



# Climate transition finance

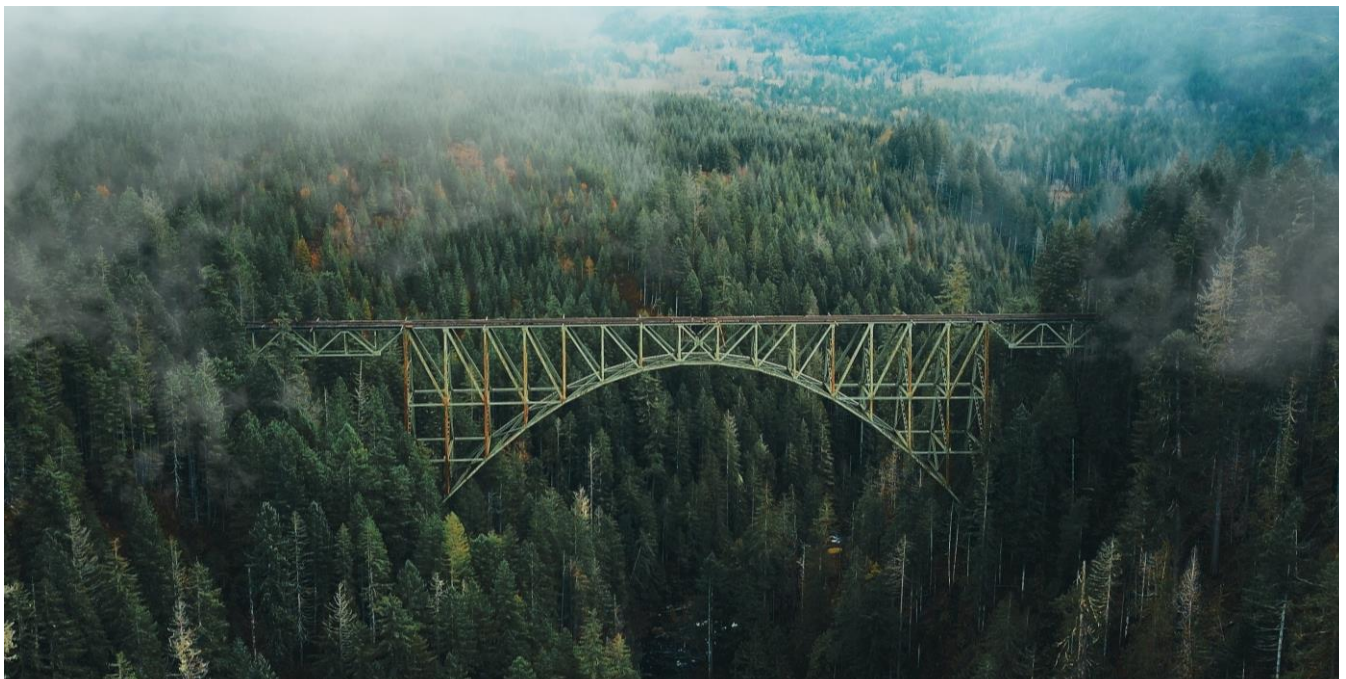
## Needs and challenges: insights from Switzerland

The latest climate science shows that the window of opportunity to avert the worst effects of the climate crisis is rapidly closing. If we are to limit global warming to 1.5°C by the end of this century, as provided in the Paris Agreement, a deep reduction in greenhouse gas emissions needs to happen rapidly, starting now and following a credible path to reach net zero emissions by 2050. Realising this far-reaching decarbonization requires a radical transformation of every part of our economy, especially high-emitting companies. While reaching net zero emissions in most sectors of the economy is feasible by switching to renewable energy sources, the lack of low-carbon alternatives in other essential sectors, commonly referred to as “harder-to-abate sectors”, makes it difficult for them to achieve that target. Gradual improvements in these sectors are nevertheless critical to realise a net zero economy.

More and more companies worldwide are making commitments today to contribute to the global efforts to tackle climate change by reducing their greenhouse gas emissions to net zero latest by 2050. In this context, the question of how to finance the climate transition of high-emitting companies is gaining increasing momentum.

To improve the understanding of transition finance and raise the awareness of its importance for a net zero economy, WWF Switzerland has commissioned an external report on this topic with a specific focus on the Swiss economy. This summary builds on the findings of the report published jointly by INFRAS and WWF Switzerland in May 2022<sup>1</sup>.

