TIAS
SCHOOL FOR BUSINESS AND SOCIETY

Introduction to Transition Finance

CFA Society - Netherlands

Understanding the role of Transition Financer in Sustainability

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Agenda – **introduction to transition finance**

- **Funding climate transition**
- **What is transition finance**
- **Financing transition**
- **An example**
- **Barries to transition finance**

Breaking down the SDGs – ***financing the transition***

Annual funding gap in sustainability highlights the need to rethink how we invest in companies to reverse the adverse impact of companies on achieving the climate targets set by the **Paris Agreement and Protocol**

US$5-7 billion

**annually*

Segments	**Environmental**					**Governace**	**Social**			
challenges	*pollution*	*emissions*	*biodiversity*	*climate change*	*ecological*		***education***	***social housing***	***healthcare***	***affordable food***	***infrastructure***
Funding	**mitigation finance**	**low carbon finance**	**bio-finance**	**climate finance**	**oceans finance**						

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Segments

Environmental

corporations

challenges

pollution | *emissions* | *biodiversity* | *climate change* | *ecological*

Funding

corporate balance sheet for transitioning

improve process

transition financing

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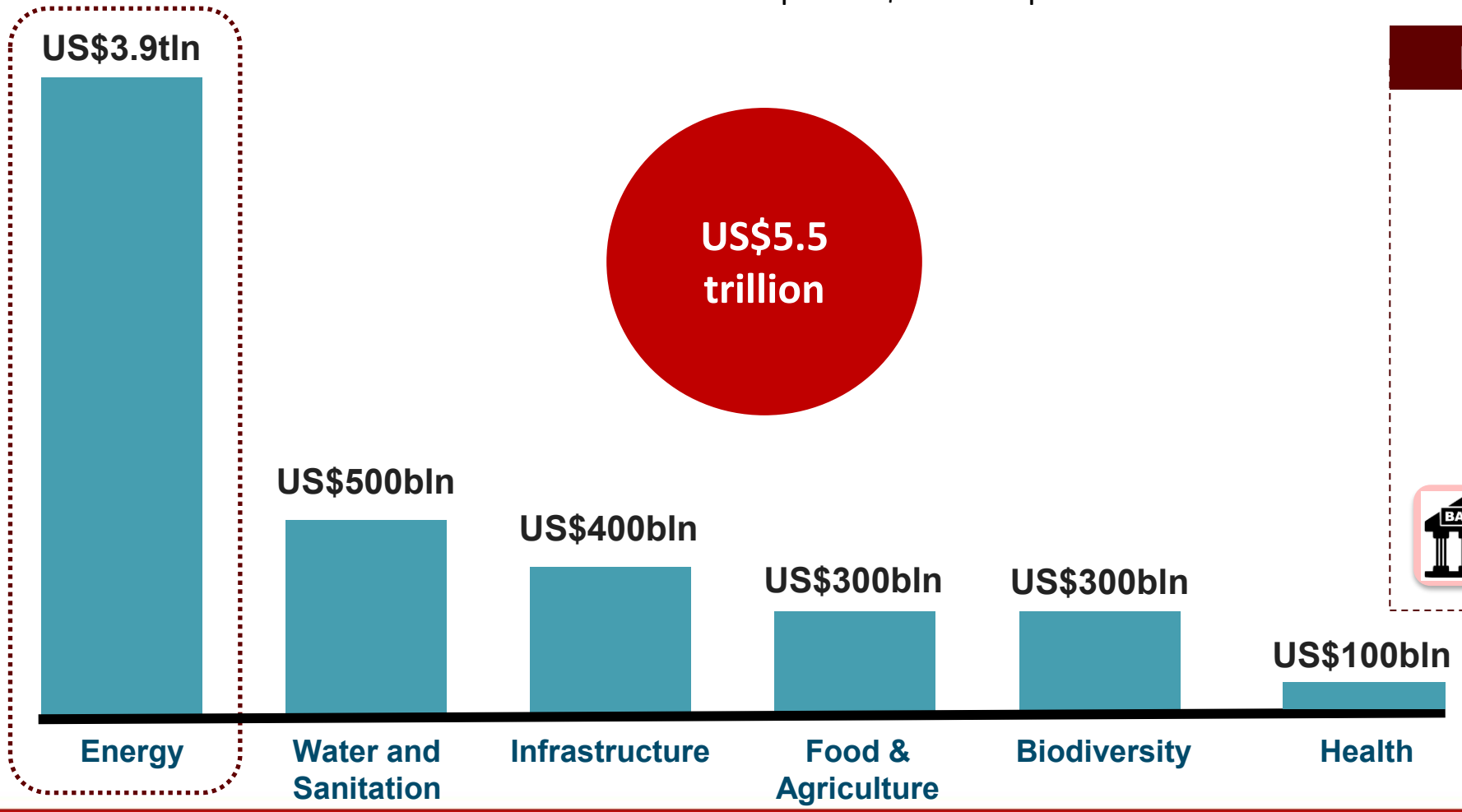
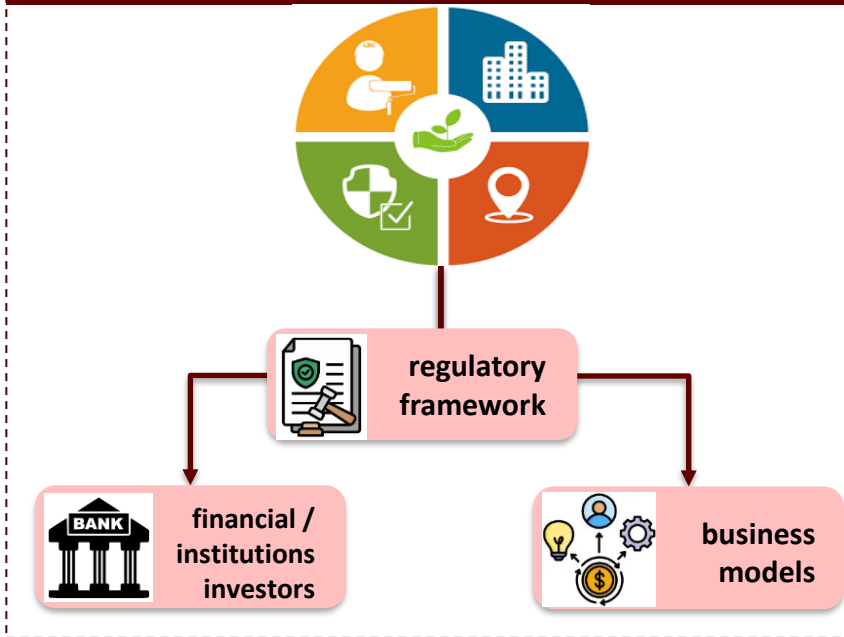
Funding needs – ***where is the funding needed***

