TFMR

Transition Finance Market Review

Transition Finance:

A Strategic Imperative for Boards

CITY OF LONDON

THE GLOBAL CITY

Chapter Zero

Foreword

Vanessa Havard-Williams OBE
Chair, Transition Finance Market Review

The finance needed to support the achievement of the global transition agreed under the Paris Agreement involves trillions of dollars in investment over a sustained period. As a major financial centre, the UK can play a leading role in financing this global transition, while supporting its own, and offering opportunities for economic growth. This is why the Transition Finance Market Review was commissioned by the last UK Government and has begun to be implemented by the current Government.

To scale transition finance in support of a sustainable and resilient future, investment in transition needs to be more attractive than it currently is. The market works within the parameters set by policy, law and regulation. Finance follows incentives in the real economy as that is what drives the perception of future returns. Incumbent sectors globally continue to receive substantial policy and fiscal support for activities incompatible with a Paris-aligned world. This can only be corrected by governments; left to the market, change will be incremental.

Our review sets out a route map for the UK to create a policy environment that unlocks transition finance for itself and facilitates the UK's establishment as a leading hub for global transition finance. Our recommendations bring together policymakers, investors and companies to unlock transition finance at scale.

This approach once adopted will reshape policy and market response and will therefore influence corporate funding options. For these reasons and because the development of investable policy demands corporate and institutional input, I would encourage you to engage with the recommendations made by the Review and to participate in the bodies that have been created to implement them.

I would like to express my gratitude to Chapter Zero for publishing this paper and convening events to discuss it and to you for taking time to read it.

Structure of this briefing

- **Section One** of this briefing provides an **overview of transition finance** and the recently published **Transition Finance Market Review** (pages 3-6).

- **Section Two** of this briefing looks at the **role of corporate governance** in realising the transition finance opportunity, separated into considerations for **financial services** (pages 7-9) and **real economy** (pages 10-11) companies.

Transition Finance: An Overview

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1. Transition Finance: An Overview

The global transition to a low carbon, climate-resilient economy represents both a climate imperative and a major commercial opportunity. As a leading financial centre, the UK is well positioned to finance this transition while creating opportunities for UK businesses.

The scale of opportunity is significant, the Climate Policy Initiative estimates that **$8.5 trillion will be needed annually by 2030 to support global transition needs**.[1] By building the frameworks, policies and tools to deliver high-integrity, investable transition finance, the UK financial sector can play a crucial role in meeting these financing needs.

To make the most of this opportunity, it is vital to look beyond 'green' finance and embrace **transition finance**. Financing already green activities and business – such as renewable energy and electric vehicles – is only part of what is required to transition the whole economy to net zero. Capital also needs to be directed towards the decarbonisation of high-emitting sectors, including for activities that are not yet commercially viable, such as lower carbon hydrogen, carbon capture and storage, and lower carbon retrofit of buildings and infrastructure.[2] This broader approach, supported by effective policy and catalytic funding, is critical for meeting climate goals and unlocking growth opportunities.

For Board directors and Non-Executive Directors, the recent publication of *Scaling Transition Finance: Findings of the Transition Finance Market Review*[3] highlights the importance of **integrating the opportunities and risks of climate transition into financial and commercial strategy to ensure long-term resilience and value creation**. In doing so, UK companies will position themselves as market leaders at the heart of the global net zero transition.

What is Transition Finance?

- Transition finance encompasses the ***financial flows, products and services that facilitate an economy-wide transition to net zero consistent with the Paris Agreement.***
- The need for transition finance will be particularly acute to support the decarbonisation of high-emitting sectors such as heavy industrial sectors, transport, energy, agriculture and the built environment.
- Examples of the types of activities and entities which might be financed under a classification of 'transition finance' in practice are provided in Appendix 2.

[1] CPI 2024 – *Assessing Top-Down Climate Finance Needs*.
[2] The TFMR report presents a *Transition Finance Classification System* (p. 26) to support understanding of the types of activities and entities that may be considered in scope of transition finance.
[3] TFMR 2024 – *Scaling Transition Finance: Findings of the Transition Finance Market Review*.

