



TRANSITION FINANCE HOW-TO GUIDE SERIES

How To Incorporate Sector-Level Analysis into Transition Finance Approaches



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Introduction

Transition finance is emerging as a core concept for financial institutions seeking to align their portfolios and business strategies with net-zero goals. Financial institutions must have a clear understanding of what the energy transition will look like in individual sectors and geographies (from sector scenarios) to effectively assess the credibility of their clients' emissions targets, transition plans, and capital expenditure plans. Using one-size-fits-all metrics such as a cross-sector absolute emissions target or an emissions-per-revenue value can place high emitting industrial sectors at a structural disadvantage and prevent the flow of transition finance to the very sectors and geographies with the greatest need for transition capital.

A transition finance strategy begins with an institution-level mandate and vision (discussed in [How To Design Transition Finance Approaches](#)),¹ but implementation of a transition finance strategy ultimately happens at the transaction level. A sector-specific approach to the deployment of transition finance can be developed in five key steps outlined below.



Designing an implementable transition finance approach with the necessary level of detail is a significant undertaking. Determining what is transition finance and which clients are credibly transitioning requires a nuanced understanding of the technologies and activities that will drive the energy transition in the real economy. These activities vary in type and scale across sectors, geographies, and time.

Scope of This Guide

This guide is intended to support banks that have set or are setting an institution-level strategy and need guidance on next steps for implementation at the sector level. This guide does not provide a specific framework or taxonomy for sector-level transition finance. Instead, it provides guiding principles that financial institutions can employ as they work through the process to develop their own strategy and tools. It is intended to be high level and flexible enough to complement financial institutions' expertise in the sectors in which they operate and align the guidance to their own strategic priorities.

This guide focuses primarily on two of the key steps in moving from from institution-level transition finance strategy to implementation: **Identify Priority Sectors** and **Understand the Sector-Level Levers of Transition**.



Identify Priority Sectors



An important first step is to identify the areas of greatest exposure to high-emitting sectors, and therefore greatest exposure to transition risk. This also identifies the areas of greatest opportunity to impact the transition and support the achievement of institutional climate targets, which many banks have already set. There may be other sectors where emissions are not as high but that have an outsized role in the transition of other sectors (e.g., mining critical minerals to supply to green technologies).



Understand the Sector-Level Levers of Transition



Sectoral scenarios are an essential tool for financial institutions to understand the technology shifts and resulting financial needs of each sector. They provide crucial informational inputs to evaluate a project or client, such as the 1.5°C-aligned emissions intensity of a sector, the target sunset date for a particular technology category, or the cross-sector technological developments that a sector may depend on for future decarbonization.

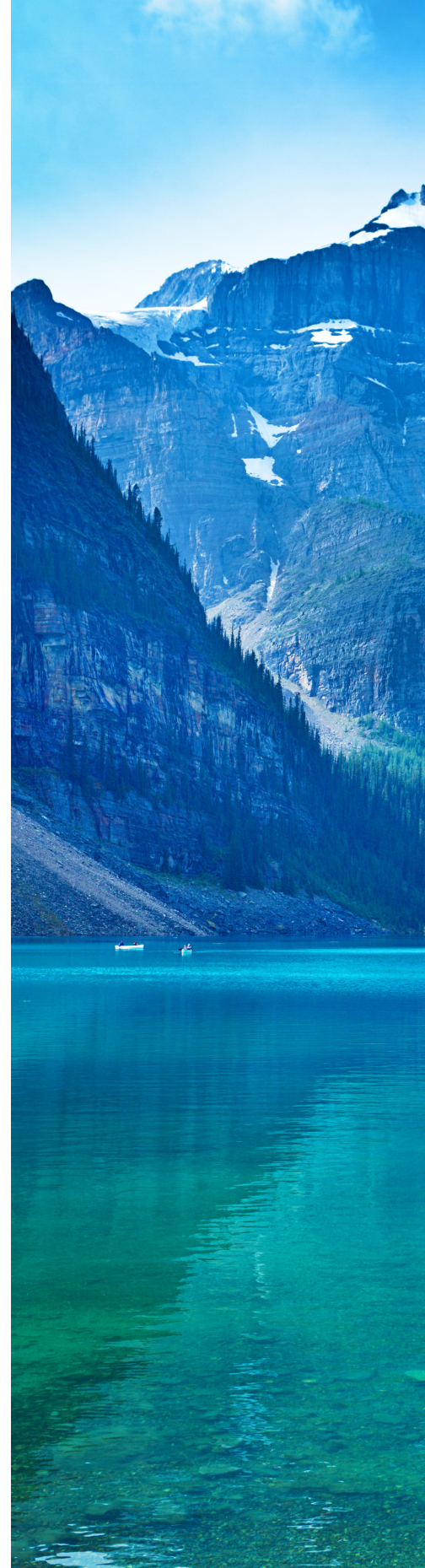
The remaining steps — assess clients and projects, and identify institutional levers and product offerings — are also important topics for banks to address as they develop their transition finance approach. The findings from the sectoral assessment are critical to informing these items, which will be addressed in future guidance.

Who This Guide Is For

This guide is primarily for sustainability and front-office teams within banks who should use their industry expertise to lead the development of sector- and transaction-level strategies. 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, regulators, and policymakers.

Although the sustainability and front-office teams are the primary audience, they should also engage with risk and credit teams to implement this guidance into a transition finance strategy that is embedded across the organization. Transition-related considerations represent the macroeconomic shifts facing the global economy and will have profound impacts on transaction risk profiles and commercial opportunities.

Lacking common definitions and standards, financial institutions are increasingly designing their own approaches to transition finance. In this guide, transition finance refers to any financing that supports the transition to a 1.5°C economy in line with current science-based pathways, including financing clients in high-emitting sectors, provided they are credibly transitioning. This broadens the definition of climate-aligned finance beyond what is explicitly “green.”