Around US$5.5 trillion a year of capital investment will be needed on average between now and 2050 to build a net-zero global economy, up from $1 trillion per annum in 2020

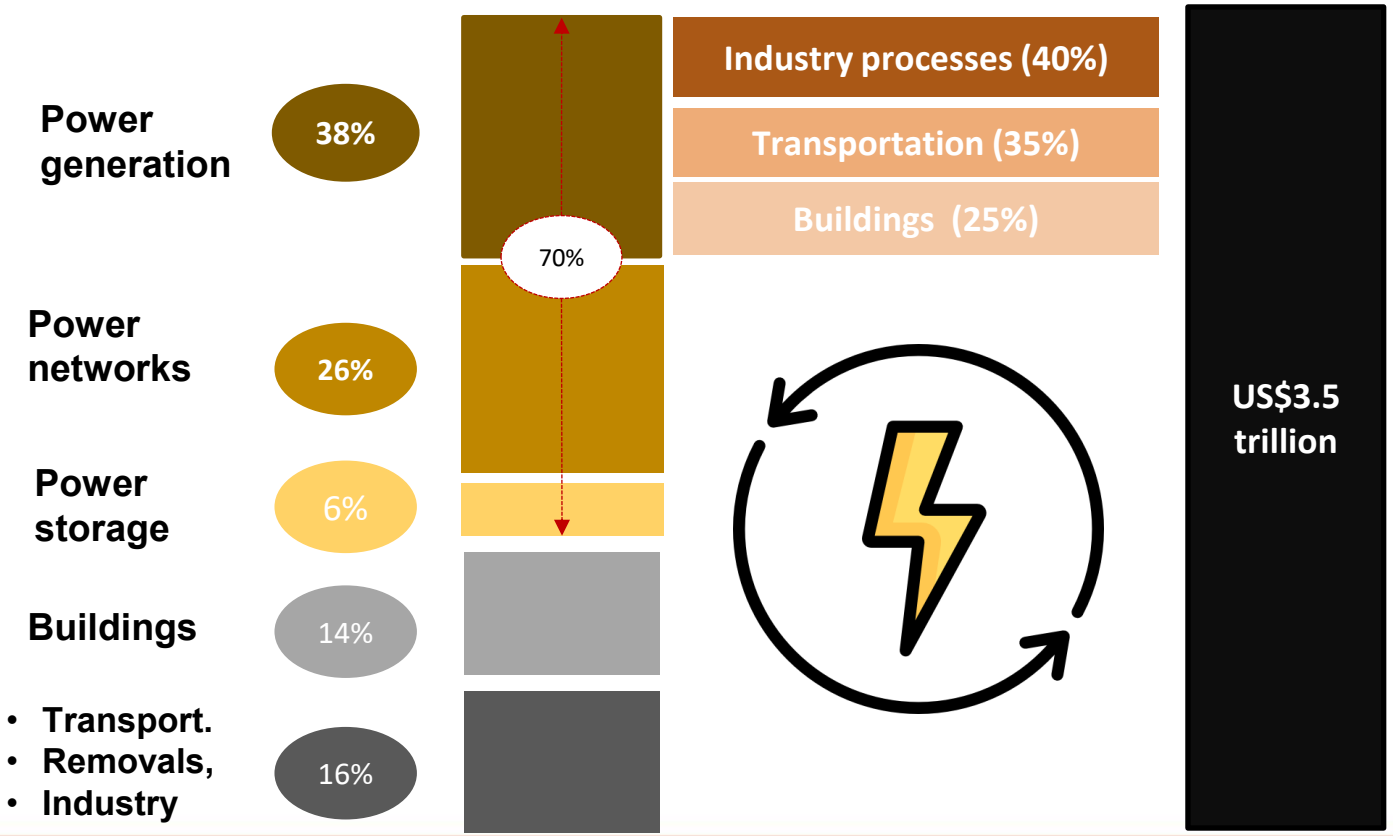


Major obstacles in the capital flow



Example, energy – *what is the capital require for net zero*

The capital requirement to reach **net zero** is massive — running into the **trillions of dollars annually** — and it depends on the assumptions (pathway, sector, region). Emerging markets require 70% of incremental investment, yet they currently receive only 20% of green capital flows, primarily due to their higher credit risk compared to developed countries.



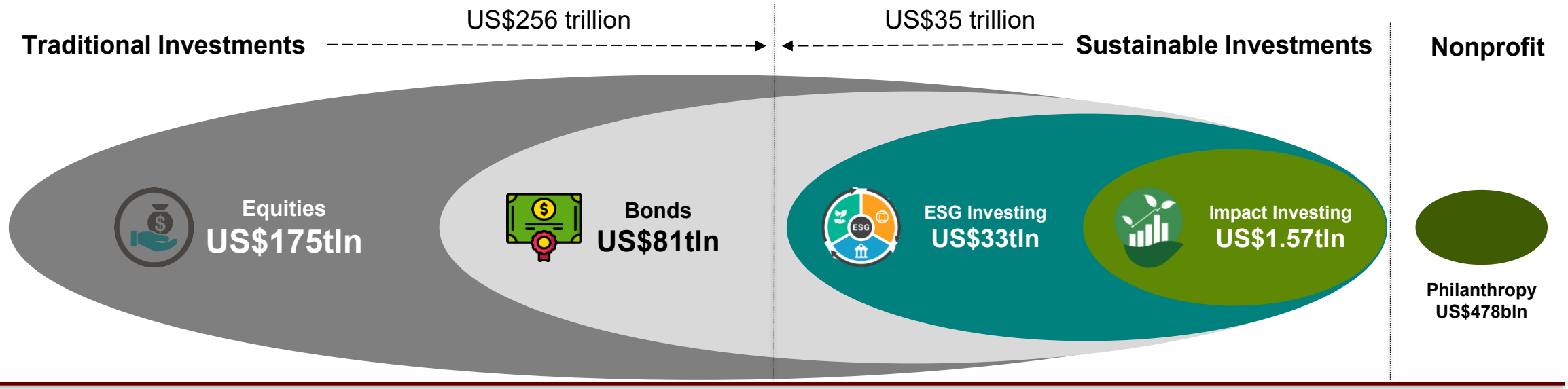
New innovations to drive transition

Energy system transformation
- renewable energy
- grid modernization
- storage

Smart construction
- energy-efficient retrofits
- electrified heating
- low-carbon construction

Transport & mobility
- electrification of vehicles
- low-carbon shipping & aviation
- fuels

Global markets > *US$1,088 trillion*



Investment Scale & Growth

- Global investment in energy transition hit **US$2.1 trillion in 2024**, up ~11% vs 2023.
- Issuance of sustainable finance instruments (green, social, sustainability, sustainability-linked etc.) was **US$1.657 trillion** in **2024**.
- Green bonds reached US$688 billion in 2024.