By looking at both the needs and the challenges of the financial sector and the real economy, the report provides a first yardstick for assessing how well prepared the Swiss financial sector is for the transition to net zero. In addition to highlighting the main results of the report, this brief outlines WWF Switzerland’s recommendations and reflects on a possible way forward.



<sup>1</sup> *Climate transition finance needs and challenges: insights from Switzerland*

## Key findings

- **Swiss financial institutions generally have a rather vague and broad understanding of transition finance** by including all types of financing that support the transition to a net zero economy. Notwithstanding the diversity of definitions used, they agree that transition finance includes a shift from brown, i.e., high-emitting activities, to less brown or green activities.
- The broader the definition of transition finance is, the more financial instruments potentially qualify for financing the net zero transition. While in theory, there are different financial instruments geared specifically towards furthering the climate transition, such as sustainability-linked bonds or loans, in practice, **most of the consulted Swiss financial institutions do not offer such instruments and instead mostly rely on general corporate loans for transition-related purposes.**
- To determine which companies may be eligible to access bank lending and services to finance their transition, the report suggests that **credible climate transition plans are essential and should be required from companies seeking external funding.** Such plans appear particularly relevant in the context of standard financial instruments where the provision of funds is not tied to the attainment of defined environmental goals. The report identifies several key criteria that transition plans should meet to be deemed credible.
- **According to these criteria, credible transition plans should:**
  - be aligned with a 1.5°C climate scenario,
  - cover the entire value chain,
  - rely only minimally on NET & CCS,
  - contain net zero commitments and verifiable key performance indicators,
  - be approved and overseen by board and top management and integrated within the overall business strategy of the organization,
  - have actionable, verified science-based near-term and long-term targets,
  - list time-bound actions to decarbonize and reach the set targets,
  - be monitored, controlled and reported on, and
  - be revisited as new activities and scientific evidence emerge.
- **Estimates indicate that between USD 3.2 and 5 billion per year is needed for the Swiss domestic economic activities to become net zero by 2050<sup>2</sup>.** As a result of the Swiss economy's characteristics, in particular its comparably lower domestic greenhouse gas emissions, the required annual investments are significantly lower than the corresponding figures for the EU and the world. **The report finds that, overall, the Swiss financial sector is well prepared to satisfy the estimated investment needs in Switzerland.** Nevertheless, Swiss financial institutions face important challenges when providing transition finance, such as the unfavorable risk-return profile of many of these investments, difficulties in measuring the impact of their financial decisions, and the uncertain regulatory environment.
- These challenges also exist in the real economy. **However, as evidenced by three case studies in harder-to-abate sectors, the net zero transition of companies is hampered by additional factors such as technological issues and profitability concerns.** These difficulties are even compounded in the case of small and medium-sized companies (SME), which often have only limited access to capital markets.
- The report concludes that **consistent definitions and standards of what transition finance means, alongside robust criteria for credible transition plans,** are needed for both financial institutions and companies. Further, **specific financial instruments** that foster companies' transition to net zero should be developed and made widely available. Finally, **regulatory action via incentives or prohibitions** is required to improve the profitability of low-carbon products and services that are instrumental for a successful transition to a net zero economy.

<sup>2</sup> The report did not analyse the necessary investments for decarbonizing the activities of Swiss companies abroad nor for the decarbonization of goods and services imported for domestic consumption.

## Recommendations & outlook

Based on the report's findings, WWF Switzerland suggests the following recommendations to the Swiss financial industry, the Swiss industry, and Swiss policymakers.

### Recommendations to the Swiss financial industry

- Adopt a clear and uniform understanding of transition finance, including specific reference to how this definition relates to green finance, and determine the eligibility criteria for transition finance by considering both the activity to be financed and the company seeking finance (credible transition plan).
- Assess which of your financial products and services align with your in-house definition of transition finance and offer specific products and services to accelerate the transition to an environmentally sustainable economy, with a particular focus on SME (e.g., sustainability linked bonds or credits, blended financial products, supporting services to companies in transition).
- Set up a detailed, verifiable, and actionable transition plan that is aligned with your science-based net zero target, including short- and mid-term targets.
- Understand, measure, and disclose the impacts of the transition finance you provide and engage with your clients to identify areas where transition finance is needed most.
- Engage with your clients to make them implement and disclose robust and time-bound transition plans. Support SME in capacity building related to their climate strategy and disclosure.
- Build in-house capacities on transition finance and make transition finance a top priority for senior management.
- Advocate for conducive policy and framework conditions that enable an orderly transition toward an environmentally sustainable economy.