Clarify Institution-Level Transition Finance Strategy

Financial institutions need to develop their institution-level transition finance strategy before proceeding to the sector-level approach. The institutional transition finance strategy will inform which priority sectors are of most interest and in need of a detailed strategy, which products are in scope, and what new commercial opportunities to pursue. *How To Design Transition Finance Approaches* provides more detail on developing an institution-level strategy.²

Once the institutional vision is established, subsequent research at the sector, region, client, and product levels may reveal new findings that feed back into and inform the institutional strategy. Clarifying the strategy is an iterative process, which is an advantage of a detailed approach to transition finance. This process helps banks identify opportunities presented by the low-carbon transition, particularly cross-sector enabling technologies such as hydrogen, grid enhancement, closed-loop recycling, carbon capture and storage, and direct air capture.





Identify Priority Sectors

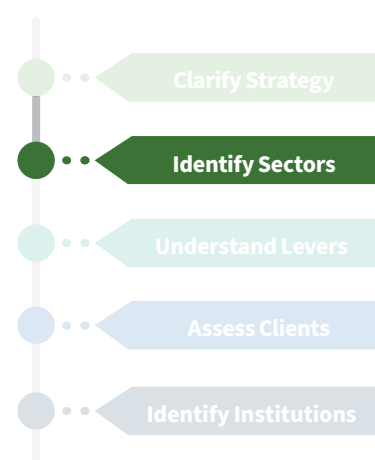
This section outlines guiding questions to help financial institutions identify priority sectors for further research in the development and implementation of their transition finance strategy. Note that financial institutions do not need to immediately pursue every sector identified for inclusion in their transition finance strategy. Instead, they can focus their efforts on a small number of sectors to test their strategy and maximize impact in areas where progress can most easily be achieved.

Looking ahead, all sectors will ultimately have a role in the transition. The Glasgow Financial Alliance for Net Zero (GFANZ) lays out four transition financing strategies — Climate Solutions, Aligned, Aligning, and Managed Phaseout — that can be applied by different clients and sectors based on their asset profile.³

QUESTIONS OF TRANSITION STRATEGY

Which sectors are a priority based on contribution to financed emissions and potential commercial opportunities?

Given the prevalence of existing measurement and disclosure frameworks for financed emissions,⁴ financial institutions likely already have a good sense of the major sources of their financed emissions. This is a good place to start to identify which sectors contribute the most financed emissions. Sectors with the highest emissions map to areas of commercial opportunity because they will undergo significant transformation in the coming decades, requiring substantial financing.



Which sectors have emissions targets been set for? Could transition finance targets help achieve the emissions targets in those sectors?

Many financial institutions have already set targets in a number of sectors. These sectors are a good starting point because the financial institution has demonstrated interest in and made public commitments about them. Financial institutions could consider whether setting further transition finance targets could provide an additional steering mechanism to meet emissions targets in a given sector. Another consideration is whether existing green finance facilities are sufficient for the sector, or if a transition finance approach could unlock additional capital.

Are there investments in sectors outside those where targets have been set that could enable the transition in target sectors?

There are many cross-sector dependencies where the transition in one sector depends on the growth of another (e.g., the aviation sector's transition depends on production of sustainable aviation fuel [SAF]). Enabling technologies in these sectors could also present significant decarbonization potential and commercial opportunities.

QUESTIONS OF FEASIBILITY AND EASE OF IMPLEMENTATION

What measurement and disclosure frameworks already exist in the sector?

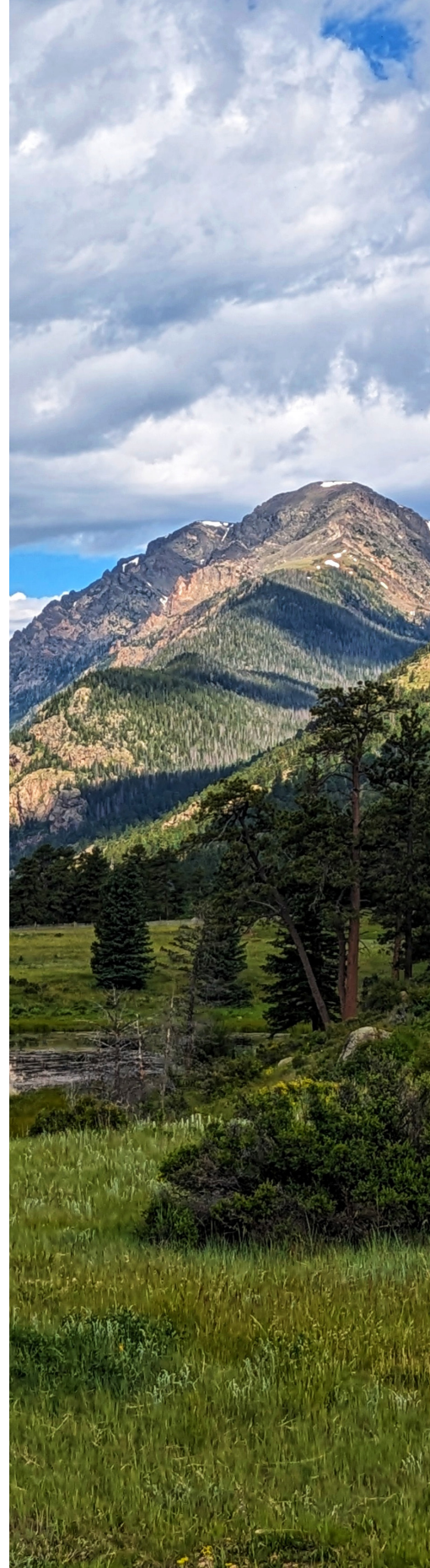
Many major sectors, the so-called hard-to-abate sectors, have existing frameworks that outline key steps to transition and that provide assessment tools. The availability of these resources improves the feasibility of implementing a transition finance approach in the sector. Note that a lack of existing resources should not be a reason to disregard an otherwise important sector where transition finance could be impactful.