Dominant sectors

- Most investment goes to established or scaling technologies: *renewables (solar, wind), electrified transport, power grid expansion and upgrades, and energy storage.*
- Emerging transition areas, including hydrogen, carbon capture & storage (CCS), clean industry, and clean shipping, are lagging behind the other sectors.

Global Patterns and Gaps

- China remains a leading market, with large-scale investment in energy transition, grid infrastructure, and other key sectors.
- Regulation (EU Taxonomy, Green Deal)and institutional investor demand continue to keep Europe competitive.
- There is continuous reliance on blended finance vehicles to de-risk senior instruments

Where's bottleneck – ***unlocking financing flow***

Private investors with intentions to invest in the SDGs face several limitations that make it challenging to deploy capital effectively. Next to specific measurement and regulatory challenges, investors face

Unpredictable outcomes

Lack of clarity on future trends, regulatory changes, and economic conditions makes decision-making difficult for investors.

Challenges in valuation

Asset valuation faces unique challenges because conventional finance tools often don't fully capture ESG risks and opportunities.

Slow returns

The J-Curve for sustainable projects is more profound as the period under the "valley of death" is prolonged. More capital investment is required at the onset.

Investment Spread

Distribution of capital across different asset classes, geographies, and sectors continues to lead to cherry-picking of IRR rather than impact issues

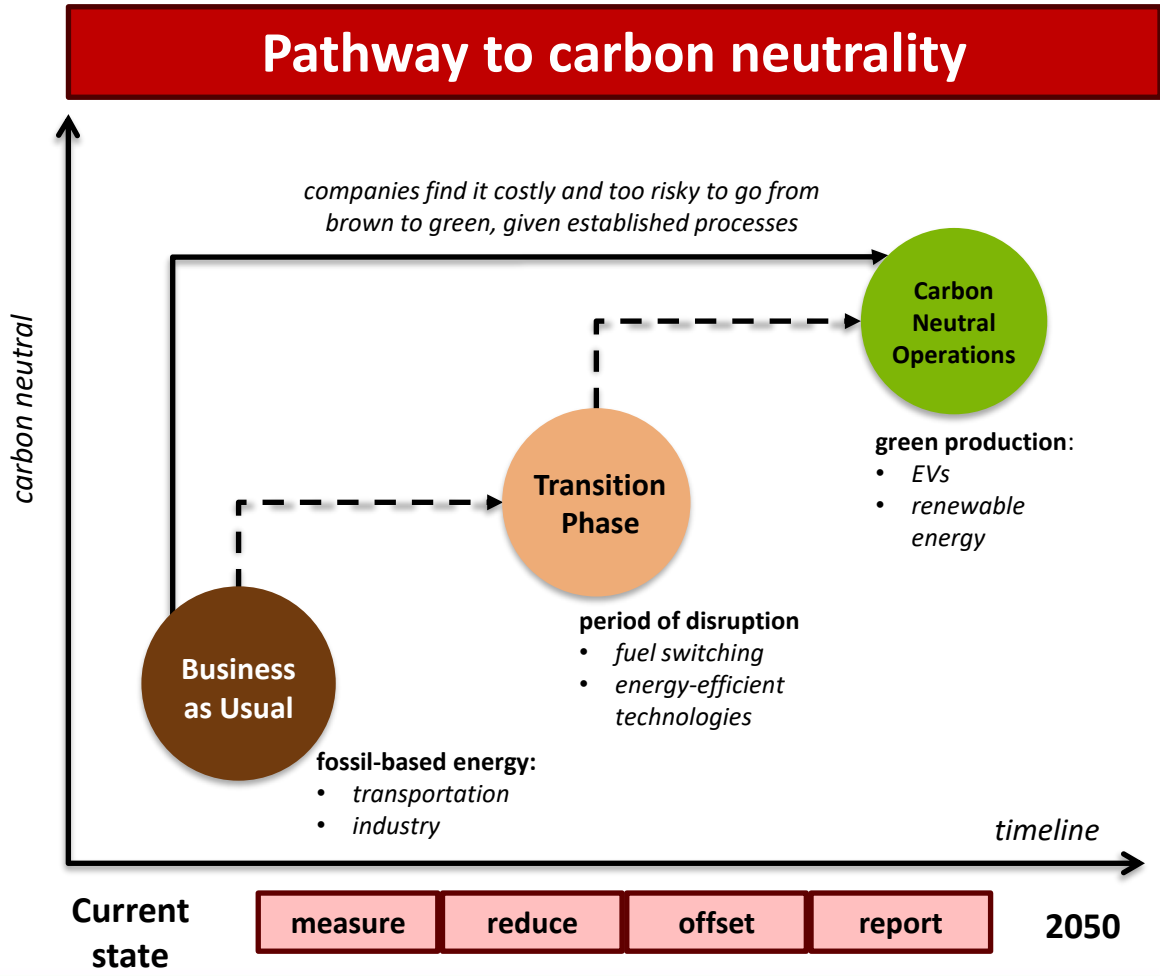
Transaction Finance – *a pathway towards transition*

Transition Finance

capital mobilized to support companies, projects, or sectors in shifting from carbon-intensive practices to low-carbon, sustainable operations, through tools like loans, bonds, equity, blended finance, or guarantees.

