ICAEW
REPRESENTATION 42/24

TRANSITION FINANCE MARKET REVIEW - CALL FOR EVIDENCE

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ICAEW welcomes the opportunity to comment on the Call for Evidence published by the Transition Finance Market Review on 14 March 2024, a copy of which is available from this link.

Our response has been prepared by ICAEW's Sustainability Team, in consultation with the Financial Services Faculty, and with input from ICAEW members particularly through the Sustainability Committee. For questions on this response please contact the ICAEW Sustainability team at representations@icaew.com quoting REP 42-24.

ICAEW is a world-leading professional body established under a Royal Charter to serve the public interest. In pursuit of its vision of a world of strong economies, ICAEW works with governments, regulators and businesses and it leads, connects, supports and regulates more than 208,000 chartered accountant members and students in over 146 countries. ICAEW members work in all types of private and public organisations, including public practice firms, and are trained to provide clarity and rigour and apply the highest professional, technical and ethical standards.

ICAEW's Sustainability Team supports members and the wider business community, including over 22,000 in ICAEW's Sustainability and Climate Change Community, to play a leading role in the net-zero, nature positive and socially just transition. ICAEW engages with and encourages governments at local, national, and international/inter-governmental levels to accelerate action towards this transition.

ICAEW is represented on the TPT Steering, Delivery and Nature Working Groups of the UK Transition Plan Taskforce (TPT), contributing to development of a transition planning framework and guidance that is relevant to jurisdiction-specific needs, and which we hope will drive meaningful action to shift our economy towards sustainability.

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KEY POINTS

1. We support improved clarity in the definition and scope of transition finance. This is key for ensuring credibility of transition finance and securing public support for transition plans. Whilst we recognise that transition finance applies to all sectors in the economy, greater focus should be given to carbon intensive sectors. A prioritisation of carbon intensive sectors and activities underscores the need for clear taxonomy.
2. With transition finance being most effective when targeting high emitting, hard to abate sectors of the economy, risks are run in perceived and actual greenwashing. To engender trust, issuers of transition finance require specific and measurable science-based targets, combined with regular and assurable disclosures and reporting. We see a role for government in ensuring such a framework and set of requirements exists.
3. The government must take firm leadership by outlining a credible whole economy transition plan. The plan should provide policy stability through long-term policymaking whilst promoting credibility and consistency through a clear UK taxonomy and rigorous regulatory frameworks. In doing so, government should look to strengthen public-private financing partnerships. This should help to create a degree of confidence in the market that will enable organisations to develop their own plans.
4. The key area of concern to be addressed is setting out guidelines to ensure transition finance does not exacerbate social inequalities.
5. We see professional accountants as partners in driving the transition finance market through their skills in developing decision-useful information for management and boards (internal) and externally to the providers of capital and stakeholders, as well as the provision of assurance services. We also see a role in leveraging these skills to facilitate support for organisational culture change needed to commit to and progress the transition plans.

ANSWERS TO SPECIFIC QUESTIONS

Q1) Do you consider there to be a lack of clarity around the scope of transition finance? Why / Why not?

6. We consider there to be a lack of clarity around the definition and scope of transition finance due to the evolving landscape of stakeholders, approaches and activities supporting a just transition. We recognise the transition will not be a linear process and as such a clear definition and scope of transition finance arrangements as well as transparency in reporting are important for promoting effectiveness.
7. As the language around decarbonising has developed over the years, the term transition has been increasingly used and applied to activities that can support the journey to net zero. In doing so, sustainable finance, green finance, and transition finance are often used interchangeably causing confusion.
8. Definitions provided by GFANZ and the G20 Sustainable Finance Working Group closely represent what ICAEW views transition finance to be. That is, investment, financing, insurance and related products and services that support an orderly real-economy movement towards net zero, nature positive and socially just futures. To promote consistency, definitions of transition finance should be aligned with international commitments such as the Paris Agreement and the Sustainable Development Goals.
9. As part of defining the scope of transition finance, it is important to define how it is different from other types of finance that also contribute to positive environmental and social outcomes. For example, green finance can fall under transition finance as its focus is primarily on delivering positive environmental outcomes, whereas in transition finance there

may be investment in intermediary technologies that are not entirely environmentally sustainable but are cleaner than current technologies.

10. In addition to effectiveness, clarity in definition and scope is key for securing stakeholder engagement and public support for transition plans, especially when public funds are being invested in areas that the public may view as opposed to net zero commitments. As evidenced globally, effective transition plans require legitimate processes of public engagement and consultation with stakeholders affected. This is important for addressing and resolving any social impacts from transition plans and maximising public support.

Q3) Do you agree with the approach that transition finance includes all sectors of the economy to the extent that it is part of a credible net zero transition? Why / Why not? If not, please specify which should be excluded and why.