What data is commonly recorded and available?

Much like existing frameworks, sectors vary in the maturity of their emissions data systems. Robust implementation of transition finance requires metrics underpinned by high-quality data. Understanding what data is available for a sector and the data's quality will inform the sector's implementation challenges.

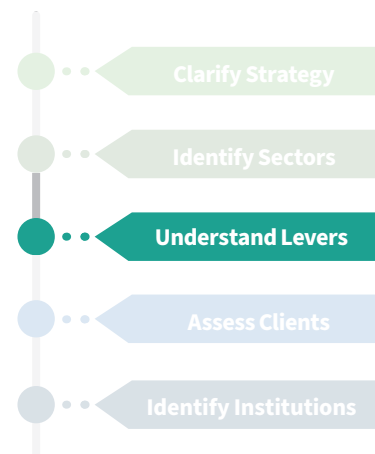
What are the financial institution's existing capabilities and areas of expertise?

A financial institution needs the necessary sector knowledge to identify key outputs in scenarios and contextualize them within the market where it operates. Financial institutions should consider whether they have the necessary expertise and resources to implement a detailed sector-level transition finance approach for a given sector.





Understand the Sector-Level Levers of Transition



Financial institutions must have a clear understanding of both sector-specific energy transition dynamics and cross-sector dependencies in order to effectively assess the compatibility of a client's emissions targets and technology investments with transition pathways. For example, a bank may need to determine whether switching from coal to gas power presents significant risk of carbon lock-in across geographies, assess the extent to which agricultural emissions reductions depend on green ammonia availability, or evaluate whether a client's stated investment plans align with a 1.5°C warming scenario.

Sectoral scenarios are an essential tool for financial institutions in navigating these questions. They provide crucial inputs when evaluating a project or client, such as the emissions intensity trajectory associated with 1.5°C in a given sector, the target sunset date for a particular technology category, or the cross-sector technological developments that an industry may depend on for future decarbonization.

In order to make full use of scenarios in the application of transition finance, financial institutions should:

- 1 Identify robust and informative sector scenarios**
Not all scenarios are created equal. Financial institutions should consider what information they are looking for, what scenarios could provide this information, and how credible they are.
- 2 Evaluate sector scenarios to inform transition assessment**
 - A.** Evaluate emissions targets
 - B.** Identify transition-incompatible technologies
 - C.** Identify key technologies and changes to facilitate the transition
 - D.** Assess risk of carbon lock-in
 - E.** Identify cross-sector dependencies and enabling technologies
 - F.** Account for subsector and regional variation

1 Identify Robust and Informative Sector Scenarios

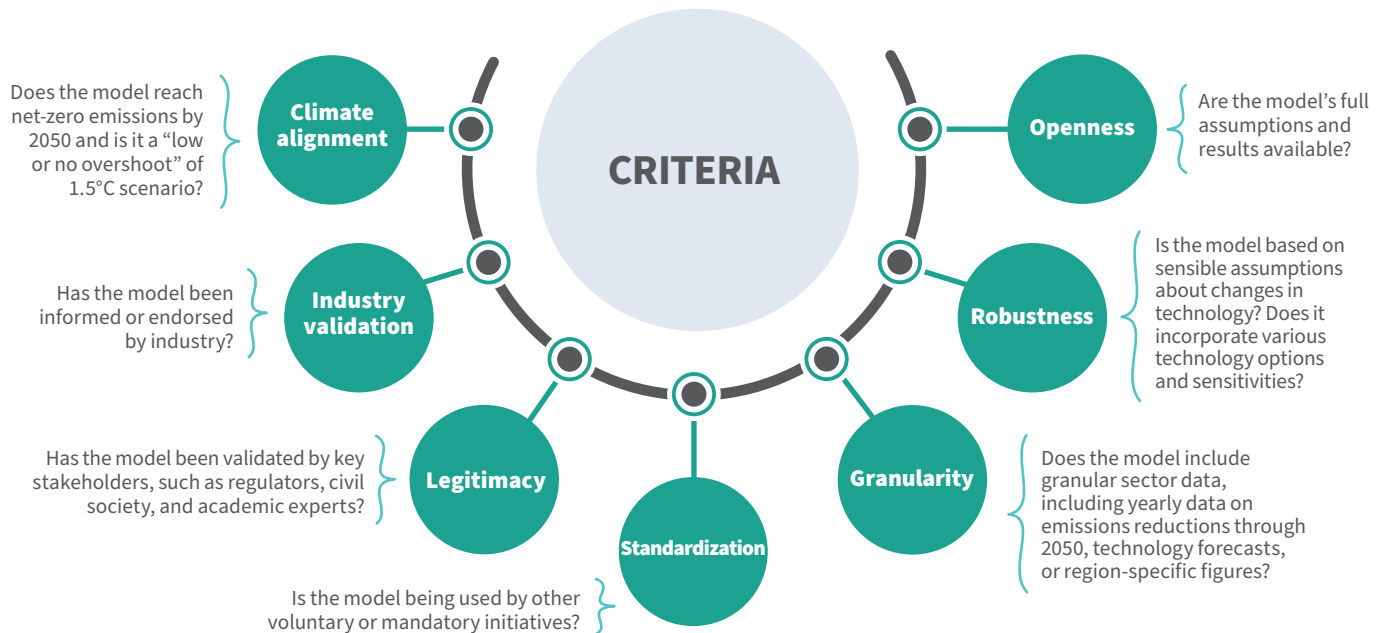
Sector scenarios typically apply to major industrial and commercial sectors such as steel production, cement production, or aviation, which may not have corresponding business lines within a financial institution. The sector categories highlighted in this guide reflect how technoeconomic climate scenarios categorize the global economy, and they can be used to inform the decarbonization levers of other sectors that use their outputs.