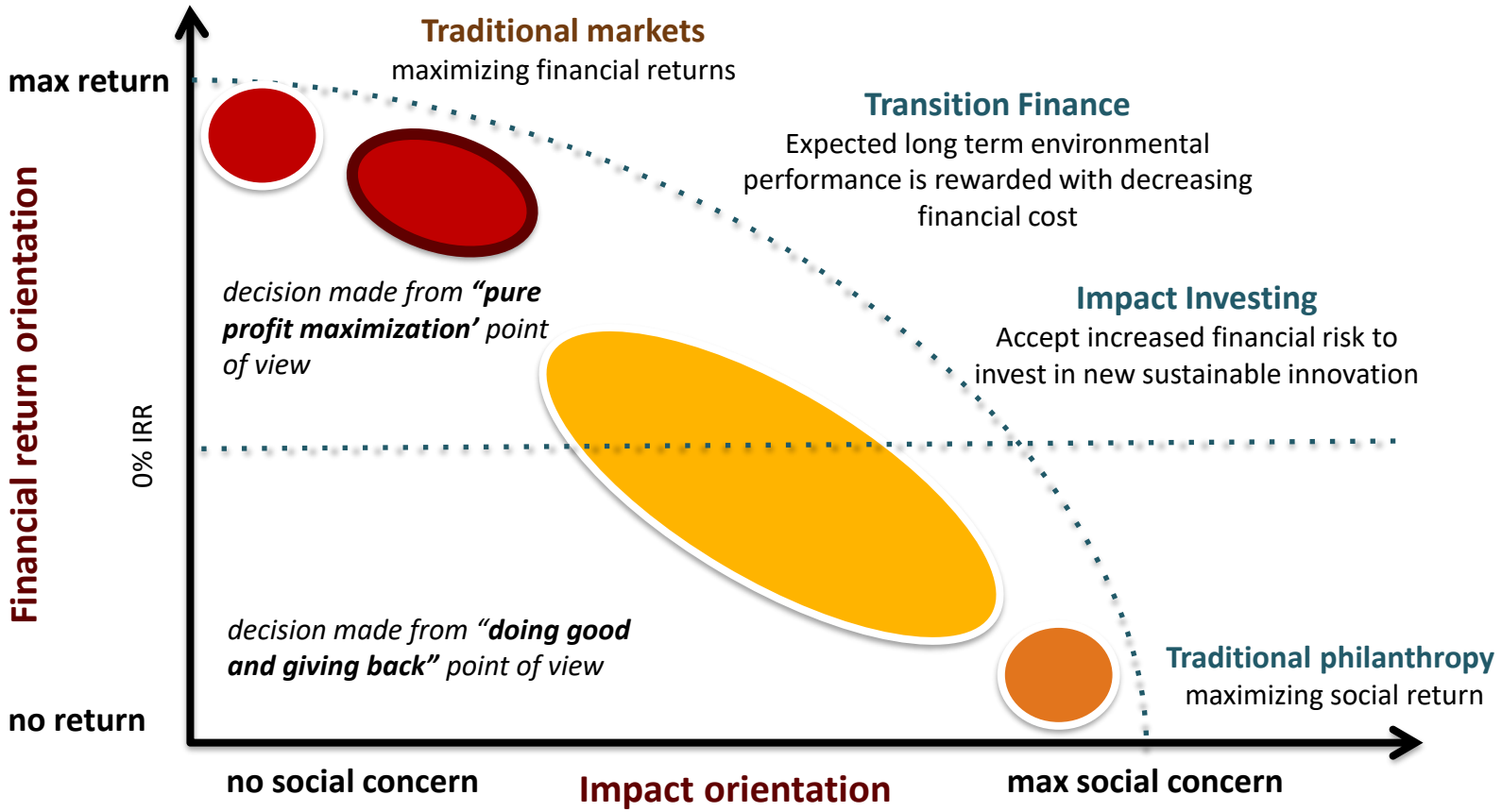
Purpose

- offers a pathway for investors to support companies that are on their journey towards sustainability but are not yet fully "green."
- allows investors to fund traditionally "grey" sectors, while helping them move toward more sustainable practices.



Expected IRR quadrant – is transition finance concessional

Sustainable finance refers to any form of financial service integrating environmental, social and governance (ESG) criteria into the business or investment decisions for the lasting benefit of both clients and society at large.



Instruments

Equity: *(10%) makes up the global transition finance*

- provide capital to companies undergoing transition

Mezzanine *(5%)*

- bridge the funding gap during the period of disruption

Debt / Bonds *(80%)*

- finance project or company-level transitions

Structured Finance

Carbon Markets / Offsets:

- financing emissions through carbon credits (e.g., REDD+)

Securitization of Transition Assets:

- pooling transition assets into investable securities.

Sustainability-Linked Derivatives:

- instruments tied to sustainability KPIs to hedge risks.

Transition Infrastructure Funds:

- investment vehicles dedicated to energy transition assets.

Transaction Finance – ***investment areas***

Transition finance is guided by **three interrelated pillars**: climate, nature, and social development. It offers investible opportunities in a wide range of areas, led by climate and nature:

Climate: Opportunities range from switching from fossil fuels to renewable energy, to changing industrial processes, developing green steel and low-carbon cement, plus carbon capture technology.

Nature: Projects include reducing pollution and waste, using less packaging, adopting more recycling and more land-use-efficient products, thereby reducing resource intensity and pressure on land and sea.

Social: **Just Transition** involves retraining or allocating workers in sectors like coal mining who will be displaced, to secure new jobs in more sustainable industries. *For example, in Egypt, the government plans to replace fuel price subsidies with food stipends.*

