Transition Finance

What is needed from UK public policy to support the scaling of high-integrity transition finance to achieve climate and decarbonisation goals?

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BARCLAYS

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About this paper

The intended audience for this paper is public policymakers and other actors engaged in shaping public policy. The report is general in nature and provided for information/educational purposes only. It does not take into account any specific investment objectives, the financial situation or particular needs of any particular person. It is not intended for distribution, publication, or use in any jurisdiction where such distribution, publication, or use would be unlawful, nor is it aimed at any person or entity to whom it would be unlawful for them to access.

Foreword

The recently published report from the Transition Finance Market Review (TFMR) is an important milestone in the transition finance discussion, and we welcome its publication. The TFMR has put forward a compelling snapshot of the current state of transition finance, the main barriers to its scale, and a set of recommendations for government, regulators and market actors, which should be taken forward with ambition and speed.

We believe that scaling transition finance is a necessary step in mobilising sufficient finance to tackle the climate crisis. We also believe it presents an opportunity for the UK to show international leadership and unlock growth and economic opportunities. In the below paper, Barclays has set out our view on the challenges facing transition finance, and the opportunities presented for the UK if these are overcome. This paper presents our high-level position and points to areas for additional work that could strengthen the UK's role in scaling transition finance.

Barclays recognises the critical role banks must play in supporting this, and has committed to facilitate $1trn in Sustainable and Transition Finance between 2023 and the end of 2030. This target reflects the scale of our ambition, and as at the first half of 2024 we had already mobilised $123.8bn. We introduced our Transition Finance Framework in early 2024, recognising the need to outline and provide clarity around how we classify finance as 'transition', thereby facilitating clear tracking and disclosure of our progress towards our $1trn goal. By leveraging our expertise and resources, we aim to drive meaningful change and contribute to the global effort to combat climate change.

We look forward to engaging further with the TFMR recommendations, and working alongside government and industry partners to play a key role in scaling up transition finance and supporting the transition to net zero.

Introduction

Transition finance will play a critical role in supporting the transition to a lower carbon economy, facilitating capital flow to all parts of the economy, including high-emitting and hard-to-abate sectors, as well as innovation and climate technology. The International Renewable Energy Agency (IRENA) estimates that yearly investments in energy transition technologies must more than quadruple to over $5 trn annually to stay on the 1.5°C pathway;[1] and in the UK, the 2023 Green Finance Strategy estimated that UK-specific decarbonisation efforts are expected to require £50-60bn of capital investment each year through the late 2020s and 2030s.[2]

Yet as transition finance moves to the forefront in discussions around the financing required to reach net zero goals, it faces several fundamental challenges that are preventing the market from scaling independently. These include: lack of clear and consistent political and regulatory support for transition finance; evolving future transition needs and the high uncertainty associated with forward-looking transition planning; the lack of a common interpretation or definition; and reputation and legal risks associated with potential accusations of perceived greenwashing. Transition financing also faces barriers similar to those present in wider green financing, including poor risk/return ratios when investing in climate technologies, infrastructure challenges, challenges with provision of and access to data to fully integrate into decision making, and international fragmentation in approaches. Additionally, the capital intensity of transition technologies further complicates the financing landscape.

These challenges mean financial institutions remain cautious about allocating or facilitating capital into transition activities, or identifying such financing as transition-focused. Despite market-led efforts, there has not to date been consolidation around consistent definitions, frameworks or support mechanisms needed to enable the scale up of transition finance to the levels needed to meet financial and decarbonisation targets.

Governments, regulators and policy have a role to play in overcoming these barriers. Well-targeted public policy can support the development of an enabling environment for scaling transition finance and private market activities to allocate finance aligned to decarbonisation pathways, allowing the market for transition finance to develop and thrive, both in the UK and internationally.

The UK has long been at the forefront of sustainable and green finance policy, and has paved the way in the evolving field of transition finance through the efforts of the Transition Plan Taskforce (TPT). With increasing policy, regulatory, and real economy focus on transition finance, there is an opportunity now for the UK government and regulators to address the barriers currently hampering the scale up of transition finance to enable capital to flow to decarbonisation efforts. Critically, we are approaching an exponential scale up in transition planning following the completion of the TPT work. Requirements around transition planning, supported by disclosure from increased Task Force on Climate-related Financial Disclosures (TCFD) reporting and under frameworks such as the EU's Corporate Sustainability Reporting Directive (CSRD) and the Corporate Sustainability Due Diligence Directive (CSDDD) are coming into force, and will scale up in the years ahead. The UK's recently completed Transition Finance Market Review (TFMR) provides a market-focused view on the challenges and opportunities for scaling transition finance. The combination of these factors presents a real opportunity for political and regulatory actors in the UK to define their ambitions and create momentum behind transition finance.