There are two broad categories of scenarios:

- **Global:** Derived from integrated assessment models (IAMs), these scenarios provide a roadmap for global emissions across all sectors.
- **Sector specific:** These scenarios are often derived from bottom-up models that analyze a single sector based on a set of sector-specific commercial and technological assumptions.

Global scenarios are typically produced by large research institutions. One of the most prominent is the International Energy Agency’s Net Zero scenario (IEA NZE), which covers global emissions and includes more than 10 sector-specific segments.⁵

Exhibit 1 Criteria to Assess Sector Scenarios



RMI graphic.



Sector-specific scenarios are developed by a wider variety of institutions, including governments, nonprofit organizations, and industry associations. Examples include the Mission Possible Partnership's (MPP's) Steel Transition Strategy Technology Moratorium Scenario and the Air Transport Action Group's Waypoint 2050 scenarios.⁶

Scenarios can be evaluated for their credibility and usability using the criteria and associated questions in Exhibit 1 (previous page). Financial institutions should use these criteria when evaluating the scenarios available within a sector and prioritize the use of scenarios that score well across these categories. Financial institutions may wish to use an ensemble of scenarios, as scenarios which meet all seven criteria in a single sector are rare. For instance, a global 1.5°C IAM can be combined with a region-specific bottom-up scenario.

Sector-specific scenarios may not have a clear 1.5°C alignment, but they often provide additional granularity and may incorporate greater technical inputs from industry members than global scenarios. For certain applications, such as identifying technologies that are clearly incompatible with a transition pathway or identifying critical cross-sector enabling technologies, a non-1.5°C bottom-up roadmap may be more useful than a 1.5°C global roadmap with less granular detail. In other cases, such as assessing whether a client's targets are well aligned with a 1.5°C ambition, the standardization and clear climate alignment of a recognized IAM such as IEA NZE may be more appropriate. As financial institutions build capacity in transition finance and transition assessment, they should aim to develop an in-house understanding of the most useful scenarios available in priority sectors.

Evaluating the 1.5°C Alignment of a Scenario

Temperature alignment for scenarios should be determined by comparing their overall global carbon budget to the warming outcomes determined by the Intergovernmental Panel on Climate Change (IPCC). IAMs will directly provide a global emissions budget figure, which can then be compared with IPCC outcomes. For example, in the 2021 edition of its net-zero trajectory, the IEA modeled a carbon budget of 500 gigatons CO₂ from 2020 to 2050.⁷ This corresponds to the 50th percentile of the carbon budget for a "low or no overshoot" of 1.5°C scenario under IPCC definitions.

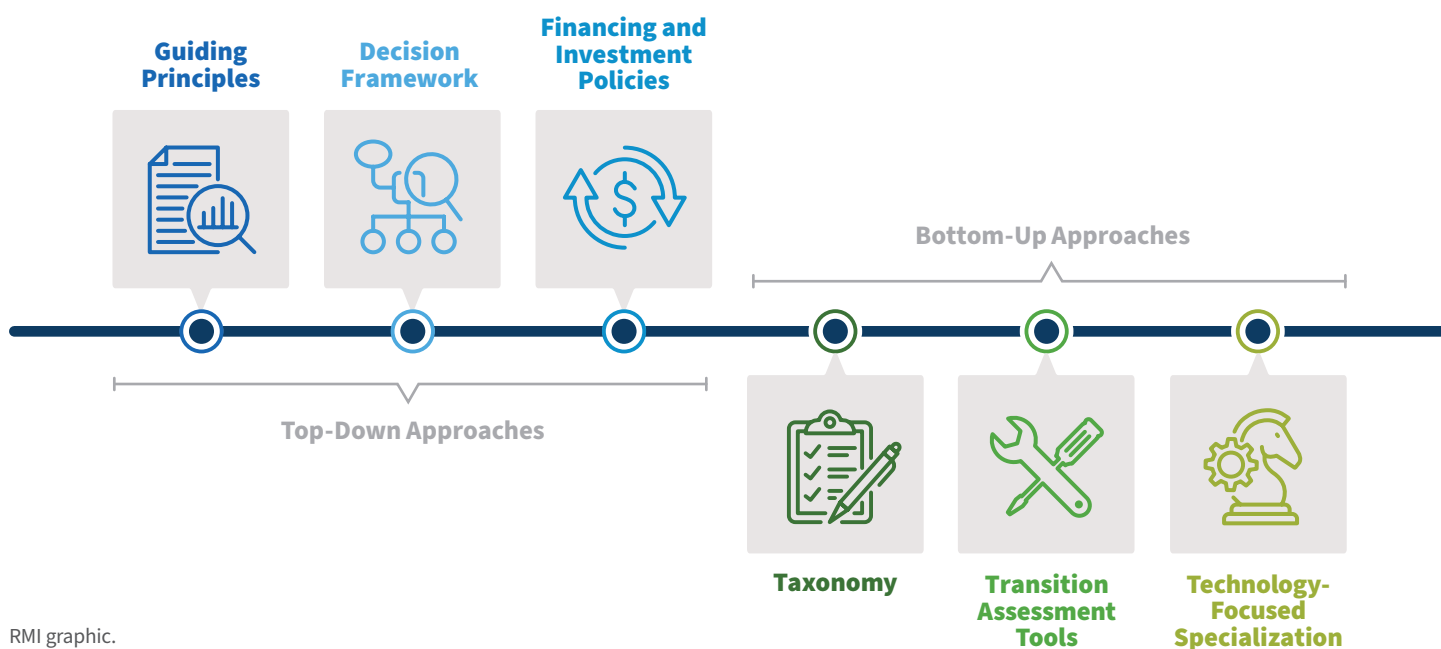
A sector-specific scenario cannot provide a global emissions budget value. Determining temperature alignment requires setting a sectoral carbon budget share, or the percent of global emissions for which a specific sector can be responsible. One practical approach is to calculate sectoral carbon budget shares from an IAM such as IEA NZE, and use the values in conjunction with a sectoral carbon budget from a sector-specific bottom-up roadmap to determine the implied global carbon budget of a single-sector scenario. Note that the emissions boundaries of the sector must be the same in each scenario for a fair comparison.