The Transition Finance Market Review

The Transition Finance Market Review (TFMR) is an independent, market-led initiative tasked with creating a roadmap for the UK to become a global hub for high-integrity transition finance, through a range of recommendations for government, regulators, businesses and financial services firms.

Commissioned by the UK Government and chaired by Vanessa Havard-Williams OBE, the review is based on extensive stakeholder engagement, including over 40 workshops and 200 bilateral meetings. Its practical recommendations aim to scale a high-integrity transition finance market that supports both UK and global net zero ambitions.

In broad terms, the TFMR's findings can be organised around three core pillars, underpinned by improved communication, capacity building and governance.

1. **Establishing clarity and credibility:** creating a high-quality, high-integrity transition finance market.
2. **Scaling finance for transition activities:** supporting increased finance for the activities and technologies needed for companies and economies to transition.
3. **Scaling finance for transitioning entities:** ensuring the flow of capital to entities with a credible transition strategy.

Snapshot of some of the key barriers and recommendations identified by the TFMR

1. **Lack of long-term regulatory and policy certainty with regard to real economy transition**

   Real economy companies and investors are uncertain as to how policy and regulatory levers will be applied over time to support real economy transition in line with stated ambitions.

   To deliver policy certainty, the TFMR recommends a focus on ***national transition planning***,[4] including a greater level of granularity in **sectoral transition pathways**, a greater level of coordination across government, and greater collaboration with industry on real economy sector policy through an expanded **Net Zero Council**.[5]

2. **Shortage of commercially viable projects**

   Many of the technologies needed for the transition already exist but need targeted interventions to make them commercially competitive and attractive to capital providers.

   The TFMR recommends more targeted use of **catalytic capital**[6] and **blended finance**,[7] and the establishment of a **Transition Finance Lab** to enable the collaborative design, development and testing of innovative financing solutions.

   It also recommends that **systemic levers** – such as carbon pricing, taxes, subsidies, and prudential policy – are used more effectively to push towards a lower carbon future, and that **companies advocate for these systemic changes** as part of their policy advocacy and engagement strategies.

   Finally, the TFMR recommends that the **insurance sector engages proactively to develop underwriting solutions for nascent transition technologies and solutions**.

