their own taxonomies from scratch may require extensive analysis and expertise to draw boundaries effectively and robustly between transition and non-transition activities across sectors and business units. This issue could lessen over time as standards, roadmaps, and taxonomies become more widely adapted and adopted.

Subjective. Decisions about what is material to the transition and the firm require judgment. This means that taxonomies from individual organizations are unlikely to be similar across the market.

Example

SMBC's Transition Finance Playbook provides a summary of activities that could be considered as transition finance within the power and energy sectors.[10] The activities are split out by region, recognizing regional differences in transition pathways. This asset list is illustrative and SMBC notes that it has a more extensive internal taxonomy to guide decision-making. SMBC also notes that it will "revise and update [the taxonomy] at least once a year in consideration of updates in technological innovation, various regulations, taxonomies and guidance."[11]

Transition Assessment Tools

Financial institutions increasingly need to be able to assess and demonstrate that their capital allocation is consistent with climate goals, especially for high-emitting clients. To do this, financial institutions must assess their clients' current and/or future climate and transition credentials. These tools may reference or rely on existing credibility frameworks, such as CBI's transition maturity scales, the Assessing low-carbon transition (ACT) frameworks, GFANZ's principles-based attributes of the four key transition financing strategies, and the recommendations in the Net Zero Investment Framework (NZIF).[12] Real-economy transition plans are emerging as the preferred publication of choice among corporations, finance, civil society, and regulators, but they remain unstandardized across the market. The ability to assess the contents and credibility of corporate transition plans in a systematic, efficient, and transparent way is therefore of growing importance for a financial institution seeking to use these as inputs into transition finance decisions and client engagement processes.

Pros

Financing and investment linked. Standardizing and scaling transition assessments within a firm could unlock capital for clients seeking financing and investment to implement parts of their transition strategies and plans. These tools can be designed to directly inform financing and investment decisions and can help firms prioritize where there is significant commercial opportunity to finance the low-carbon transition.

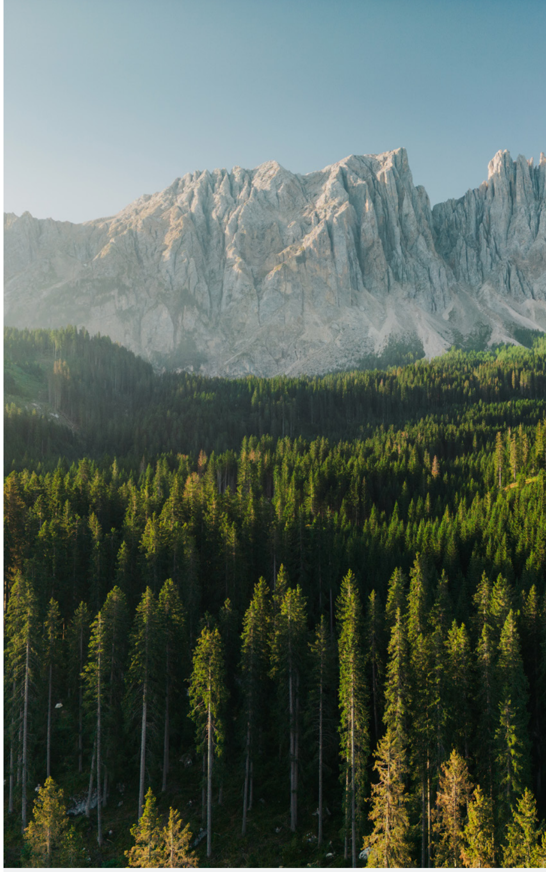
Scalable. Once the tools have been designed and integrated, they can be used by all relevant teams across a financial institution. If designed by a third party, they could be used across the market.

Cons

Less standardized. A growing number of tools are available in the market, but few are widely used. This means different firms will likely build and implement their own tools — at least in the short term. This could make it hard to compare transition plans and lead to heterogenous definitions of credible transition plans (and consequently transition finance) across the market.

Lacks transparency. Depending on implementation, an internal assessment tool could lead to opaque decision-making, particularly for external stakeholders.

Data dependent. The quality of output and insight relies on the quantitative and qualitative data input. Transition plans are rare and data within them is based on many assumptions. This likely will remain in portions of the economy, reducing benefits across a portfolio.



Example

Nordea Asset Management built an in-house alignment assessment tool.[13] It assesses individual issuers using NZIF's maturity scale approach. NZIF's approach includes 10 current and forward-looking criteria with a binary yes/no outcome that combine to place companies into one of four categories: aligned, aligning, committed to aligning, or not aligning. The tool uses 139 different indicators across six data providers. The assessment is further enhanced by individual research into and engagement with companies to firmly establish alignment status. The tool is used to inform portfolio and investee analysis, as well as engagement activity.