£50-60bn

GREEN FINANCE STRATEGY ESTIMATED THAT UK-SPECIFIC DECARBONISATION EFFORTS ARE EXPECTED TO REQUIRE £50-60BN OF CAPITAL INVESTMENT EACH YEAR THROUGH THE LATE 2020s AND 2030s[2]

[1] International Renewable Energy Agency (IRENA). *World Energy Transitions: Outlook 2023*. June 2023.
[2] HM Government. *Mobilising green investment: 2023 green finance strategy*. April 2023.

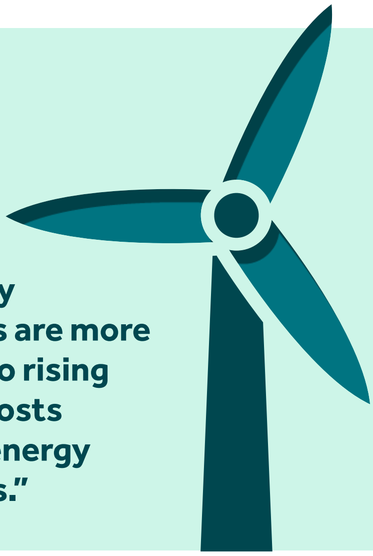
Challenges & opportunities from transition finance

Barclays considers transition finance to be a critical component of reaching net zero goals. Yet right now, the market faces barriers with regard to its scale up and development, stemming from the features and reputation of transition finance that currently exists.

Challenges with transition finance currently

Market economics at present do not sufficiently support or enable the transition. The International Energy Agency notes that the current macroeconomic climate makes it more challenging to finance projects, affects companies' profitability due to increased reliance on costly equity, and raises the risk of default for highly leveraged companies.[3] Furthermore, clean energy investments are more vulnerable to rising borrowing costs than other energy investments because they involve relatively high upfront costs that are balanced by lower operating expenses over time.

> **"Clean energy investments are more vulnerable to rising borrowing costs than other energy investments."**



> **"Without a cohesive national strategy, financial institutions and companies face uncertainty and lack the necessary direction to allocate resources effectively."**

There is a lack of clear and consistent political and regulatory support for transition finance, supported by real economy measures and incentives. This lack of overall clarity and support feeds into challenges that financial institutions have in clearly articulating the role of transition finance to stakeholders. This includes the absence of a UK national transition plan, which has hindered the progress of transition finance. Transition plans rely on real economy pathways, levers, and incentives to guide investments towards sustainable projects. Without a cohesive national strategy, financial institutions and companies face uncertainty and lack the necessary direction to allocate resources effectively. This gap in planning results in fragmented efforts and missed opportunities to drive the transition to a sustainable economy.

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[3] International Energy Agency (IEA). *Financial headwinds for renewables investors: What's the way forward?* December 2023.

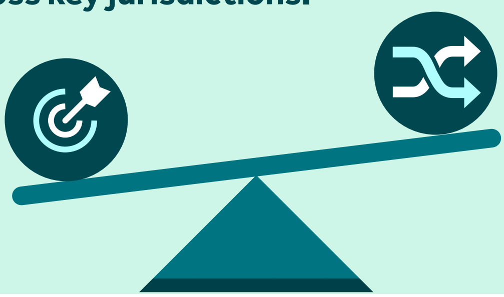
Defining transition activities remains a contentious issue. The lack of clarity around both the scope and definition of transition finance presents issues for both real economy companies accessing financing, as well as for financial institutions extending or facilitating transition finance. Whilst the market has coalesced around definitions and supporting frameworks for green activity, this hasn't been the case for transition to date despite some attempts to do so.

There are several reasons a universal definition is still lacking:

- 'Transition' by nature is a dynamic process and as we move to a more decarbonised future, what today is 'transition' might change rapidly as low carbon alternatives emerge and new technologies are deployed.
- The low-carbon transition is unique to each country's socioeconomic and domestic context.
- Contention with respect to feasible pathways and scenarios for 1.5 degree-aligned transition.

> **"What today is 'transition' might change rapidly as low carbon alternatives emerge and new technologies are deployed."**

> **"A framework should incentivise global flows of capital to the UK and support interoperability across key jurisdictions."**



Creating the right balance between clarity, interoperability and flexibility when defining and labelling transition finance is essential. Transition is, by its nature, a dynamic process. There are concerns that a rigid regulatory framework could stifle innovation and progress, as well as become quickly outdated, and overly stringent regulations could inadvertently hinder capital flows to sectors in need of investment for decarbonisation and progress towards sustainability. The emerging array of regulations and standards, which often are not interoperable, creates barriers for financial institutions and companies attempting to invest in sustainable projects. This complexity often leads to increased compliance costs and delays, discouraging investment in green initiatives. A framework should incentivise global flows of capital to the UK and support interoperability across key jurisdictions.