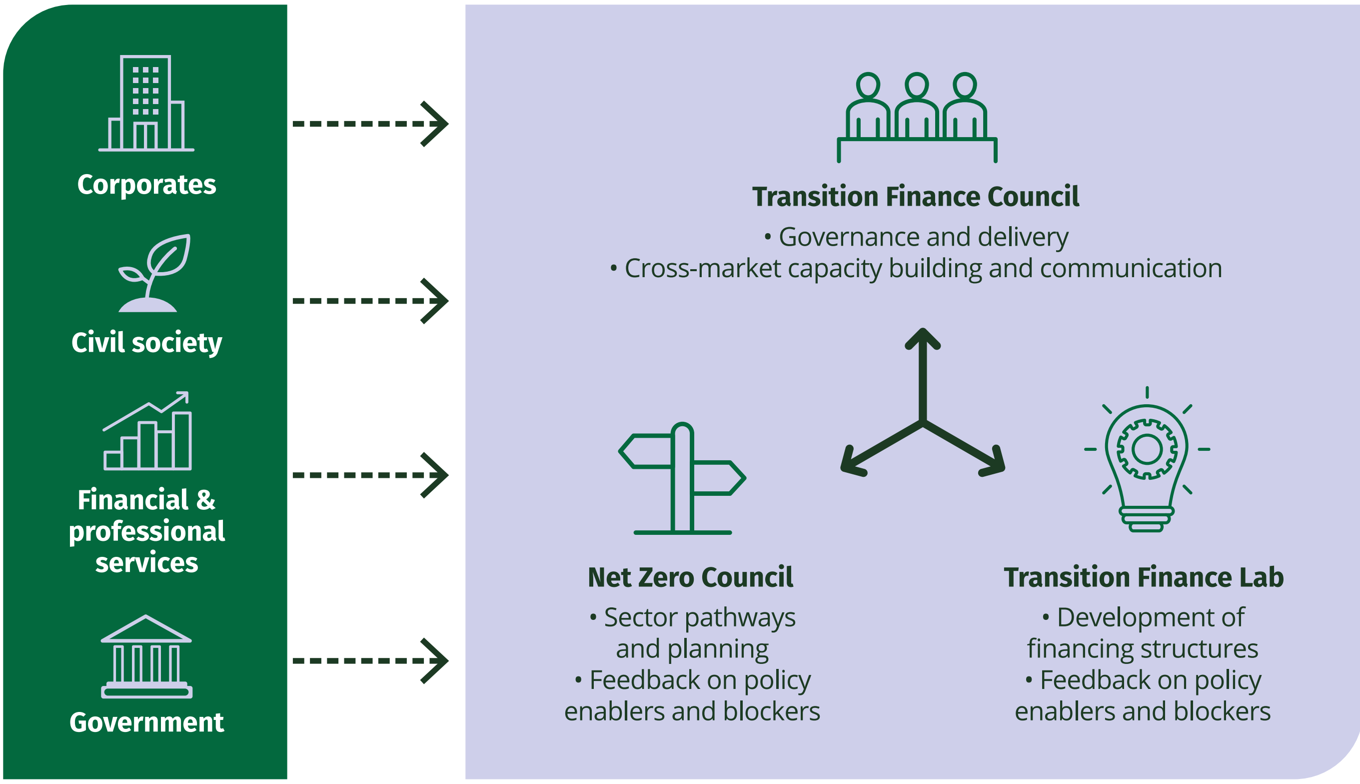
3. **Difficulty in defining and establishing credibility and integrity in practice,** including **risk of greenwashing** and reputational damage for providing finance to transitional activities and certain transitioning entities[8]

   Assessing the impact of transition finance will be more difficult than 'green' as transition is by nature dynamic and context dependent. Overcoming this challenge will require:

   - a shared understanding of the scope and objectives of transition finance – the Review proposes a *Transition Finance Classification System* (p. 26) and *Guidelines for Credible Transition Finance* (p. 28) to support this understanding;
   - widespread, credible transition planning;
   - comparable, forward-looking, transition data (e.g. planned capital expenditure, timeline for phase-out of carbon-intensive assets); and
   - streamlined assessment of corporate transition plans, referenced to sector pathways.

[4] *Taking the lead on climate action and sustainable development* (Mark Manning et al., 2024) outlines a framework for national transition plans.
[5] The Net Zero Council is a partnership between government, business and civil society and provides advice to government on net zero strategy development.
[6] Catalytic capital refers to investments that accept higher risk or lower returns with the aim of attracting private investment.
[7] Blended finance refers to funding interventions which combine public and private funding, with the aim of lowering risk and attracting private investment.
[8] Through its stakeholder engagements the TFMR heard that there is a particular reputational concern for finance which supports the decarbonisation of high-emitting sectors in the long term, but which may increase financed emissions in the short term. 'Paper decarbonisation' where financial institutions meet decarbonisation targets by divesting from high-emitting entities and activities can lead to perverse outcomes where these activities or entities then attract finance from less public or rigorous sources.

To ensure accountability and delivery of the TFMR's recommendations, and support greater collaboration and capacity building across the market, three governance bodies; the Transition Finance Council, Net Zero Council, and Transition Finance Lab (see diagram below) are suggested by the Review.



Progress has already been made on the establishment of these bodies, with the Government recently announcing the relaunch of the **Net Zero Council**,[9] and the Government and City of London Corporation co-launching the **Transition Finance Council**.[10] Dialogue and engagement with these governing bodies offers pathways for Boards and Executive teams to influence and support the development of the transition finance market, ensuring that the opportunities for UK financial services firms and businesses across the economy are realised.