Although assessing the temperature alignment of bottom-up roadmaps is more challenging, using bottom-up roadmaps can provide many more options to financial institutions, including scenarios that may have more technical or regional detail than existing IAMs. Financial institutions should exercise caution and perform transparent sectoral carbon budget share calculations when using bottom-up roadmaps while not discounting the insights these roadmaps can provide.

2 Evaluate Sector Scenarios to Inform Transition Assessment

Analyzing sector scenarios can provide several important assessment inputs across six use cases outlined in this section. For each use case, a description is provided. Examples of how to apply each use case to transition finance approaches are also provided based on the approaches laid out in the *How To Design Transition Finance Approaches* guide and repeated below in Exhibit 2.

Exhibit 2 Summary of Top-Down and Bottom-Up Transition Finance Approaches



RMI graphic.

“ Sectoral scenarios are an essential tool for financial institutions in navigating these questions. They provide crucial inputs when evaluating a project or client, such as the emissions intensity trajectory associated with 1.5°C in a given sector, the target sunset date for a particular technology category, or the cross-sector technological developments that an industry may depend on for future decarbonization. ”

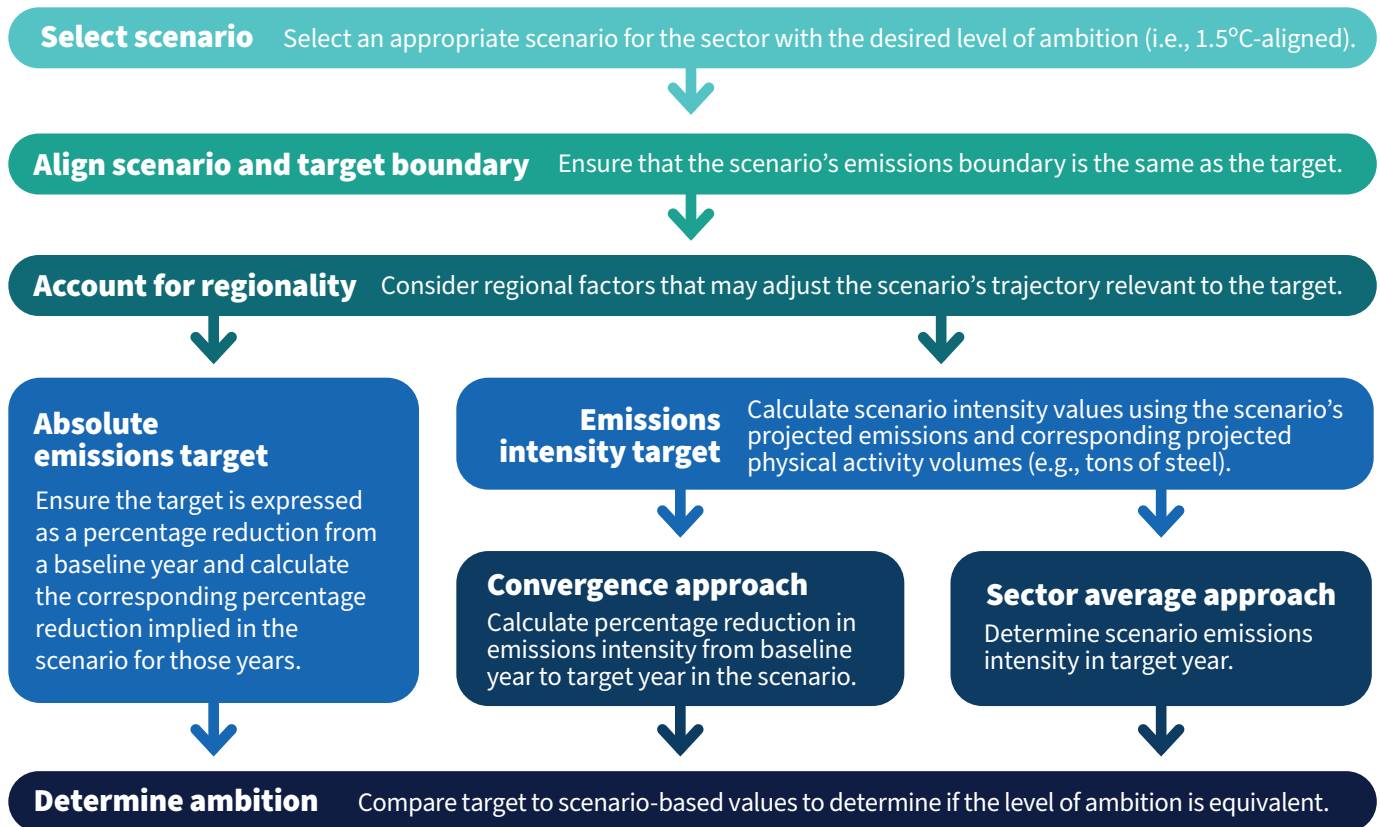
A. Evaluate emissions targets

Whether assessing a client's targets or observing internal financed emissions goals, financial institutions frequently must make sense of emissions targets. Targets may be set in absolute terms or in terms of emissions intensity. Although some clients may set entity-level targets that encompass multiple sectors, financial institutions should prioritize sector-specific targets when evaluating a client's ambition and credibility. Absolute emissions and emissions intensity vary significantly by sector, and emissions intensities may be measured in different units across sectors.

Any intensity targets should be based on physical production units, such as tons of steel or revenue-ton-kilometers, because these parameters form the basis for scenario modeling. Per-revenue intensity metrics are subject to inflation and price volatility, and are not typically directly modeled within sector scenarios, preventing comparisons.