Placing transition finance– ***where does it fit***

Carbon Neutral Operations

Sustainable finance

Investments in green assets or companies to fund their operations

Transition Phase

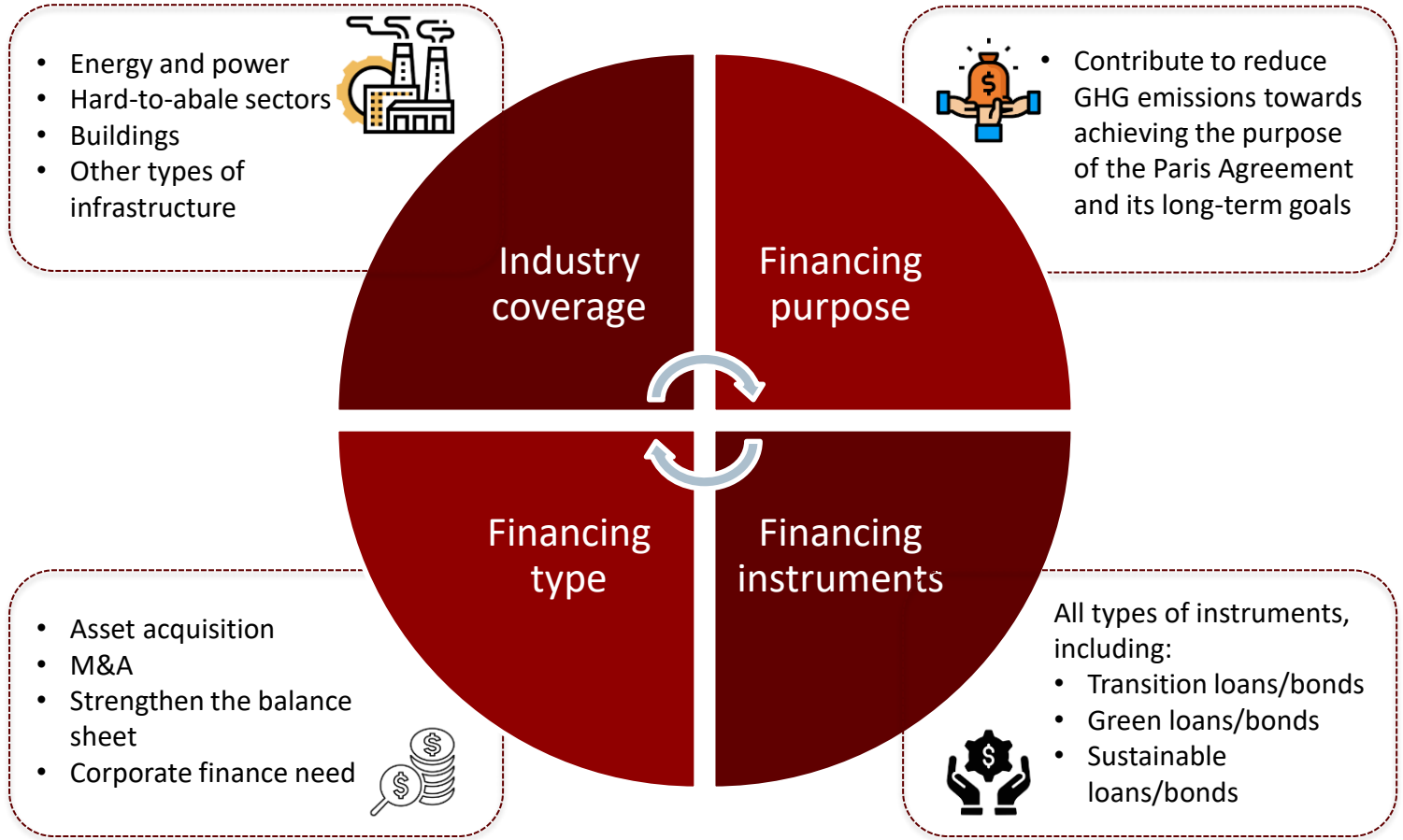
Transition finance

Investments in assets where the investment itself enables the delivery of a transition activity

Business as Usual

Traditional Finance

funding to companies without being subject to sustainable reflections



Core Principle - **underpinning transition finance**

Core Principles

1. Alignment with science-based targets and climate pathways (limiting global warming to well below 2°C or 1.5°C).
2. Transparent, measurable emission reduction targets with interim milestones.
3. Credible transition plans validated by clear strategies on asset, operational, and business model changes.
4. Consideration of a "***just transition***" ensuring fair social impacts for workers and communities.

What makes it "transition finance"

Intentionality: the finance has a clear objective to deliver transition outcomes.

Accountability: there is a mechanism in place to ensure that the outcome is delivered.

Pre or during investment

transition objectives are made clear and built into the investment process

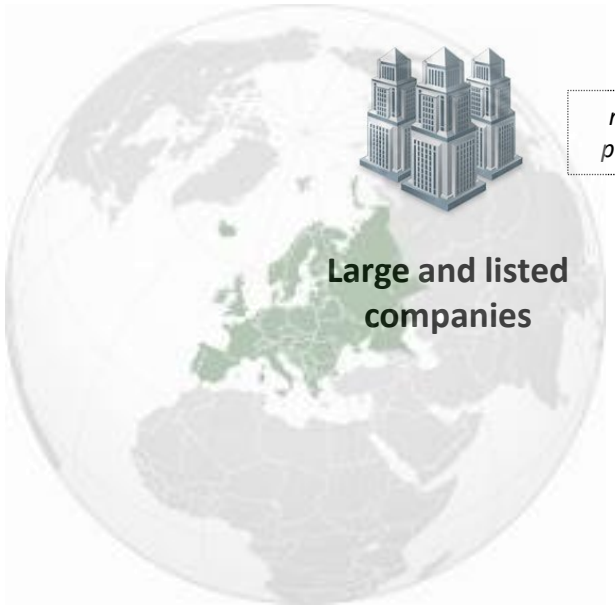
During or post investment

outcomes are delivered, and the level of success is transparently reported

Role of regulations – *emerging regulations help transition finance*

Corporate Sustainability Reporting Directive (CSRD)

Sustainable Finance Disclosure Regulations (SFDR)



Large and listed companies

report publicly

CSRD

reporting by large companies on sustainable risk/impact, including other CSRD information on ESG

% of activities aligned with Taxonomy

companies to report the % of current/future revenue and activities aligned with Taxonomy

information used by

End users

(civil society, customers)

Financial institution

Asset managers, insurance companies, pension funds, etc..

Products with ESG characteristics

partially pursue sustainable investments as an objectives in product development – "green products"

Product with "sustainable investment" objective

activities aligned with EU taxonomy are included in the definition of sustainable investment

classification of economic activities significantly contributing to environmental objectives

EU Taxonomy

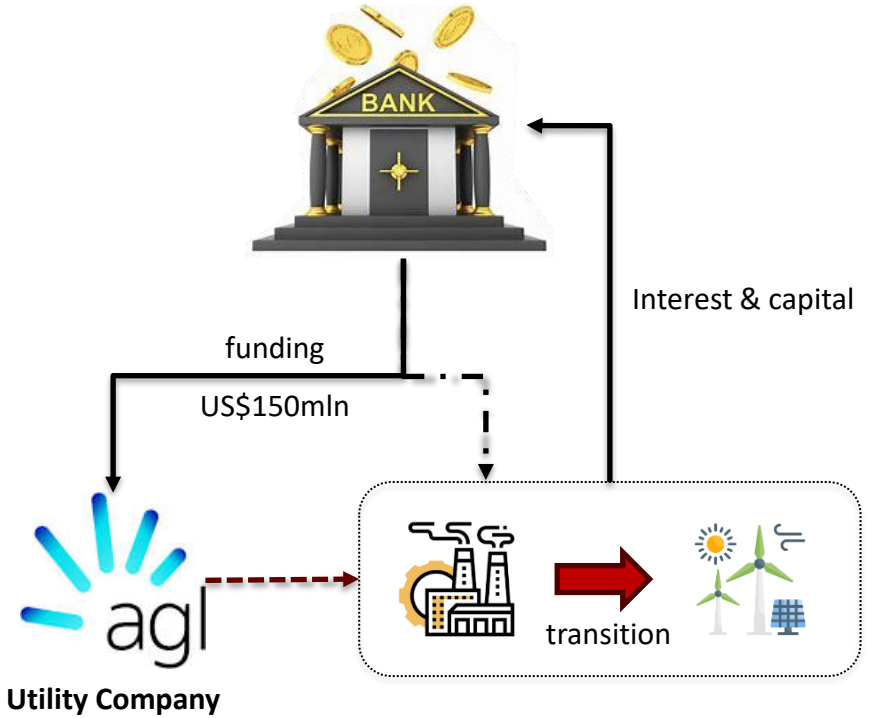
Example – *decommissioning coal coal-fired power plant*