Key discussion questions for the boardroom: contributing to a robust market for transition finance

- Could the entity be engaging with sector decarbonisation pathway development via the Net Zero Council?
- Is the entity engaging with upcoming transition planning consultations to advocate for widespread credible transition planning?
- Are there any other collaborative groups such as the Transition Finance Council that the entity can get involved in to influence change and become a market leader in transition finance?
- How does the entity's policy and industry engagement align with its long-term transition ambition, including advocating for the enabling environment set out in its transition plan?
- Does the entity's climate transition plan also integrate nature, adaptation and just transition considerations?
- Does the entity have the appropriate governance processes, skills and capacity to take advantage of the transition and manage associated risks?

[9] UK Government, Net Zero Council.
[10] Transition Finance Council.

Mobilising corporate governance to realise the transition financing opportunity

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2. Mobilising corporate governance to realise the transition financing opportunity

The TFMR emphasises that achieving net zero goals requires all actors to work together as a whole-of-system endeavour, with financial services firms and businesses across the economy well-positioned to take a leading role. Collaborative efforts need to also be matched by robust implementation at the company level. Boards have a crucial role to play in ensuring that their governance structures are aligned with their transition ambitions and those of the economy as a whole. Below are some **key considerations for Boards in the financial sector and in the real economy as they review their approach to transition finance.**

2.a) How should financial institutions approach transition finance?

The TFMR notes the importance of well-designed governance processes, systems and controls to monitor, oversee and communicate financial institutions' transition financing strategies. **Developing a transition finance approach**[11] allows organisations to align their portfolios and strategy with net zero goals while capturing commercial opportunities.

A transition finance approach helps financial institutions:

- Strategically allocate capital towards real-world decarbonisation impact.
- Translate high-level net zero commitments into actionable strategies.
- Create frameworks for supporting investee company transitions.
- Provide transparency to mitigate greenwashing concerns and regulatory risks.
- Integrate transition considerations into risk management.

Seizing the opportunity of transition finance, while navigating policy differences in key markets and managing potential greenwashing risks, will require careful articulation of an entity's transition finance framework. This will include: how the entity identifies credible transition activities; how its approach is embedded in internal policies and conditions; and how the entity's framework is aligned with its public transition commitments. To support this articulation, the Review proposes a set of principles-based *Guidelines for Credible Transition Finance* (p. 28).

[11] *How to Design Transition Finance Approaches* published on the RMI's Transition Finance Resource Hub offers an informative guide for designing a transition finance framework, primarily designed for banks but with broader applications.

Stewardship and engagement

The TFMR recognises **effective investor stewardship as crucial to the successful management of the risks and opportunities presented by the transition to a low carbon economy**. Investors must develop stewardship approaches (see opposite case study for an example), understanding their transition risk appetite, the assessment tools they will deploy, and setting out when engagement and escalation might be triggered. Macro-stewardship – providing clear inputs to policy development – is particularly important to unlock investment opportunities.

The Role of Transition Planning

The TFMR identifies widespread, credible transition planning as a foundational element for effective transition finance, informing capital allocation and pricing decisions. Non-Executive Directors of financial institutions therefore have an important oversight role, challenging the Executive on the design and application of the entity's transition finance framework, and how this framework is embedded in the entity's transition plan and its wider corporate strategy.

Insights from the TFMR can therefore be used alongside Chapter Zero's Transition Planning Toolkit to shape governance strategies.

Case study – Phoenix Group's approach to investor stewardship (excerpted from the TFMR report)

Beyond the thresholds of its exclusion policy, Phoenix Group (Phoenix) embraces a stewardship approach centred on supporting investee companies' transition planning. Dialogue with company representatives is taking place through its strategic asset management partners, participation in CA100+ and the Net Zero Stewardship Initiative, and direct engagements.

Dialogue with investee companies is reviewed every year against set engagement objectives. In 2022, Phoenix defined its focus engagement list of 25 companies, which accounted for 40% of financed emissions in high-emitting sectors in corporate fixed income and listed equity holdings (using 2019 as baseline carbon footprint). Analysis was completed on each of the 25 companies against Phoenix's in-house climate change scorecard to define tailored sector-specific engagement objectives.