At the client level, financial institutions may choose to make additional adjustments rather than use the sector averages implied by a scenario. Financial institutions may

Exhibit 3 Flow Diagram for Evaluating a Target's Alignment with Scenarios



RMI graphic.

also consider methods such as the convergence or absolute contraction approaches currently used by the Science Based Targets initiative (SBTi) for voluntary corporate target setting.⁸

The convergence approach enables users to set emissions intensity targets based on a percentage reduction derived from a sector scenario. This provides a viable pathway for high emitters to set ambitious but achievable targets, which can contribute to their case for much-needed transition finance. However, the approach should be used with caution and should not give high emitters a pass on phasing out high-emissions technologies by required sunset dates or allow for carbon lock-in.

Exhibit 3 (previous page) outlines a process for evaluating whether targets set are aligned with scenario values using a range of approaches.

EXAMPLE

Sustainable Aluminum Finance Framework

The Sustainable Aluminum Finance Framework is an RMI emissions measurement and disclosure framework for banks lending to the aluminum sector.⁹ It also provides all the necessary tools for these banks to set 1.5°C-aligned targets based on the MPP and International Aluminum roadmaps.¹⁰

This framework uses the convergence approach and, importantly, applies it separately to electricity- and non-electricity-derived emissions. Per the MPP aluminum roadmap, most of the near-term emissions reductions associated with aluminum come from decarbonizing electricity. This means producers with high electricity-derived emissions have a larger near-term obligation to reduce emissions than those with low electricity-derived emissions.

In contrast, if the convergence approach were applied based on the overall sector trajectory, it would underestimate the reduction required from high emitters, and overestimate the reductions required from low emitters compared with the available technologies.

Resource

Science Based Targets initiative

is one of the most well-recognized standard setters for corporate target setting. See its corporate and sector-specific net-zero standards for details on target-setting frameworks, including the convergence and absolute contraction approaches.¹¹

Application to Transition Finance Approaches



Transition Assessment

Tools: Evaluating the credibility of emissions targets is a critical component of client assessment frameworks. Client assessment tools are critical to transition finance implementation as identified at the start of this guide.

B. Identify transition-incompatible technologies

Sector scenarios can provide a critical guardrail for transition finance by identifying technology categories that are incompatible with a 1.5°C trajectory. These production technologies must not be expanded and should not be eligible for transition financing that extends or expands their operational capacity.

These technologies may further be excluded from all financing in accordance with a financial institution's investment policies intended to prevent increasing or maintaining exposure to transition-incompatible technologies, in pursuit of supporting the transition and meeting institutional climate targets. One point of caution with this approach is the potential to exclude support for managed phaseout or early retirement of high-intensity assets — one of the four transition finance strategies outlined by GFANZ.¹²

EXAMPLES

Mission Possible Partnership's Steel Transition Strategy

The MPP Technology Moratorium (MPP TM) Scenario for the steel sector models that no new investments in unabated basic oxygen furnace–blast furnace (BOF-BF) can be made after 2030 to keep emissions trajectories achievable. For a financial institution financing the steel sector, this indicates that unabated BOF-BF projects that add post-2030 capacity should not be eligible for transition financing, and that client transition plans that allow for additional unabated BOF-BF capacity may not be credible.

Early Retirement of Coal

Thermal coal is a common example of an energy source that must be phased out in a 1.5°C scenario. This includes early retirements of existing coal assets that require new capital and restructuring to close or repurpose the assets before the end of their current economic life span. A blanket exclusion policy might lead an investor to avoid such deals despite the clear real-economy impact of early retirement. Financial institutions should assess these real-economy reductions and consider such financing if it aligns with their sector policies, public commitments, and environmental, social, and governance strategy. RMI has published several papers exploring strategies and metrics for early coal retirement.¹³

Application to Transition Finance Approaches



Financing and Investment

Policies: This analysis could inform exclusion policies for activities that are wholly incompatible with the transition. ING recently released updated policies,¹⁴ announcing that it would phase out upstream oil and gas financing by 2040.



Taxonomy: In much the same way that a taxonomy of transition-driving activities can be created to identify transitioning clients and projects (see next section), a taxonomy of transition-incompatible activities could be established to inform client and project assessments.

C. Identify key technologies and changes to facilitate the transition

In addition to transition-incompatible technologies, sectoral scenarios can help identify two additional categories of technology: transition-facilitating technologies that will drive the transition and are priority areas for transition finance investment, and transition-compatible technologies that do not impede the transition but may not meaningfully contribute to it.

In many sectors, the majority of emissions reductions are driven by a handful of major technology shifts. Sector scenarios allow financial institutions to quickly identify these transition-facilitating technologies, the rate at which they need to be scaled, and in some cases the scale of investment required. These insights can then be incorporated into assessments of clients' investment and transition plans to determine whether they align with the transition.

In addition to these transition-facilitating technologies, there will also be many transition-compatible technologies and activities that do no harm from an emissions standpoint. Importantly, these technologies are different than transition-incompatible technologies, and they should not disqualify a project or client from receiving transition finance even though they do not directly contribute to the transition. However, financing for compatible technologies in isolation may not necessarily be considered transition finance just because the technologies are compatible with a 1.5°C scenario, especially because many of them may be financed in the course of regular business. Transition-compatible technologies should be just one part of a broader transition plan, complemented with concrete actions to execute on that plan, in order for investments to be considered transition.

EXAMPLE

Transition-Compatible Technologies in Aviation

Aircraft engines capable of burning high blending ratios of SAF are compatible with existing 1.5°C roadmaps but do not themselves contribute to emissions reductions. In the case of SAF-ready engines, any emissions reductions depend on upstream supply of alternate fuels. Therefore, financing SAF-ready engines in isolation of other transition efforts (such as SAF offtake agreements) should not be considered transition finance. However, SAF-ready engines could be an important component of a client's transition plan.

Resource

The Transition Plan Taskforce

has a qualitative sector summary that lays out its view on transition activities in a greater number of sectors than typically covered by climate scenarios.¹⁵

Application to Transition Finance Approaches



Taxonomy: The technologies driving the transition can be classified in a taxonomy of transition activities. There are many existing taxonomies to draw from and build on, including the regional EU and Singapore-Asia taxonomies, Barclays's Transition Finance Framework, and SMBC's Transition Finance Playbook.