Technology-Focused Specialization

Financial institutions can establish expertise and specializations in new transition-enabling technologies. This can be particularly effective if chosen areas are cross-sectoral technologies. Specialization could involve setting up new teams, hiring additional staff with expertise, and providing targeted training to existing employees. This approach is most effective when integrated into existing business operations and governance, and if the knowledge and insights are frequently distributed across the firm.

Pros

Reduces perceived technology risk. One of the main barriers to a firms' allocation of capital is the perceived technology risk associated with new and innovative transition technologies. Internal expertise and specialization can reduce the perceived risk, develop a more nuanced understanding of the risks, and help identify transactions with lower risk.

Unlocks new capital. Such an approach can accelerate transition finance allocated to these technologies through increased familiarity and expertise to enable identification and assessment of suitable financing and investment opportunities.

Flexibility. Specialization could be done in several ways, and the chosen implementation can be designed to fit the business structures and transition priorities of the financial institution. Depending on how they are implemented, specializations could also be adapted and enhanced with new technologies, additional geographies, and more as the transition needs evolve.

Con

Resource intensive. This approach will likely require hiring new employees and investing in training and data capacity. This is relatively more resource intensive compared with using existing capacity to design principles and policies, for example.

Examples

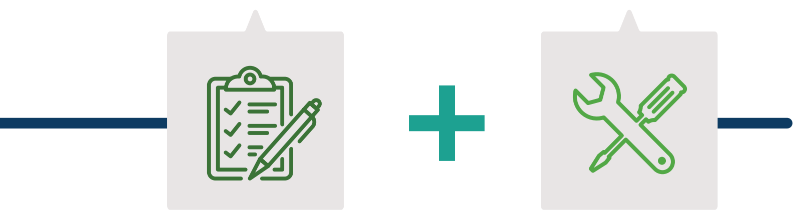
Barclays established an Energy Transition Group within its Corporate and Investment Bank.[14] The new group is responsible for providing strategic advice to clients as they explore potential energy transition opportunities. The team includes industry sector specialists from within Barclays's global Natural Resources, Power, and Sustainable and Impact Investment Banking teams. It offers a center of excellence that provides a broad spectrum of expertise regarding the energy transition, including hydrogen, energy transition finance, carbon capture, renewables, nature-based solutions, and renewable natural gas.

JP Morgan Chase has established a Center for Carbon Transition (CCT) within its Corporate Advisory & Sustainable Solutions business.[15] This team provides clients globally with advice and expertise focused on the low-carbon transition. It also works with industry coverage and product teams within the Commercial & Investment Bank on a wide range of strategic sustainability-focused transactions. The CCT also works to develop and implement the firm's net-zero strategy, oversees the implementation of its Carbon Assessment Framework to monitor progress toward net-zero aligned targets, and is responsible for supporting banking teams in identifying green business opportunities.

HSBC launched a new global Sustainability Centre of Excellence.[16] This team of sustainability specialists has deep expertise on sector transitions, new technologies, climate data and analytics, and sustainable finance, policies, and regulations. The Sustainability Centre of Excellence has a global footprint, so it can work effectively and on demand with global businesses and functions as well as with regional and country teams serving local customers.

Examples of How to Combine Approaches

The above approaches are not mutually exclusive, and their effectiveness could be increased by using them in combination. A financial institution will need to choose the approaches that work for its goals and organizational structure, balancing between an effective yet feasible set. In other words, choosing too many approaches could create unnecessary complexity and opacity, whereas choosing a single approach could fall short of being useful for decision-making or lack the necessary inputs, processes, or outputs. Exploring different approaches can also help a financial institution identify and assess nuances and trade-offs in a potential transition finance transaction. Below we provide examples of how different approaches could complement each other, although the list is not exhaustive:



Taxonomy + Transition Assessment Tools

A financial institution could create a taxonomy, listing which sectors are eligible for transition finance. To then identify which companies within those sectors should receive transition finance, the firm could use a transition assessment tool to check that the company has a credible plan to transition or to enable the transition of relevant sectors.

Decision Framework = Guiding Principles + Taxonomy

A financial institution could create a decision framework for transition finance that outlines a combination of approaches and how they will be implemented. For example, a framework could establish the process through which activities are chosen from an asset-based taxonomy and then checked against a set of guiding principles to enhance credibility and avoid reputational risk.

Technology-Focused Specialization + Financing and Investment Policies

A financial institution could create a center of excellence on transition technologies, developing expertise in hydrogen, sustainable aviation fuel, methane abatement, and carbon capture, utilization, and storage (CCUS). This expertise could then be deployed to assess existing investment policies to see how they relate to these emerging opportunities and suggest amendments where obstacles to financing them are found. Further, the center could be tasked with writing and supporting the implementation of new investment policies on the activities themselves that provide clarity and authorizations for front-office bankers in relevant sectors. It could also run training for staff on how these new policies should be interpreted and applied.

