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Navigating the Rise of Climate Transition Financing

Asia has emerged as the largest source of emissions globally and Southeast Asia is also one of the most at-risk regions. Addressing climate change is therefore a matter of particular urgency for ASEAN and its companies. However, it has been estimated the region will need to raise capital of over US\$50 billion over the next few years to fund the green transition.¹ With Singapore as a leading investment and financial hub in Asia, banks in Singapore, can and arguably should go beyond financing activities that are already aligned with a green economy to also finance the real-economy activities that are not yet aligned but are in transition to becoming so aligned. This update offers an overview of the increasing imperative for climate transition planning for corporates, and how banks can responsibly navigate the challenges and pitfalls of financing the transition.

Mandatory Climate Reporting and Transition Planning

Earlier this year, the Second Minister for Finance announced that from FY2025, all listed companies in Singapore would have to prepare climate reporting based on local prescribed reporting standards, which are aligned to those of the International Sustainability Standards Board (“ISSB”); and from FY2027, non-listed Singapore companies with annual revenue of at least S\$1 billion and total assets of at least S\$500 million would also be required to provide climate-related disclosures.²

This is a significant step-up depth- and breadth-wise from the current requirement for listed issuers only to prepare climate-related reports based on the recommendations of the Task Force on Climate-related Financial Disclosures. While both reporting standards are broadly similar in structure, the requirements of the former are more detailed and more onerous.

Other jurisdictions in Southeast Asia, notably the Philippines and Malaysia, are also aligning or are consulting to align their mandatory climate reporting requirements with ISSB standards.

Notably, under the ISSB standards, paragraph 14 of IFRS S2 on climate-related disclosures³ provides that an entity must disclose,

“(a) information about how the entity has responded to, and plans to respond to, climate-related risks and opportunities in its strategy and decision-making, including how the entity plans to achieve any climate-related targets it has set and any targets it is required to meet by law or regulation;

(b) information about how the entity is resourcing, and plans to resource, the activities disclosed in accordance with paragraph 14(a); and

(c) quantitative and qualitative information about the progress of plans disclosed in previous reporting periods in accordance with paragraph 14(a)”.

¹ Shoeb Kagda, “Transition Finance Critical for South-east Asia to Achieve Net-zero Goals: Panel”, *Business Times* (18 March 2024).

² “FY2024 MOF Committee of Supply Debate Speech by Second Minister for Finance Mr Chee Hong Tat”, Ministry of Finance Speeches (28 February 2024) <<https://www.mof.gov.sg/news-publications/speeches/fy2024-mof-committee-of-supply-debate-speech-by-second-minister-for-finance-mr-chee-hong-tat>>.

³ IFRS S2 Climate-related Disclosures (June 2023) <<https://www.ifrs.org/issued-standards/ifrs-sustainability-standards-navigator/ifrs-s2-climate-related-disclosures/#standard>>.

Transition Planning for Banks

Companies have to plan for climate transition, and massive financing will be required for the successful execution of these plans. However, banks have to plan for their own climate transition too. Banks in Singapore that are listed issuers or large non-listed companies would come within the scope of the newly announced sustainability reporting requirements. The Monetary Authority of Singapore (“MAS”) had also in 2020 issued guidelines setting out its expectations that banks, amongst other things, disclose their metrics and targets for assessing and managing relevant climate-related risks and opportunities in line with the TCFD recommendations; and actively manage and monitor its environmental risk exposures at both customer and portfolio levels.⁴ In October last year, MAS proposed, for public consultation, further guidelines for banks, setting out its expectation that as banks play a key role in mobilising capital to enable their customers to transition in an orderly manner, this should be reflected in their own transition planning processes.⁵ Banks should engage with their customers to guide them in developing or enhancing their own plans to address climate-related risks, and implementing effective measures to reduce their carbon footprint and build resilience to climate change. The indiscriminate withdrawal of credit from customers deemed to be of higher climate-related risks would deprive those entities with credible transition and adaptation plans of the financing they need to decarbonise. In other words, as the Glasgow Financial Alliance for Net Zero (“GFANZ”), explained eloquently, “... financial institutions should focus not only on reducing their financed emissions, but also on financing emissions reduction ... such an approach to transition finance is essential to driving the real-economy transition”.⁶

Financing Credible Transition Strategies

One of the most challenging aspects of transition finance is managing its associated greenwashing risks when it is nominally used to extend financing to heavy polluters which do not have a credible transition strategy or are not held accountable for implementing such strategy. MAS expects banks to clearly communicate their risk management strategies and approaches for different sectors, and how their financing activities relate to their publicly committed climate objectives, particularly where financing of such sectors or sub-sectors could be negatively perceived due to high financed emissions intensity in the shorter term, to avoid adverse reactions and accusations of greenwashing. MAS also recommends that banks consider the use of credible and well-regarded green and transition taxonomies in their product-level disclosures, such as their sustainability and transition-labelled products, to facilitate better stakeholder understanding of how these products contribute to Banks’ publicly committed climate objectives.⁷