Transaction overview

- Coal-powered power plant with a 30-year life span
- Early retirement of coal-fired power and conversion to battery
- Coal-fired power plants to be shut down in 20 years
- Total investment required: US$150mln

Funding structure

- Quantum = US$150mln
- Instruments = Debt + mezz
- Split = US$100mln debt + US$50mln, 10 yrs



Eligibility assessment

Evaluated assets and strategy

Coal-fired power plant

Assessment results

- **Intentionality:** funding to be used to finance the decommissioning of the coal-fired plant
- **KPIs:** Replace generation capacity with renewable energy – KPIs - reduce emissions by 30% in 2030 – increase in renewable share of generation by 50%
- **Social justice:** support workers and the local communities impacted by the closure

Assessment on strategies

- Net zero commitments by stated timeline
- Replacement capacity and cash flow
- Interim targets - KPI target –
- Scalability

monitoring

Regular monitoring on:

- Progress of the client's strategy
- Progress of decommissioning plans
- Progress of conversion to battery facilities

Base Interest Rate:

- Debt (SOFR + 300 bpp), mezz 10% cash coupon + 3% PIK

Performance Targets:

- Borrower commits to measurable sustainability KPIs

Step-Down Mechanism:

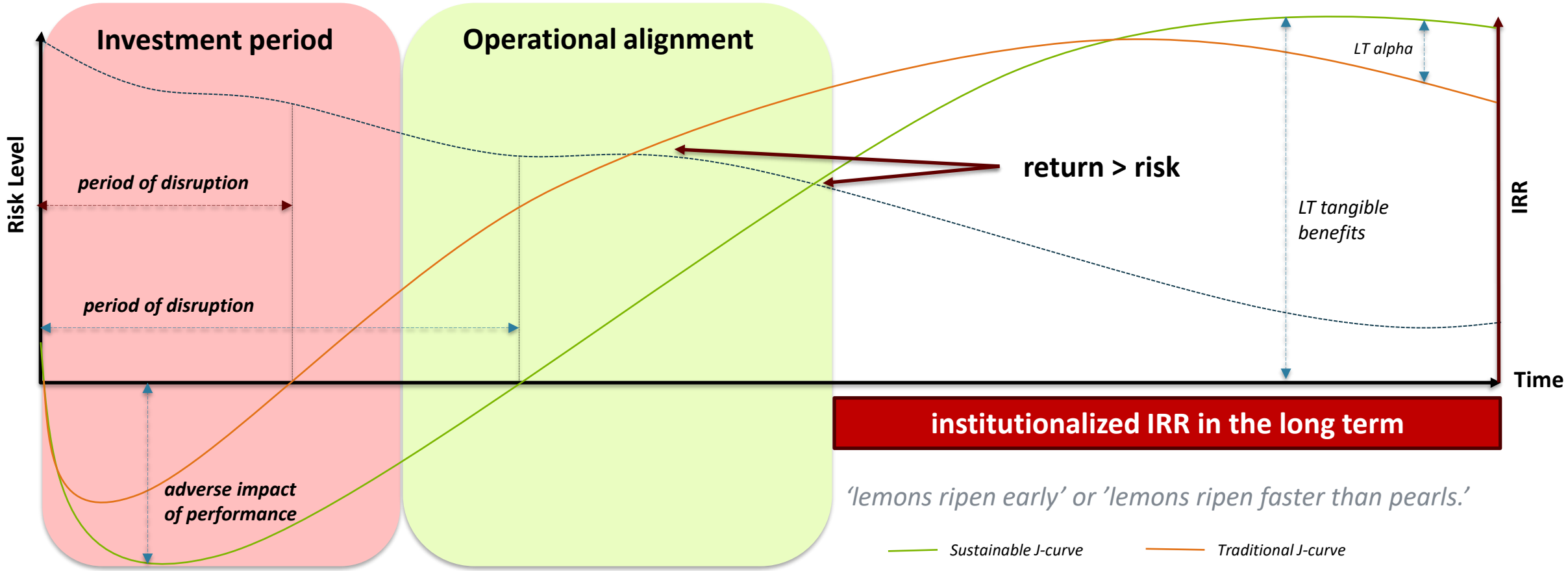
- KPIs achieved at interim checkpoints, the margin decreases by 150 bps.

Independent Verification:

- Progress is checked by an external reviewer (auditor).