Example

Barclays' Transition Finance Framework (TFF) incorporates five of the six approaches outlined above in one streamlined document.[17]

Guiding Principles

Barclays has developed a set of transition finance principles to inform the application of its own definition of transition finance. An activity will qualify as potentially eligible where it falls into one of the following categories:

1. The activity references to key sectorial decarbonization levers identified in established 1.5C low/no overshoot benchmark global scenarios such as IEA NZE developed by globally accepted and influential institutions; OR

2. The activity references to relevant existing regional or national scenario pathways where available to reflect local market developments and jurisdictional policy; OR

3. The activity falls within relevant thresholds set out in regional sustainable and transition finance taxonomies (e.g., EU Taxonomy) or adapted proxy policy driven performance thresholds (e.g., Inflation Reduction Act).

When reviewing whether a financing will be eligible as transition finance Barclays will consider, amongst others:

- The transition plans or decarbonisation strategies the client produces, including any just transition elements; AND

- The management of any identified environmental and social risks associated with the relevant purpose of the financing or, where the client is a pure play client, its activities.

Decision Framework

The TFF decision tree sets out the process for identifying eligible transition financing for the purposes of Barclays' $1 trillion Sustainable and Transition Finance target. This decision tree differentiates criteria for dedicated and general purpose financing.

Financing and Investment Policies

Barclays' revised Climate Change Statement introduces restrictions for new and non-diversified oil and gas clients engaged in expansion and establishes clear expectations of transition strategies and decarbonisation requirements for energy clients.[18]

Taxonomy

The TFF includes a comprehensive list of over 110 transition activities covering 11 high emitting and hard-to-abate sectors which may be eligible to be classified as transition finance activities.

- Activities cover specific use cases for key cross sectoral technologies (e.g., Carbon Capture Utilisation and Storage (CCUS), blue hydrogen, low-carbon fuels) as well as sector-specific decarbonisation activities across the value chain (e.g., clinker substitutes for cement upstream production).

- The activity level criteria is supported by further detailed internal guidance including regional differences, variation in specific performance thresholds based on national/regional taxonomies or other regulatory measures.

- This list of eligible transition activities will be reviewed on a regular basis as industry principles and approaches mature, there is greater consensus on appropriate global, regional and national pathways, and as policy and regulatory frameworks, taxonomies and technology solutions evolve.

Transition Assessment Tool

Barclays's Client Transition Framework (CTF), first piloted in 2022, supports its evaluation of corporate clients' current and expected future progress as they transition to a low-carbon business model. CTF assessments are increasingly used to inform decision-making across Barclays, including client engagement, restrictions on financing, and capital allocation. During 2023, Barclays expanded how CTF scores are used in support of its broader climate strategy. The CTF informs engagement with clients while also helping to identify and manage transition risk in the bank's own financing portfolios.

Looking Ahead

While an individual financial institution's transition finance approaches will be chosen to match its own firm structures, portfolio priorities, and climate goals, it is important to keep at least one eye on the ultimate goal of financing the net-zero transition. The Intergovernmental Panel on Climate Change is clear that the rate of progress is not yet sufficient to get us there. As financial firms and the wider market adopt transition finance approaches, processes need to be in place to assess whether they are having the desired effect, and if not, to diagnose the barriers and adapt the approaches as needed.

This report has outlined key transition finance approaches, and explored their utility and relative transparency, ease of design, and flexibility. However, these positive characteristics do not guarantee impact and the design choices taken by financial institutions will shape how effective and efficient transition finance will be. As more examples emerge, there is a need for future case studies and reviews of these strategies and their effectiveness.

Additional Resources and Guidance

1 CFA Institute: *Navigating Transition Finance: An Action List*, **https://rpc.cfainstitute.org/-/media/documents/article/industry-research/transition-finance.pdf**

2 Climate Bonds Initiative: *Financing Credible Transition: How to ensure the transition label has impact*, **https://www.climatebonds.net/files/reports/cbi_fincredtransitions_final.pdf**

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Authors and Acknowledgments

Authors
Kaitlin Crouch-Hess, Elizabeth Harnett, Tricia Holland

Authors listed alphabetically. All authors from RMI unless otherwise noted.

Contacts
Elizabeth Harnett, eharnett@rmi.org
Tricia Holland, tholland@rmi.org

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RMI is an independent nonprofit, founded in 1982 as Rocky Mountain Institute, that transforms global energy systems through market-driven solutions to align with a 1.5°C future and secure a clean, prosperous, zero-carbon future for all. We work in the world's most critical geographies and engage businesses, policymakers, communities, and NGOs to identify and scale energy system interventions that will cut climate pollution at least 50 percent by 2030. RMI has offices in Basalt and Boulder, Colorado; New York City; Oakland, California; Washington, D.C.; Abuja, Nigeria; and Beijing.

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RMI Innovation Center
22830 Two Rivers Road
Basalt, CO 81621

www.rmi.org