At the end of 2023, Phoenix assessed that target companies had either progressed or committed to achieve 40% of Phoenix's tailored requests to decarbonise their business model. Phoenix will continue to review its programme following the second year of dialogue, and consider different engagement strategies in cases of limited progress.

Key discussion areas for the boardroom: financial institutions

- Has the entity set out how it will identify and assess credible transition finance, for example through the publication of a transition finance framework, and has this been informed by the *Guidelines for Credible Transition Finance* (p. 28)?
- Is the entity's transition finance framework embedded within its transition plan and broader business strategy?
- How does the entity's stewardship and engagement approach align with its transition plan and reflect its wider strategy to preserve and enhance long-term corporate value?
- How are the entity's governance processes, systems and controls designed to ensure consistent application of its transition plan, including how the Board will be engaged on an ongoing basis to oversee delivery?
- How is the entity developing transition plan assessment capabilities and ensuring effective engagement with issuers on transition strategies?
- How does the entity assess the transition impact of its activities and investments, and how is this communicated to stakeholders?
- Is the entity keeping abreast of changes to ESG rating agencies products and regulation?
- Does the entity need to broaden its definition and offering of sustainable products and services to better service transitioning clients in high-emitting sectors?
- Has the entity identified gaps in the market where it could gain a competitive advantage in its product and service offering, particularly in areas which could become profitable with changing policy / regulation (e.g. subsidies, incentives)?

2.b) How should real economy companies approach transition finance?

As the TFMR recommendations are implemented, they have the potential to reshape policy and regulatory incentives and the finance available to real economy companies. Entities will need to consider what aspects of the TFMR recommendations, including its governance bodies they should monitor and engage with, and the needs of their stakeholders.

The TFMR highlights the importance of transition plans and engagement with policymakers on real economy pathways and policies. **Entities will increasingly require evidence of robust transition strategies in order to maintain access to capital and stay competitive**, as investors increasingly adopt transition strategy assessment into their strategic frameworks.

The strategic benefits of incorporating transition planning into financial and strategic decision making include:

- Maintain competitive access to finance.
- Meet growing regulatory requirements and stakeholder expectations.
- Protect against stranded asset risks.
- Gain competitive advantage as markets shift.

Key actions companies can take now:

1. Develop a transition plan and embed this within broader business and financial planning.[12]
2. Implement clear metrics and governance to track progress.
3. Identify and articulate specific investment needs for decarbonisation.
4. Ensure transparency about opportunities, challenges, and dependencies.

> **“For the UK, leading the growth of transition finance presents a major opportunity.”**

Key discussion areas for the boardroom: real economy

- Does the entity have a credible transition plan and has it considered how this would be assessed applying the TFMR's proposed *Guidelines for Credible Transition Finance* (p. 28)?
- Is the entity's transition plan fully integrated within the business strategy? Does it integrate nature, adaptation and just transition considerations?
- How can the entity best collaborate within its industry sector and with government to influence change? Does the entity's engagement approach reflect its transition plan?
- How are the entity's governance processes, systems and controls designed to ensure consistent application of its transition plan, including how the board will be engaged on an ongoing basis to oversee delivery?
- How does the entity track progress against its transition plan and how is this reflected in performance metrics and remuneration?
- How does the entity assess the transition impact of its activities and investments, and how is this communicated to stakeholders?
- How does the entity enable transition-related capacity building across core decision making departments (not confined to sustainability teams)?
- Has the entity considered the potential risks and opportunities associated with changes in policy, regulation or market activity in response to the transition, such as taxes, carbon pricing, or loss of insurance cover?
- With regulatory and policy focus on transition finance, does the entity want to invest in product or service innovation to capture this opportunity?

[12] The Transition Plan Taskforce's transition plan disclosure framework, adopted by the IFRS sets industry best-practice for a transition plan disclosure.