11. We agree with the approach that transition finance should include all economic sectors and consider regional, national, and international contexts. To maximise effectiveness, opportunities for transition finance are greatest when deployed in the most carbon-intensive sectors that require huge capital investment and infrastructure changes to decarbonise. These include energy, transport, heavy industry, and agriculture.
12. We also stress the importance of considering land-intensive sectors that have high forest, land and agriculture (FLAG) emissions due to land conversion, as described by SBTi.
13. While it is important to target carbon-intensive sectors, we recognise that these sectors do not work in silos and are integrated with other segments of the economy. For instance, the energy sector influences transportation through fuel production and distribution, while heavy industry relies on transportation networks for raw material delivery and product distribution. Agriculture also depends on energy for machinery and transportation, with its products feeding into various industries.
14. The integrated nature of economic sectors further stresses the importance of clarity and taxonomy of transition finance, with a focus on transparency of such classifications to protect the integrity of transition and eliminate the risk of greenwashing. The principles of credibility, integrity and transparency are key components in this endeavour.
15. Building on this, the ongoing development of credible transition plans for the UK across all key sectors is needed. Leadership and stability from government in terms of policy decisions is required to provide confidence and support the whole economy transition.

Q5) Do you agree with the approach that transition finance includes all types of economic activity that are compatible with a credible net zero transition? Why?/Why not? If not, please specify which should be excluded and why.

16. ICAEW agrees the approach should include all activities that are compatible with a net zero transition. We recognise that the economic activities required to support and deliver the transition to net zero will vary across organisations, sectors, and must take into account regional, national and international contexts, as required.
17. However, there is a need for clarity and a taxonomy over what is meant by transition finance (as referenced above) and a focus on transparency and integrity of such classifications to mitigate the increased risk of transition finance being a source of greenwashing risk. The principles of credibility, integrity and transparency are key components in this endeavour.

Q8) Please describe any concerns you have with the application of transition finance through certain types of financial products or services?

18. Where there are preferential terms in a transition finance package, we should be mindful of the unintended social consequences in terms of equity and fairness. For example, there may be a case where green mortgages are offered to borrowers who invest in sustainable upgrades or purchase energy-efficient homes with the concession of qualifying for lower interest rates, reduced fees, or other financial benefits. This could disproportionately affect certain demographics or regions if they are unable or unwilling to make necessary transitions and consequently may face higher financing costs or limited access to credit.
19. It is essential to ensure that mechanisms are in place to support inclusivity and assist those encountering obstacles to decarbonising. This might involve offering alternative financing options, providing financial aid or incentives for retrofitting existing properties, in addition to the implementation of supportive policies and programmes to facilitate a smooth transition for all stakeholders.
20. Common complaints made in respect of transition finance revolve around a lack of specificity and scientific rigour when it comes to the tangible real world outcomes financing is seeking to achieve, inadequate transparency in respect of progress against such goals, ambiguity as to the use of proceeds and limited or poor third-party verification.
21. When it comes to verifying these products, there are different requirements for assurance depending on the financial product or service. While issuers may require any "sustainability-linked" metrics to be reported annually and be independently assured, it is not consistent.
22. It is also important that developments in transition finance are considered as part of and keep pace with the broader regulatory ecosystem and include fundamental components such as effective internal controls (reiterated in the recently revised UK Corporate Governance Code) and prevailing and emerging regulation e.g. Sustainability Disclosure Requirements (SDR) and investment labels PS23/16: Sustainability Disclosure Requirements (SDR) and investment labels | FCA and FCA anti-greenwashing rule consultation GC23/3: Guidance on the anti-greenwashing rule | FCA.

Q10) Do you agree there is a significant role for good quality transition plans aligned with the TPT Disclosure Framework in the provision of transition finance? Why/ Why not? If yes, please describe this role?

23. ICAEW held positions on the TPT Steering Group, Delivery Group, Nature Working Group, and SME Working Group. Therefore, we strongly agree that it is best practice for transition plans to be aligned with the TPT Disclosure Framework and to utilise the subsequent sector guidance in the preparation and implementation of such plans.

Q11) Which core transition principles, such as transition plan disclosures, science-based targets, and capital allocation plans, and other key metrics and tools for assessing the credibility and integrity of transition finance do you consider essential for its success? Please describe these in detail.

24. ICAEW is supportive of a principles-based approach, and particularly those of credibility, integrity and transparency as outlined by the Transition Finance Market Review. We recognise that how the transition is operationalised and financed will depend on the unique function and position of the organisation, sector, regional, and national context.
25. It is important that effective controls are in place to monitor and report progress alongside robust governance and oversight. This includes appropriate mechanism to test validity and accountability to ensure sustainable investments and transition finance deliver on their promises. To support this, robust targets and performance indicators need to be established

and progress against these are monitored and reported. Companies should consider what level of independent validation or assurance they require (be it required by the lender or in line with their own risk management practices).

26. ICAEW is supportive of the Transition Plan Taskforce (TPT) Disclosure Framework which provides recommendations for companies and financial institutions to develop robust and credible transition plans. These plans are essential for navigating the transition to a more sustainable economy, particularly in the context of climate change mitigation.