### Recommendations to the Swiss industry

- Set and implement a science-based net zero target for your emissions, covering the entire value chain, through joining the Science Based Targets initiative (SBTi).
- Develop and disclose a detailed, verifiable, and actionable transition plan that is aligned with your net zero target, based on your assessment of how reliant your business is on carbon intensive activities and assets.

- Refrain from using Carbon Capture and Storage (CCS) and negative emission technologies (NET) in your decarbonization trajectory as much as possible.
- Identify and pull all available levers for action within and outside of your company to achieve net zero emissions while maximizing resource efficiency and generating broader positive impact for the environment (e.g., advocate for conducive policy framework conditions).
- Foster technological innovation and cooperate with businesses across sectors and academia to accelerate progress toward net zero.

### Recommendations to the Swiss policymakers

- Enshrine Switzerland's net zero target in law and elaborate detailed decarbonization pathways for the financial sector and harder-to-abate industries, in collaboration with the industry.
- Promote the adoption of a clear and common definition of transition finance, in collaboration with the financial sector and the industry.
- Develop effective, consistent minimum quality standards and cutting-edge metrics for credible transition plans, aligned with international developments and best practice.
- Make disclosure of net zero aligned transition plans mandatory for financial institutions and corporates and produce practical guidance and tools to support them.
- Drive the disclosure of standardized non-financial information from companies, particularly SME, through effective regulation.
- Set up a mechanism to analyze regular progress made by the industry and the financial sector with regard to Switzerland's net zero target.
- Create incentives for financing the transition to net zero, by de-risking investments in financially not (yet) viable activities or technologies (e.g., through the creation of a Swiss green investment bank) and by improving the risk profile of low-carbon alternatives (e.g., through comprehensive carbon pricing).
- Foster the development and application of technological solutions to reduce GHG emissions in harder-to-abate industries.

## Looking ahead

With the growing wave of climate commitments and net zero targets from financial institutions and real economy companies sweeping across the globe, the wider discussion of how to finance the transition to a net zero economy has gained much traction lately. While more definitions and standards related to climate transition finance are expected to emerge and converge over time, this trend may not unfold with the necessary speed and quality unless robust concepts and practical guidance are developed and actively promoted. Critical elements in this context are **clear, science-based criteria to assess the credibility of high-emitting companies' transition (plans) to net zero**. These criteria should be flexible enough to accommodate the differences between sectors and geographies and the need for contextualised approaches to climate transition finance. The proposal by the Platform on Sustainable Finance for an extended EU taxonomy is an essential reference point in enhancing clarity in financial markets about which economic activities can improve their environmental performance in the future and which cannot (see box on the right<sup>3</sup>).

However, creating more transparency on companies' decarbonization pathways is only one part of the equation. To make true progress towards net zero, it is **equally important that the financial sector leverages its full power by shifting greater capital flows towards transition projects and activities that are not attracting enough finance today**. This necessitates financial institutions to differentiate between those companies that can and are willing to transform their business model in line with a net zero trajectory and those that are unable or unwilling to do so. Restricting or ending finance to the latter may become inevitable if time-bound attempts to encourage these companies to transition fail. Further, **asset owners should use their influence to step up scrutiny of corporate transition plans and hold management accountable for plans that are insufficient**.

Given the complexity and relative novelty of climate transition finance, it is critical that **practical insights and experiences on how to navigate an orderly transition to net zero are gathered and openly discussed among all stakeholders**, including financial institutions, businesses, policymakers, civil society organizations, and academia. This should go hand in hand with the development of actionable guidance and templates for good quality transition plans, drawing from the body of existing work and reflecting latest science. **WWF Switzerland is keen to help drive this conversation with a view to supporting accelerated action on climate transition finance**.

### Making the case for an extended EU taxonomy

On 29 March 2022, the Platform on Sustainable Finance, a permanent expert group advising the European Commission on its sustainable finance policies, published its final report on environmental transition taxonomy. Building on the existing EU green taxonomy, the Platform on Sustainable Finance suggests extending the current taxonomy framework "beyond green" to classify a wider range of activities that typically do not meet the green performance level of the current EU taxonomy. By including "red" and "amber" economic activities in addition to "green" activities, the proposal for an extended taxonomy framework would introduce greater transparency and clarity for investors and help direct more finance to the urgently needed green transition of the entire economy. It would also support companies and other entities in their transitions and transition planning. WWF believes in the transformative power of an extended environmental taxonomy and calls on the European Commission to support the Platform's report.

<sup>3</sup> Platform on Sustainable Finance's report on environmental transition taxonomy



#### Our Mission

Together, we protect the environment and create a future worth living for generations to come.

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