A key concern exists around the reputational and legal risk arising from potential accusations of perceived greenwashing. Transition finance will inevitably require financing of firms to support a transition and decarbonisation journey, rather than those already operating at a green end-state. If regulatory and policy frameworks are ill-designed and do not recognise this role, wider pressures on financial institutions to reduce their financed emissions, and the supporting KPIs around disclosures, could disincentivise financing for the high-emitting sectors or activities most in need of support to transition. It is also important to highlight that the current sustainable finance regulatory framework in the UK and EU does not yet effectively address transition finance.

> **"The current sustainable finance regulatory framework in the UK and EU does not yet effectively address transition finance."**

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Opportunities presented by transition finance

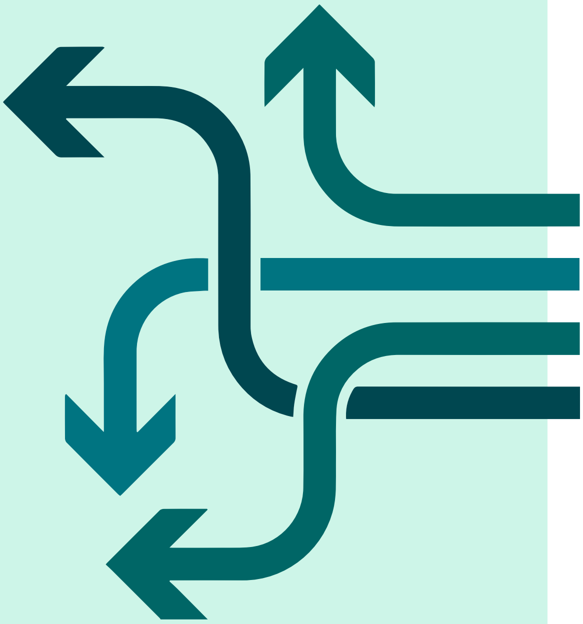
If these challenges are overcome, there are significant opportunities from increased transition finance provision for both overall global decarbonisation as well as UK-specific climate and economic goals.

Increased capital flows. Transition finance presents a real opportunity for the UK to catalyse the mobilisation of transition capital towards decarbonisation efforts, which would support companies in accessing the requisite funds to innovate and implement more sustainable practices. This would support UK-specific decarbonisation efforts, which are expected to require £50–60bn of capital investment each year through the late 2020s and 2030s, with an additional £44–97bn for domestic nature-related goals.[4]

"This would support UK-specific decarbonisation efforts, which are expected to require **£50-60bn** of capital investment each year through the late 2020s and 2030s."

Economic diversification. Transition finance presents an opportunity to diversify the UK's economic model by fostering growth in new sectors, reducing reliance on traditional industries that risk being stranded in the future – as well as supporting the transition of business models and operations towards more low carbon activities. This has implications for future economic security here in the UK, as well as 'just transition'.

"Transition finance presents an opportunity to diversify the UK's economic model by fostering growth in new sectors."



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[4] HM Government. *Mobilising green investment: 2023 green finance strategy.* April 2023.

Job creation. Connected, the financial mobilisation associated with transition finance has the potential to create more and better-quality jobs, both in transitioning sectors as well as in new sectors such as climate tech. This can play an important role in the just transition and public support for achievement of net zero goals.

"The financial mobilisation associated with transition finance has the potential to create more and better-quality jobs."

International leadership. Transition finance is a real opportunity for the UK to reassert international leadership through helping to set standards for integrity and innovation in financial products and services. Fragmentation in this area would lead to increased costs and reduced capital flows, hindering the global effort to achieve climate and decarbonisation goals. By leading the way in shaping and implementing standards from international groups and standard-setting bodies, the UK can help ensure that frameworks and standards are interoperable and flexible, which is essential for facilitating global capital flows to support the transition. By continuing to build on its strengths, the UK can attract more investment, create high-quality jobs, and enhance its reputation as a centre for innovative financing approaches. This, in turn, will support the development of expertise in financing net zero and transition projects, further solidifying the UK's status as a global leader in sustainable finance.

"Transition finance is a real opportunity for the UK to reassert international leadership through helping to set standards for integrity and innovation in financial products and services."