Conclusion

There is a global race to provide the transition finance and technologies that the world needs to move towards a resilient, low-carbon future, and while the UK has the right ingredients to be a market leader, it will need to move quickly and collaboratively. Other markets are also alert to the opportunities this global transformation involves. The TFMR's engagements showed untapped enthusiasm to seize the opportunity of this transition. The TFMR's recommendations offer a roadmap to realise that potential. Now is the time for Boards to champion these recommendations and support their implementation at an organisational level and beyond.

Appendices

Appendix 1 – Summary of key recommendations from the TFMR

	Key Recommendations*	Applies to	Timing**
Chapter 1	**Defining the scope of transition finance**		
	• Promoting a **dynamic and pragmatic understanding of transition finance** - responsive to jurisdictional, sectoral, and entity-specific context. • The Review presents a ***Transition Finance Classification System*** to support readers in understanding the 'transition activities' and 'transitioning entities' that could be considered in scope for transition finance classification.	Government and regulators, Corporates, Financial & professional services	Ongoing
	• Developing and embedding the ***Guidelines for Credible Transition Finance*** set out by the Review which present a voluntary, principles-based framework to support institutions in developing their own transition finance frameworks.	Financial & professional services	6-12 m
Chapter 2	**Pathways and policy**		
	• **More granular national and sectoral pathways and planning**, developed in partnership with industry, via a reinstated ***Net Zero Council***, and communicated in a way that provides confidence and certainty to issuers and investors.	Government and regulators, Corporates, Financial & professional services	1-3 y
	• **Macro policy levers**, including subsidies, incentives, carbon pricing, and prudential policy, all tilting towards transition.	Government and regulators	1-3 y
Chapter 3	**Scaling finance for transition activities**		
	• **Catalytic capital and blended finance** which targets specific sectoral market failures, embedded within a streamlined landscape of public finance institutions.	Government and regulators	1-2 y
	• Establishing a ***Transition Finance Lab***, based in the Green Finance Institute, which enables the collaborative design, development and testing of innovative solutions to accelerate finance for sector-specific transition challenges.	Government and regulators, Financial & professional services	6 m
	• Improving the commercial viability of transition activities through all available levers, **including insurance solutions** and **demand incentivisation and aggregation.**	Government and regulators, Corporates, Financial & professional services	1-3 y
Chapter 4	**Scaling finance for transitioning entities**		
	• Interventions needed to achieve widespread **transition planning**, and the development of a suitable ecosystem to support the assessment and verification of transition plans, with access to effective data and ratings	Government and regulators, Corporates, Financial & professional services	1-3 y
	• Collaboration between the market and regulators to establish key transition finance metrics, through the establishment of a **Climate Financial Risk Forum (CFRF) transition finance working group**	Government and regulators, Financial & professional services	6-12 m
	• Measures to align capital providers to transition opportunities, including **unlocking productive finance, supporting stewardship,** maturing of the **labelled debt market** and improvements to retail product offering.	Government and regulators, Corporates, Financial & professional services	1-3 y
Chapter 5	**Scaling transition finance with credibility & integrity**		
	• **Proactive engagement from regulators** which provides confidence to the market on best-practice transition finance.	Government and regulators	6-12 m
	• **International alignment and collaboration** on supportive sustainable finance policy and frameworks.	Government and regulators	1-3 y
Chapter 6	**Scaling transition finance in emerging markets and developing economies**		
	• **Strategic and catalytic deployment of UK grant funding** for the transition of emerging markets and developing economies (EMDEs).	Government and regulators	1-3 y
	• **International advocacy and diplomacy** supporting the development of jurisdictional pathways and planning, and improvements to the international financial architecture which allows greater blended finance support for EMDEs.	Government and regulators	1-3 y
Chapter 7	**Delivering on the ambitions of the Review**		
	• Establishment of a ***Transition Finance Council***, based in the City of London Corporation, which ensures delivery of the Review's recommendations and supports **communication** and cross-market **collaboration**.	Government and regulators, Corporates, Financial & professional services	6-12 m

Government and regulators   Corporates   Financial & professional services

Table 1 - Summary of report recommendations at a glance

*These recommendations are a core subset of a wider set of recommendations summarised at the beginning of each chapter, and discussed in detail in the body of the report.
**Timing denotes the expected time period to deliver on the recommendation.