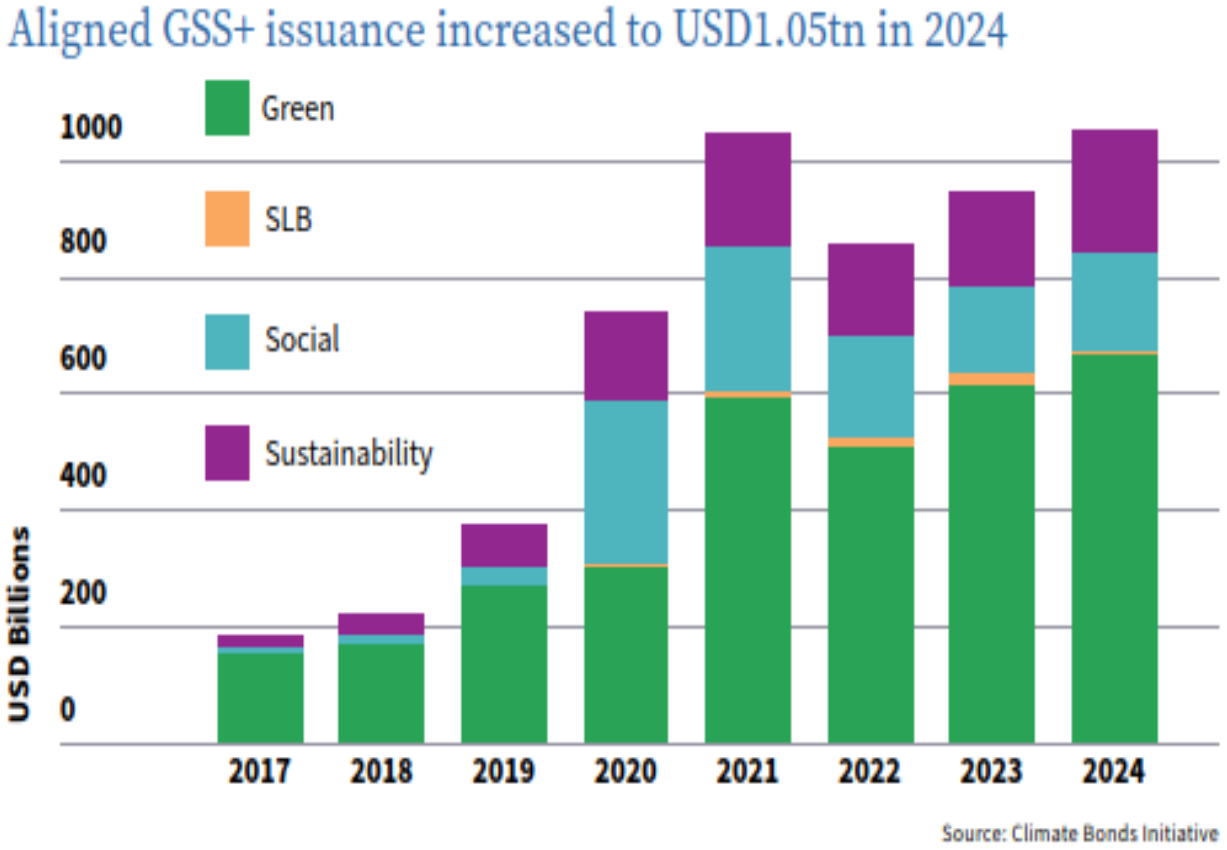
Investment cycle – ***what investor miss***

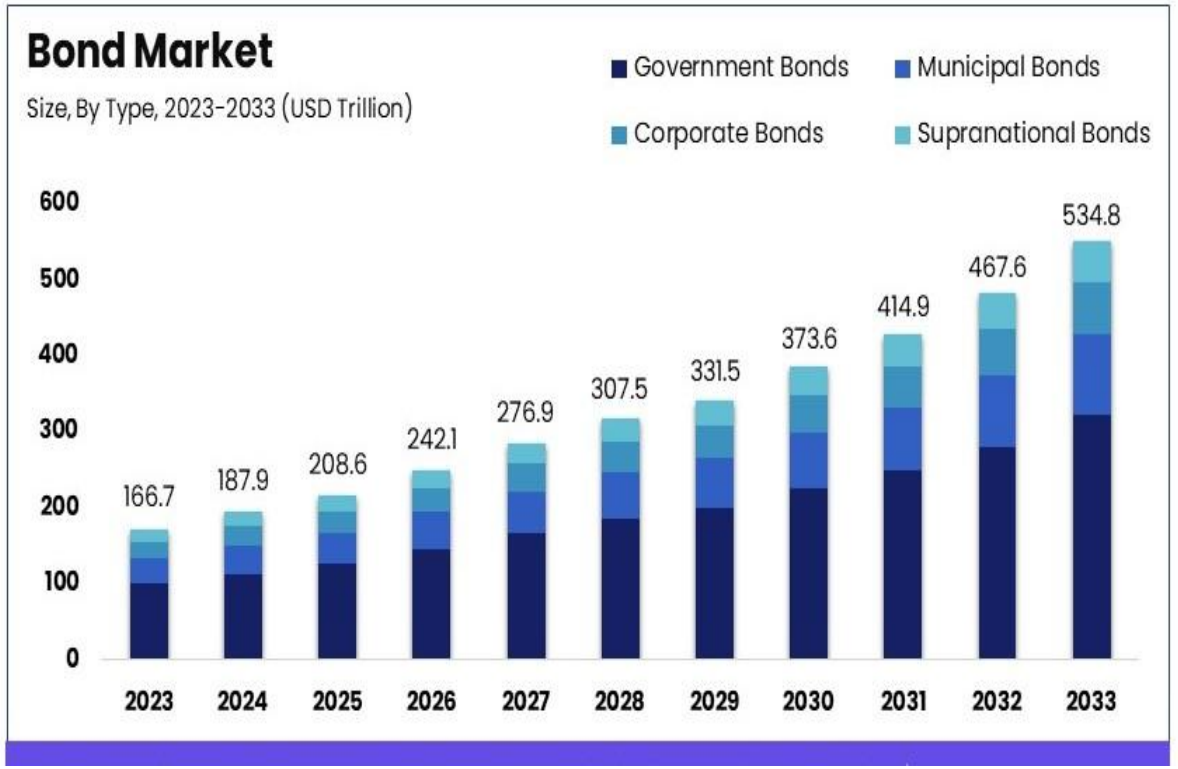
Understanding the misalignment between investor expectation and actual investment profile of sustainable assets – investors mistakenly expect the curves to follow a traditional path, however, a lack of derisking prolongs the initial learning period