Transition Assessment Tools:

Identifying the technologies to drive the transition in different sectors is critical to developing tools for client and project assessment. This empowers financial institutions to understand if their clients are investing in the necessary technologies and can inform their client engagement strategy.

D. Assess risk of carbon lock-in

In taking steps to reduce emissions or expand productive capacity in the short and medium term, companies and financial institutions must take care not to create unintended barriers to long-term decarbonization. Technologies or projects that appear compatible with a transition pathway in the short run may conflict across longer time horizons, indicating that they should not be eligible for transition financing despite potential short-term benefits.

Existing transition finance frameworks take a variety of approaches to mitigating these risks. The Singapore-Asia Taxonomy, for example, recommends explicit sunset dates for categories of investments in different sectors.¹⁶ GFANZ and the Climate Bonds Initiative (CBI) include avoiding carbon lock-in as a screening criterion across all categories of transition investments.¹⁷ Detailed sector scenarios can aid financial institutions in identifying technologies and projects that pose significant lock-in risks by comparing asset lifetimes with technology sunset dates.

EXAMPLE

Natural Gas Power Generation

New natural gas power generation plants can have meaningfully lower emissions than existing coal-fired plants. In the EU, however, the IEA Announced Pledges Scenario (IEA APS) forecasts a 99.63% reduction in generation from unabated natural gas from 2022 to 2045.¹⁸ Despite potential short-term emissions reductions by replacing coal-fired capacity, a new natural gas facility in the EU that intends to operate through 2045 poses significant risk of carbon lock-in because meaningful operation of the facility in 2045 is incompatible with the APS scenario.

Application to Transition Finance Approaches



Transition Assessment Tools: Lock-in risk is an important part of client and project assessment to determine the credibility of investment plans and ensure that the proposed technologies do not have operational life spans that extend beyond the sunset date or phase out trajectory of credible transition scenarios.



Taxonomy: Financial institutions creating taxonomies should be cautious not to include technologies that would expose them to lock-in risk. A long-term view of emissions mitigation must be maintained when determining which technologies and activities to include.

E. Identify cross-sector dependencies and enabling technologies

Emissions reductions within a sector frequently depend on enabling technologies in related sectors or advancements in cross-sector technologies. Sector scenarios can help inform financial institutions of the potential impacts that an individual client or project may have on the broader energy transition and also identify the limits of an individual client's influence over its emissions.

Some existing frameworks, including GFANZ and CBI,¹⁹ encourage giving credit to companies that engage in activities that aid the energy transition in other sectors even when the activities may not meaningfully affect the company's direct emissions. Recognition of these positive externalities helps ensure that company- and sector-specific analysis does not neglect the importance of crosscutting technologies and supports the allocation of transition capital to critical technologies. The impact of these activities on a company's direct emissions may be limited, and financial institutions should take care not to overlook their potential benefits.

In other cases, sector scenarios can help financial institutions understand the limits of an individual client's action for reducing its emissions. Cases where a client is heavily reliant on upstream technologies, such as the availability of drop-in fuels, may present limited opportunities for transition finance despite best efforts. In these cases, financial institutions may consider prioritizing support of enabling technologies outside the sector of focus through transition finance. This also emphasizes the need for collaboration among front-office teams working with different sectors.

EXAMPLE

Aviation's Dependence on Sustainable Aviation Fuel

The aviation industry is much more dependent on SAF for decarbonization than road transport is on biodiesel. This dependency is recognized by scenarios such as the MPP's Aviation Transition Strategy,²⁰ which highlights road-to-SAF retrofits for existing biofuel capacity as a critical transition method for the aviation sector, even though those investments may not alter a fuel producer's total biofuel production. A refining company that retrofits existing biodiesel production to optimize a greater portion of the distillate for SAF may not increase its total volume of biofuel production, but it can have a greater real economy impact by displacing fossil jet fuel, which is otherwise more difficult to find low-carbon alternatives for than biodiesel.

Application to Transition Finance Approaches



Technology-Focused

Specialization: Financial institutions can establish expertise and specialization in transition-enabling technologies. This could particularly apply to cross-sector transition catalysts such as green hydrogen, renewable electricity, electrification, biofuels, and power-to-liquids.



Finance and Investment Policies:

Building on a specialization, financial institutions could set transition finance policies to increase financing for key cross-sector levers such as hydrogen and renewable electricity. ING recently announced an aim to triple new financing for renewable energy by 2025.²¹

F. Account for subsector and regional variation

Whether assessing targets or evaluating the suitability of different transition technologies, financial institutions should consider the regional and business context of their clients. Sector scenarios provide sector-wide emissions and production trajectories, and these sector average figures are often used for benchmarking or planning. However, these values can differ substantially by region and industry subsectors, making the use of industry average values not always appropriate.

A single sector can include a long value chain where emissions may be concentrated in one or two steps. Corporations in those sectors will have different levels of exposure to high-intensity processes that affect their transition investment priorities. Financial institutions should account for relative exposure to different segments within a sector when evaluating the operating context of a client or project.

In addition to industry subsector, the regional operating environment of a company may influence what scenarios are applicable or necessitate making qualitative adjustments to scenario-based results. Companies in regions with higher emissions or less low-carbon technology market share than the global average may need to prioritize relative improvements in line with global scenarios (e.g., via the convergence approach) rather than targeting global average values in the interim. Similarly, company transition investment priorities may vary significantly based on the regional technological and commercial landscape.

EXAMPLE

Steel Subsectors

In steel, producers can have significantly different emissions profiles and opportunities for emissions reductions depending on their relative production of primary and secondary steel. Evaluating a purely primary producer against an industry average that includes significant secondary steel production may lead to unachievable goals and incorrectly dismiss the importance of efficiency improvements in primary production. Detailed steel scenarios highlight the significance of these industry subsectors.