27. Key features of the TPT Disclosure Framework includes good practices that companies can follow when disclosing their transition plans, and aligns with regulatory requirements and expectations related to transition planning. In addition to the framework, the TPT offers implementation guidance that outlines the steps for developing a transition plan and provides instructions on when, where, and how to disclose the plan.

Q15) Do you consider there to be a role for taxonomies in the provision of transition finance? Why / Why not? If yes, please describe this role and consider any interaction with the role of transition plans?

28. To maximise effectiveness, opportunities for transition finance are greatest when deployed in the most carbon-intensive sectors such as energy, transport, heavy industry, and agriculture. However, there's a risk of transition finance being perceived as greenwashing by the public.

29. To enhance the depth and liquidity of capital markets supporting transition finance, a credible framework is essential to address this risk. When investors are confident that financing activities genuinely contribute to achieving net-zero outcomes, demand will inevitably rise.

30. Government support is crucial to establish transition taxonomies, determining appropriate energy sources to support the transition, and defining medium to long-term timelines for their acceptability.

31. Clear definitions and scenarios are needed to identify what constitutes transition finance. For instance, distinguishing between an energy company issuing a green bond to transition to renewables and a renewables manufacturer seeking generic finance that indirectly supports the transition.

32. The UK Government must make steadfast progress on the UK green taxonomy, which has experienced delays in being finalised, in order to provide much needed clarity to the transition finance market. Maintaining and adapting the UK’s green taxonomy must be supported by a suitable regulatory framework to provide trust and confidence. In doing so, this will provide businesses with much needed clarity to support in their transition plans.

Q31) How should government, and other public bodies such as public finance institutions and local authorities, collaborate with industry, the finance sector and investors to create a supportive ecosystem for transition finance? Please consider factors such as i) the balance of public and private capital risk responsibility and ii) where expertise is located.

33. Due to the complexity and interdependencies of industries, alongside the high cost/high risk associated with the large-scale infrastructure changes needed to transition, the government must take firm leadership in establishing the most effective policy and regulatory environment to support economy wide transition.

34. This must include a national transition plan that provides strategic direction and instils confidence in the private sector to allocate resources and capital more effectively. Work in this area is ongoing at the Grantham Institute at LSE on a proposed structure and has been an area of research for Aviva Investors, as noted in their climate finance paper.

35. In creating a national transition plan, the government must support industry in setting out sector-based transition plans, utilising resources such as the sector guidance developed by the TPT.
36. Leadership from government in terms of long-term policy decisions will provide consistency that engenders confidence in businesses and institutional investors to direct finance in line with net zero ambitions over the short, medium, and long term. For example, prohibition dates for new gas boilers or fossil-fuel powered vehicles provide the private sector with a timeline to transition giving rise to greater certainty around potential demand and definitive investment windows.
37. We encourage government to consider its role in supporting a common reporting standard for issuers of transition finance, where they seek to do so in public capital markets. Such reporting standards should instil discipline and consistency around appropriate science-based targets and other measurable outcomes. They should set expectations for appropriate investor disclosure and regular reporting to progress against agreed targets.
38. The role of assurance should be considered to ensure reporting is accurate, in compliance with standards and gives a fair reflection of the performance of the issuer in delivering positive outcomes.

Q33) How can the UK better leverage its existing financial and professional services expertise to support the growth of transition finance capacity and related activity and revenue?

39. Professional accountants with knowledge and skills in measuring, reporting, and assuring have a critical role to play in the growth of transition finance. This will primarily be through measurement of financial and sustainability metrics and in preparing and executing transition plans. As previously stated, these plans must be assured. Independent assurance builds trust in reporting, promotes comparability and consistency, and plays a part in reducing the risk of greenwashing. Assurance will also help establish credibility and integrity to build confidence in the market and in scalable, trusted solutions.
40. Financing the transition is essentially about financing systems change and this can come with resistance to change as well as uncertainty, and complexity for organisations and stakeholders. Accountants can leverage their critical skills of measuring, reporting and assurance to build trust and confidence in the credibility and integrity of transition plans.
41. ICAEW aims to support the accounting profession to apply the skills mentioned above to drive the transition forward.

Q34) Do you think the UK government could make better use of blended finance approaches to de-risk and scale up transition finance? Why / Why not? If yes, please explain.

42. As noted in the ICAEW Manifesto, government leadership in driving public-private partnerships is essential to explore ways to share the risk and reward of green infrastructure projects and sustainable finance. Blended finance arrangements could include debt arrangements where government is an equity investor or provides debt finance that is subordinated to tranches offered to the private sector. Green gilts and green savings bonds could also be expanded, providing the private sector with a way to support net zero without taking on undue risk.
43. The UK Infrastructure Bank was set up to provide £22bn of infrastructure finance as a sole investor and in partnering with the private sector. The government should consider ways in which the private sector is not only the recipient of funds for investment but is also given the opportunity to take part in their financing, providing incentives for greater capital flows into

the UK to support green finance and investment. Regulators should also be sufficiently resourced to support the authorisations process, as delays in assessment and approval are an inhibitor to market entry and scale up.