The ASEAN Capital Market Forum (“ACMF”) also offers guidance in this regard. It considers that a credible transition plan should demonstrate two main elements: a sufficient climate ambition aligned with the objectives of the Paris Agreement; and robustness of the ability to deliver on the ambition. The former entails a long-term ambition to converge to a science-based pathway based on a commonly accepted model, and a short-term plan to be at least parallel to or converging to the pathway. Robustness entails the inclusion of an implementation strategy (that in turn includes an action plan, a capital allocation plan, a risk assessment and mitigation of the delivery risks associated with the strategy, capabilities to track and report progress of the implementation of the strategy, and a mechanism to oversee and support the execution of the strategy); public disclosure of the ambition and strategy and ongoing progress; and independent verification of public disclosures.⁸

⁴ Monetary Authority of Singapore, *Guidelines on Environmental Risk Management (Banks)* (December 2020) <<https://www.mas.gov.sg/-/media/mas/regulations-and-financial-stability/regulations-guidance-and-licensing/commercial-banks/regulations-guidance-and-licensing/guidelines/guidelines-on-environmental-risk--banks/guidelines-on-environmental-risk-management-for-banks.pdf>>.

⁵ Monetary Authority of Singapore, *Consultation Paper on Guidelines on Transition Planning (Banks)* (October 2023) <<https://www.mas.gov.sg/-/media/mas-media-library/publications/consultations/bd/2023/consultation-paper-on-guidelines-on-transition-planning-banks.pdf>>.

⁶ Glasgow Financial Alliance for Net Zero, *Financial Institution Net-zero Transition Plans: Fundamentals, Recommendations, and Guidance (Final Report)* (November 2022) <<https://assets.bbhub.io/company/sites/63/2022/09/Recommendations-and-Guidance-on-Financial-Institution-Net-zero-Transition-Plans-November-2022.pdf>>

⁷ Monetary Authority of Singapore, *Consultation Paper on Guidelines on Transition Planning (Banks)* (October 2023).

⁸ ASEAN Capital Markets Forum, *ASEAN Transition Finance Guidance (Version 1)* (17 October 2023) <<https://www.theacmf.org/images/downloads/pdf/ASEAN%20Transition%20Finance%20Guidance%20Version%201%20-%20FINAL%2017%20Oct%202023.pdf>>.

Official and Market Guidance on Transition Pathways

Official and international market-based taxonomies and guidance may be used to help identify credible transition strategies and support climate transition-themed financial instruments. Some of these are listed in the International Capital Markets Association (“**ICMA**”)’s *Climate Transition Finance Handbook: Guidance for Issuers* (“**CTFH**”).⁹ The ACMF also offers a non-exhaustive list of common science-based and industry-published reference pathways by temperature outcome, geographic scope and sector.¹⁰ Amongst these guidances, the *Singapore-Asia Taxonomy for Sustainable Finance* (“**Singapore Taxonomy**”)¹¹ and the *ASEAN Taxonomy for Sustainable Finance* (“**ASEAN Taxonomy**”)¹² stand out in terms of geographic and sector relevance.

Singapore-Asia Taxonomy for Sustainable Finance

The Singapore Taxonomy is said to be,

“designed to promote the development of an environmentally sustainable economy for Singapore and ASEAN through defining science-based and robust technical screening criteria for economic activities and projects that are aligned with Singapore and region’s overall environmental objectives ... In addition, it serves as a practical guidance for market participants such as asset owners, investment managers, financial institutions, as well as issuers, policymakers, regulators, and other stakeholders to identify and allocate capital to green and transition activities and projects”.¹³

According to the MAS, it is the first taxonomy globally to pioneer the concept of a “transition” category. By defining and contextualising transition for the Asian region, the taxonomy provides clarity on what constitutes credible sustainable and transition financing and helps to reduce the risk of greenwashing, particularly in hard-to-abate sectors, as financial institutions will be able to identify and disclose how their financed activities and labelled products are aligned with the taxonomy.¹⁴

The taxonomy adopts a ‘traffic light system’ that defines green, transition and ineligible activities across eight focus sectors – Energy; Real Estate; Transportation; Agriculture and Forestry/Land Use; Industrial; Information and Communication Technology; Waste/Circular Economy; Carbon Capture and Sequestration. “Transition” refers to existing activities that do not meet the green thresholds for substantial contribution to climate change mitigation by operating at near zero emissions or are on a 1.5°C-aligned pathway; but instead meet amber thresholds for moving towards a green transition pathway within a defined time frame, or facilitating significant emissions reductions in the short term with a prescribed sunset date, without locking-in emissions from such activities beyond the sunset date. Apart from amber thresholds, amber *measures* are also set out for some sectors of the taxonomy to provide additional options to encourage capital investments into decarbonisation measures or processes that will help reduce the emissions intensity of activities and enable the activities to meet the green criteria over time.¹⁵