Resource

IEA Announced Pledges Scenario:

Financial institutions can use regionally differentiated scenarios such as IEA APS to understand the specific operating context of a client or project.²² Although there is currently a lack of region-specific 1.5°C pathways for direct quantitative benchmarking, non-1.5°C pathways such as IEA APS still provide valuable information for financial institutions seeking to understand the potential limitations of global average values from scenarios such as IEA NZE in the context of a specific project or client.

Application to Transition Finance Approaches



Transition Assessment Tools:

Subsector and regional considerations should be built into transition assessment tools to create an approach that does not inadvertently exclude certain market segments or geographies. Financial institutions should also be cautious not to use such tools to simply lower ambition in certain areas. Instead, they can and should be used to raise ambition in areas where barriers to transition are lower.



Looking Ahead

This guide provided an overview of how financial institutions can incorporate sector-level analysis into their transition finance approaches. By focusing on sector-specific scenarios, financial institutions can better understand the technology shifts and financial needs required to support the transition to a 1.5°C economy. While sectoral levers are essential for understanding the varying needs of different sectors, two additional steps laid out in the introduction are critical to implementation of a sectoral transition finance strategy:



Assess clients and projects

With the increase in the prevalence of transition plans and heightened reputational risks from accusations of greenwashing, it is increasingly important for financial institutions to distinguish between transition and investment plans that are credible and aligned with accepted levels of ambition, and those that do not effectively plan for the transition.

Using sector insights, financial institutions can develop tools to understand their clients' transition readiness, ensuring that transition finance is effectively allocated. Such assessments can be carried out at the client level (examining the alignment of transition plans, targets, and investment strategies with transition pathways) or at the project level (assessing the contribution of a project to sectoral transition needs).



Identify institutional levers and product offerings

Financial institutions can assess the financial and nonfinancial levers available to them as an institution to develop a cohesive, tailored sector transition strategy. By aligning sectoral levers with institutional levers, banks can identify the most impactful transition opportunities, tailor their products and services to support them, and identify the areas requiring further development.

By analyzing the capital structures common to priority sectors against the institutional exposure to each sector, banks can better tailor their financial products and services to meet sector-specific needs, whether financing for new projects, long-term technology shifts, or operational efficiencies. Nonfinancial levers, such as client engagement, standards development, and policy advocacy, can further provide much-needed support to sectoral transitions that are ramping up.

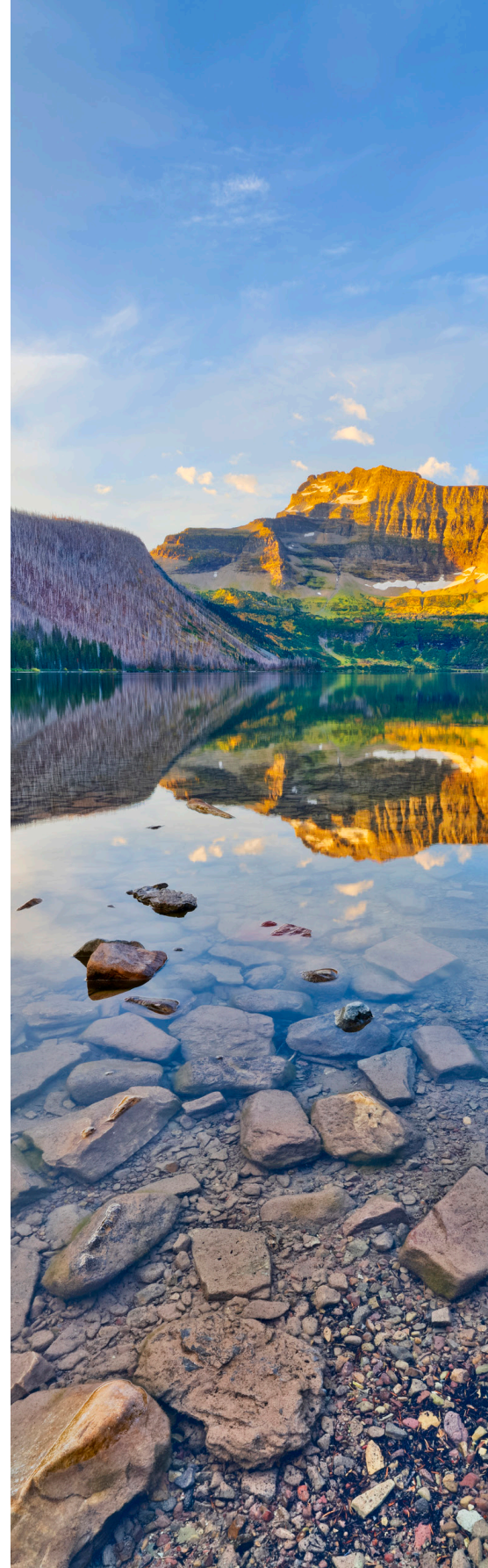
Within a transition finance strategy, the above components can be linked to sectoral levers to ensure that the financial institution's internal processes are aligned with sector-specific transition needs. Future guidance will aim to lay out a process for integrating sectoral analysis, client assessment, and institutional levers into a cohesive transition finance strategy aligned with the financial institution's overall net-zero goals and embedded across the organization.

Additional Resources and Guidance

- 1 Accelerate Climate Transition: *ACT Assessment Methodologies*, <https://actinitiative.org/act-methodologies/>
- 2 Climate Bonds Initiative: *Financing Credible Transitions*, https://www.climatebonds.net/files/reports/cbi_fincredtransitions_final.pdf
- 3 Glasgow Financial Alliance for Net Zero: *Guidance on Use of Sectoral Pathways for Financial Institutions*, https://assets.bbhub.io/company/sites/63/2022/06/GFANZ_Guidance-on-Use-of-Sectoral-Pathways-for-Financial-Institutions_June2022.pdf
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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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