Appendix 2 – Examples of the types of activities and entities that might be financed under a 'transition finance' classification

Illustrative categories of transition finance[13]	Description	Examples of activities/entities which may be financed within each category
(1) Climate solutions and enablers (activity-level)	Financing climate solutions activities and activities which enable climate solutions	• Generation and storage of renewable and low carbon fuels and CO²e, e.g. sustainable aviation fuel and nuclear • Production and sales of products substituting existing high-carbon products, e.g. bamboo packaging
(2) Climate solutions and enablers (entity-level)	Financing 'pure play' companies, where the majority of revenues or assets within a portfolio are derived from climate solutions and enabling activities (Category 1 activities)	• Financing 'pure play' companies, where the majority of revenues or assets within a portfolio are derived from climate solutions and enabling activities (Category 1 activities)
(3) Activities to support alignment (activity-level)	Financing activities which support an entity in aligning to a credible decarbonisation pathway	• Electrification of equipment and industrial processes • Lower carbon retrofit of buildings, transport, machinery and infrastructure
(4) Entities which are aligned/aligning (entity-level)	Financing entities that are aligning or aligned to a credible decarbonisation pathway	• 'Pragmatic prioritisation' of higher emitting sectors, e.g. steel, cement, aviation, energy, real estate, agriculture
(5) Early retirement of high-emitting assets	Financing activities which lead to the early retirement of high-emitting assets which would otherwise continue to produce emissions	• Buyout and early wind-down of coal plants • Repurposing of coal plants (e.g. REPOWER)

[13] This table is a simplified version of the *Transition Finance Classification System*, introduced on page 26 of *Scaling Transition Finance: Findings of the Transition Finance Market Review*.

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Transition Finance Market Review

Acknowledgements

The City of London Corporation would like to thank the following individuals for their valuable contributions to this paper: Vanessa Havard-Williams (Chair, Transition Finance Market Review), Mark Manning (Strategic Advisor, Chapter Zero), Alexandra Innes (Chapter Zero Fellow; Non-Executive Director and Chair of the Sustainability Committee, Waverton), Vicky Moffatt (CEO, Chapter Zero), Jo de Vries (Content Partnerships Director, Chapter Zero), Lidiia Vatutina (Programme Manager, Chapter Zero) and Sashawne Smith (Content Coordinator, Chapter Zero).

This briefing draws extensively on the findings of the Transition Finance Market Review, and we acknowledge the contributions of all those involved in its development.

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Chapter Zero

About the City of London Corporation:

The City of London Corporation is the governing body of the Square Mile dedicated to a vibrant and thriving City, supporting a diverse and sustainable London within a globally successful UK.

We aim to:
• Contribute to a flourishing society
• Support a thriving community
• Shape outstanding environments

By strengthening the connections, capacity and character of the City, London and the UK for the benefit of people who live, work and visit here.

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About the Global City campaign:

The Global City campaign is the City of London Corporation's overarching initiative to promote the UK as a world-leading international financial centre.

It showcases the UK as a great place for financial and professional services firms to invest, locate and grow.

www.theglobalcity.uk

About Chapter Zero:

Chapter Zero, the Directors' Climate Forum, is a global centre of excellence for thought leadership working in partnership with the Climate Governance Initiative. We work with directors and chairs to integrate climate into business strategy.

Through expert-led curation, convening and community building, Chapter Zero's purpose is to equip and inspire non-executive directors with the tools, knowledge and capabilities needed to ensure that climate is a strategic priority in boardrooms. Our events and publications programme brings the latest thinking on climate to our members.

With over 3,000 members, Chapter Zero is represented on the boards of over 80% of the FTSE 100 and 75% of the FTSE 250.

To join or explore our resources go to:
www.chapterzero.org.uk