Apart from meeting green or amber thresholds, to be eligible under the taxonomy, activities must also be assessed against “Do No Significant Harm” (“**DNSH**”) and “Minimum Social Safeguards” criteria, i.e., whether the activities significantly harm other environmental objectives, namely climate change adaptation, healthy ecosystems and biodiversity, resource resilience and circular economy, and pollution prevent and control; and

⁹ International Capital Markets Association, *Climate Transition Finance Handbook* (June 2023)

<<https://www.icmagroup.org/assets/documents/Sustainable-finance/2023-updates/Climate-Transition-Finance-Handbook-CTFH-June-2023-220623v2.pdf>>.

¹⁰ ASEAN Capital Markets Forum, *ASEAN Transition Finance Guidance* (Version 1) (17 October 2023).

¹¹ Green Finance Industry Taskforce, *Singapore-Asia Taxonomy for Taxonomy for Sustainable Finance: 2023 Edition* (December 2023)

<<https://www.mas.gov.sg/-/media/mas-media-library/development/sustainable-finance/singaporeasia-taxonomy-updated.pdf>>.

¹² ASEAN Taxonomy Board, *ASEAN Taxonomy for Sustainable Finance* (Version 3) (25 April 2024)

<<https://www.theacmf.org/images/downloads/pdf/ASEAN-Taxonomy-Version-3.pdf>>.

¹³ Green Finance Industry Taskforce, *Singapore-Asia Taxonomy for Taxonomy for Sustainable Finance: 2023 Edition* (December 2023).

¹⁴ Monetary Authority of Singapore, “MAS Launches World’s First Multi-Sector Transition Taxonomy” (3 December 2023)

<<https://www.mas.gov.sg/news/media-releases/2023/mas-launches-worlds-first-multi-sector-transition-taxonomy>>.

¹⁵ Green Finance Industry Taskforce, *Singapore-Asia Taxonomy for Taxonomy for Sustainable Finance: 2023 Edition* (December 2023).

whether the entity conducting the activities complies with the *OECD Guidelines on Multinational Enterprises on Responsible Business Conduct* and the *UN Guiding Principles on Business and Human Rights*.¹⁶

ASEAN Taxonomy for Sustainable Finance

The ASEAN Taxonomy Board's ASEAN Taxonomy also offers useful guidance for transition financing. It is intended to be the overarching guide for all ASEAN Member States ("**AMS**"), providing a common language and complementing their respective national sustainability initiatives. Like the Singapore Taxonomy, the ASEAN Taxonomy adopts a traffic light system of green, amber, and red activities. However, as it has to cater to a more diverse range of potential users across the ten AMS, it adopts two assessment approaches – a principle-based "Framework Foundation" developed as a 'starter' assessment approach for AMS; and a more advanced threshold-based and process- or practice-based "Plus Standard" ("**PS**") assessment approach that uses technical screening criteria not unlike those used in the Singapore Taxonomy, except that the PS divides its thresholds into three tiers –

- (a) Green, where an entity's climate ambition is already aligned or aligning with a science-based 1.5°C trajectory and meet all other criteria of transition credibility, i.e., robustness of ability to deliver on the ambition;
- (b) Amber Tier 2, where an entity's climate ambition is already aligned or aligning with a science-based well-below-2°C trajectory and meet all other criteria of transition credibility; and
- (c) Amber Tier 3, where an entity's climate ambition is materially but not fully aligned or aligning to well-below-2°C, and/or has mostly but not fully met all criteria of transition credibility, but has committed to addressing any material omissions in the next two years;

to accommodate different starting points for AMS due to their different levels of development and varied economic activities. Amber Tier 2 and Amber Tier 3 are considered transition thresholds. The sectors covered under the PS are Agriculture, Forestry and Fishing; Electricity, Gas, Steam and Air Conditioning Supply; Manufacturing; Transportation and Storage; Water Supply, Sewerage, and Waste Management; Construction and Real Estate.

In addition, to be classified as green or amber under the ASEAN Taxonomy, an activity that substantively contributes to climate change mitigation must satisfy the essential criteria of DNSH (the other three environmental objective that must not be significantly harmed are climate change adaptation, protection of healthy ecosystems and biodiversity, and resource resilience and the transition to a circular economy). An activity that does not satisfy DNSH may still be categorised as Amber Tier 3 while remedial measures are taken to remove its significant harm to the other environmental objectives within 5 years of the assessment date. The company undertaking the activities must also satisfy the Social Aspects criteria (namely the promotion and protection of human rights, prevention of forced labour and protection of children's rights, and impact on people living close to investments).