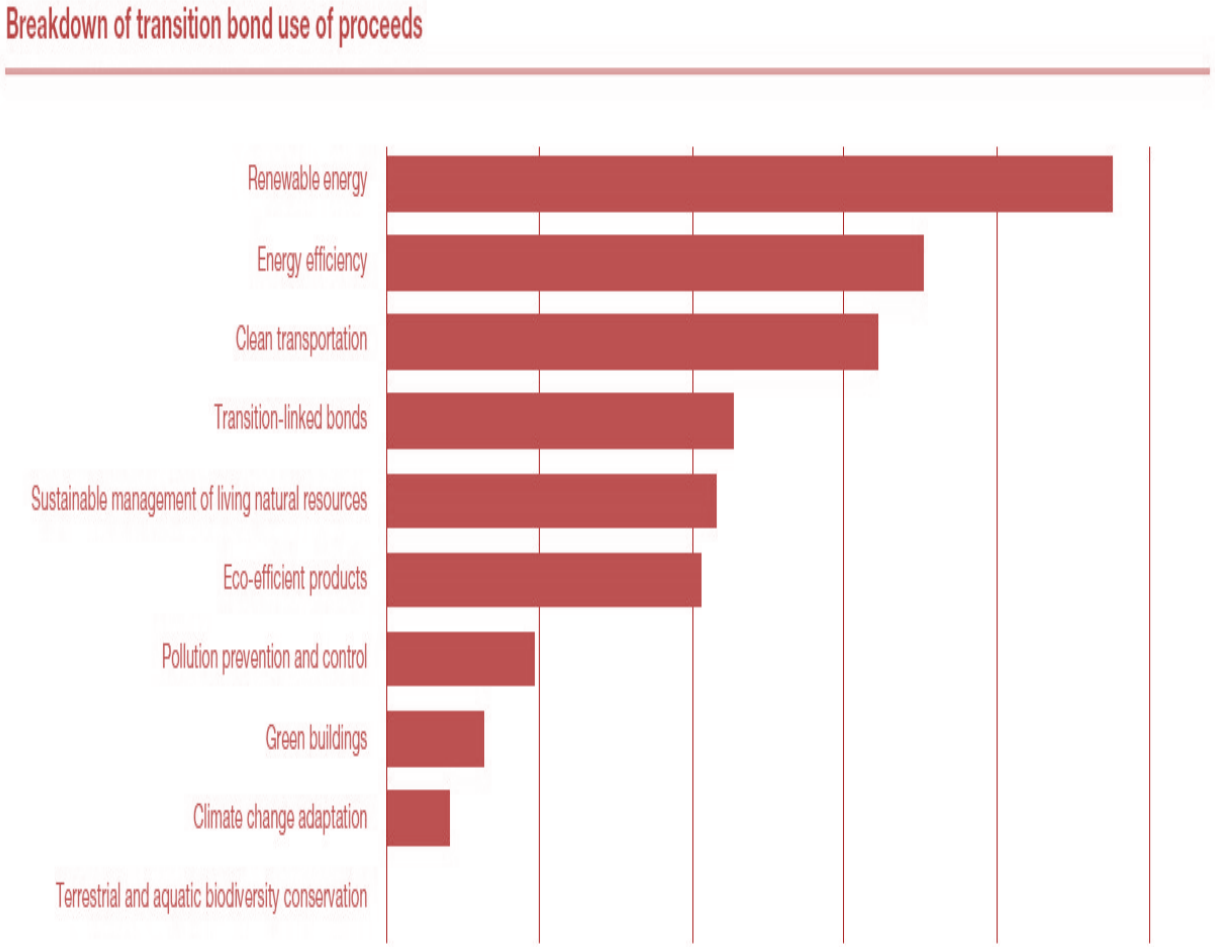
Sustainable bond issuance – ***performance***

Europe was the largest source of sustainability-related debt instruments, USD475bn in 2024, representing 45% of global issuance. North America delivered a 45% rise YOY and represented 16% of the volume in 2024.



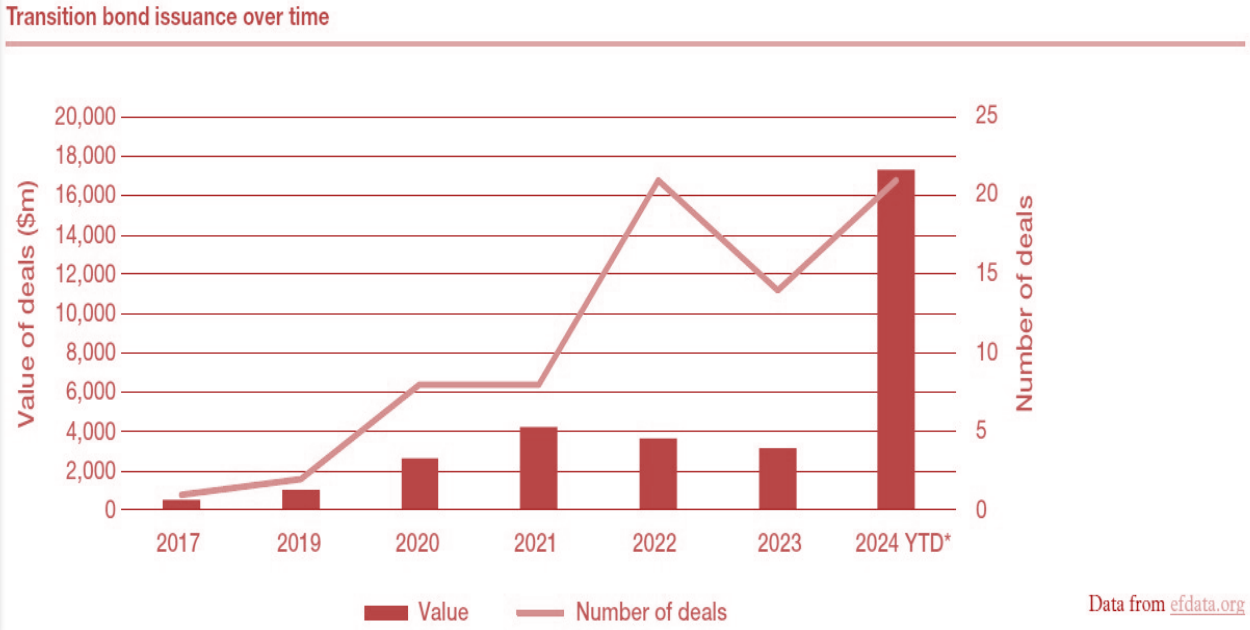


Transition finance sector – ***market size***



Szie of

- growth Market Reports estimates the **global transition finance market** at **USD 445.2 billion in 2024**
- the figure is relatively small compared to the broader sustainable finance market investments of US$35 trillion
- report projects a CAGR (compound annual growth rate) of about **22.4%** from 2025 to 2033, growing toward US$2.4667 trillion by 2033



Challenges – ***barriers to transition finance***

Lack of long-term regulatory and policy certainty regarding the real economy transition.

- Ultimately, finance will follow incentives in the real economy, as that is what drives the perception of future returns. Transition finance will struggle to scale if the real economy transition is not incentivised over the status quo.

Mismatch in the risk-return profile required by capital providers and the investible opportunities:

- The transition will rely on emerging technologies, which have a different risk-return profile than incumbents. Bridging solutions are needed to connect the deepest pools of capital with key transition technologies.

Challenges with assessing whether financing a particular activity or entity will have a credible decarbonisation impact:

- There are also related difficulties in preparing and assessing private sector transition plans.

There is a limited provision for "transition" activities and strategies in the global sustainable finance regulatory regimes.

- This is also the case in other jurisdictions, where sustainable finance regulation generally focuses on provisions for **green** rather than **transition** activities.

Risk of actual greenwashing and risk of greenwashing allegations and reputational damage for providing finance to certain transition activities and transitioning entities.

- This is a particularly significant problem when it comes to financing activities or entities aimed at decarbonising high-emitting sectors.

Questions

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