Documenting Transition Finance

To help provide clear guidance and common expectations on the practices, actions and disclosures to be made available by issuers when raising funds for their climate transition strategy, the CFTH provides guidance and common expectations on the practices, actions and disclosures to be made available by issuers when raising funds for their climate transition strategy, whether this be in the format of use of proceeds instruments aligned with the ICMA's Green Bond Principles – where the use of proceeds intends to make a meaningful contribution to an issuer's GHG emissions reduction strategy; and/or, general purpose sustainability-linked instruments aligned with the ICMA's Sustainability-linked Bond Principles – where one or more of the KPIs are monitoring GHG emission reduction metrics.

The CFTH recommends that, to credibly position the issuance of climate-transition themed use of proceeds or sustainability-linked instruments to finance the transition, particularly of "hard-to-abate" sectors, such

¹⁶ Green Finance Industry Taskforce, *Singapore-Asia Taxonomy for Taxonomy for Sustainable Finance: 2023 Edition* (December 2023).

instruments must not only demonstrate alignment with the Green Bond Principles or Sustainability-linked Bond Principles but also be underpinned by organisation-level climate transition strategies and disclosures aligned with the recommendations of the CFTH. There are four key elements to these recommendations:

- (a) Issuer's climate transition strategy and governance – the financing is directed toward enabling an issuer's GHG emission reduction strategy in alignment with the goals of the Paris Agreement;
- (b) Business model environmental materiality – the climate transition strategy is relevant to the environmentally material parts of an issuer's business model.;
- (c) Climate transition strategy and targets are 'science-based' – the climate transition strategy references science-based targets and transition pathways; and
- (d) Implementation transparency – market communication regarding the offer for financing is transparent on the underlying investment programme.

Issuers' disclosures of their climate transition strategy and governance should also be referenced in the green or transition finance framework or offering documentation, with the recommended independent review, assurance and verifications included within a Second Party Opinion, as part of the offering documentation, and/or provided in the context of an issuer's non-financial disclosures. Such reviews etc, should include assessments of the alignment of targets with the relevant science-based trajectories or climate scenarios; the credibility of the climate transition strategy to reach its targets; and the independent governance and oversight of an issuer's climate transition strategy.

While the CFTH focuses primarily on the issuance of bonds, its recommendations, suitably modified, are in practice applicable and are also being applied to transition-themed use of proceeds and sustainability-linked loan instruments aligned with the Loan Market Association, Asia Pacific Loan Market Association, and Loan Syndication and Trading Association's Green Loan Principles ("GLP") and Sustainability-linked Loan Principles ("SLLP") respectively.

This means that for the purpose of the legal documentation for a use-of-proceeds transition loan, the production of a transition loan framework that references the borrower's climate transition strategy and aligns with the requirements of the Green Loan Principles and the CFTH, should be a condition precedent to the disbursement of the loan. Another condition precedent should be the production of an independent second party opinion from an external reviewer to confirm the alignment of the transition loan framework with the GLP and CFTH, and the proposed use of proceeds aligns with the framework. The borrower should also represent and covenant its continuing compliance with the framework, and provision should be made for the legal consequences of a breach of transition loan-related representations and covenants, typically the declassification of the transition loan.

Similarly, when it comes to general use sustainability-linked loans, a transition loan framework that is aligned with the SLLP and the CFTH, accompanied by an independent second party opinion should be made conditions precedent to the loan. One or more of the agreed key performance indicators ("KPI") and sustainability performance targets ("SPT") would also need to be tied to the transition pathway identified in the borrower's climate transition strategy. The borrower should covenant to submit externally verified reports on its performance in respect of the agreed KPIs and SPTs, and depending on the loan characteristics, economic consequences such as sustainability margin adjustments may flow from such performance or a breach of representations and covenants.

Final Comments

Expectations of corporate climate action has been shifted from the exuberant voluntary declarations of ambition towards net-zero or low carbon transitions to the reality and sobriety of mandatory disclosures of the strategies and measures for making good on these commitments and how to adequately resource such strategies and measures. Banks play an important role in facilitating the realisation of the ambitious and credible transition strategies and plans of their high greenhouse gas emitting customers in hard-to-abate sectors but must walk a fine line between financing such transitions on the one side and maintaining the ambition and credibility of their own transition strategies and plans by avoiding greenwashing risks on the other. Transition finance is in its

nascency but is quickly gaining momentum with increasing clarity over how to prepare and assess climate transition plans and establish the credibility of transition finance instruments.

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