UK as a global hub for transition finance. The UK already has many of the characteristics required to be an internationally competitive centre for transition and green finance: a large quantity of assets under management; the presence of the world's largest banks in an open system that enables them to connect to other markets; an internationally relevant capital market; and a concentration of wider advisory expertise that can connect with jurisdictions all over the world to support sophisticated and innovative financing approaches. This provides the foundation for what is a developing reputation for expertise in financing net zero and transition projects, further solidifying the UK's status as a global leader in sustainable finance.

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Public policy recommendations

As the challenges above demonstrate, whilst many businesses and financial institutions are demonstrating a strong commitment to facilitating the energy transition and supporting clients with their decarbonisation pathways, there are limits to the pace and scale at which the private sector can drive this change without broader supportive economic and policy conditions. We therefore recommend a series of policy recommendations for government and regulators to consider how public policy can overcome these challenges, and best support the scaling of transition finance to support climate and decarbonisation goals. These should be considered in the context of the recommendations from the TFMR, many of which will support the delivery of the priorities put forward below.

We consider there to be three thematic areas of actions for the UK government and regulators to take action in:

1

Provide the right economic conditions for transition finance to thrive, including through delivering policy clarity and incentivising investment.

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2

Create a supportive regulatory enabling environment for transition finance to scale, addressing definitional challenges and delivering a balanced and flexible regulatory framework, alongside providing global leadership.

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3

Transition in a just way, addressing the negative impacts of the transition on workers and communities while ensuring the social and economic benefits of the transition are accessible and equitably distributed.

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As policymakers consider their approach to supporting transition finance to scale, they should keep in mind the following operating principles in their policy approaches and frameworks:

- Flexibility to accommodate the dynamic nature of transition, and to enable support to flow to companies and jurisdictions with different transition starting points and pathways.
- Recognition of the global operating environment, and the importance of interoperability between the frameworks and policies of different jurisdictions.
- Partnership with the private sector, collaborating with real economy corporates and financial institutions on the design, implementation and financing of initiatives.

1. Provide the right economic conditions for transition finance to thrive

Recommendation 1a: National transition plan. Government should implement a national transition plan that provides an enhanced roadmap for the transition of key sectors.

One of the challenges with allocating financing for the transition is the lack of clear, government-backed sector decarbonisation pathways for the real economy, against which transition plans can be assessed, and finance provided in line with those. Absent roadmaps, and therefore lacking confidence in the landscape and ecosystem in which they are making the investment, investors are often hesitant to lock up capital for the time periods required for much of the infrastructure- and capex- heavy investment required for the transition. Roadmaps can support in giving investors confidence to invest over the long timeframes often required.

Government should therefore implement a national transition plan that provides an enhanced roadmap for the transition of key sectors, such as power, energy, food & agriculture, industry, transport and housing. This should provide specific timelines for key activities, setting clear expectations of relevant actors, and requirements for investment, particularly to inform firms' investment planning.

Government should work with corporations, institutional investors, and downstream financial institutions to draw on the expertise of UK-based financial and related professional services to create these transition pathway roadmaps. These should be cognisant of, and align with, the various regulatory imperatives and initiatives that have developed over the past few years, including the Sustainability Disclosure Requirements and TCFD compliance, the TPT Disclosure Framework, and the application of the UK's Green Taxonomy Advisory Group's (GTAG's) taxonomy principles.

A national transition plan can also serve as a 'one stop shop' for investors looking to invest in the UK. By consolidating all relevant information, guidelines, and incentives into a single, comprehensive framework, it can simplify the investment process and provide clarity and confidence. This streamlined approach could not only attract more investment, but also direct resources towards projects that align with the UK's sustainability and energy security goals.

> **"A national transition plan can also serve as a 'one stop shop' for investors looking to invest in the UK."**

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Recommendation 1b: Incentive framework. Government should review the wider incentive framework for companies looking to raise and issue transition finance, especially in light of internationally competitive regimes, and ensure that the UK can remain internationally competitive and meet ambitions to be a global hub for transition finance.

Whilst the UK has many features that make it a compelling place to be an internationally competitive centre for transition and green finance, the government needs to focus on creating favourable conditions to make the transition commercially viable in the UK. A stronger suite of incentives across the policy landscape is being offered by competitive jurisdictions, notably within the Inflation Reduction Act in the US. This will require the UK to consider the incentives it can offer for transition investment, and the implication this has on the UK's international competitiveness. This includes developing new innovative financial products (such as transition or 'greening' bonds) and financing mechanisms (such as blended finance solutions) to de-risk and support the growth of transition finance activity in the UK.

"The UK has the opportunity to be a leader in this area, fostering a dynamic market that supports its ambitious net zero targets and promotes global emission reductions."

SPECIFIC OPPORTUNITIES INCLUDE:

- Opportunities through the government's new **National Wealth Fund and GB Energy** to scale up support for climate tech companies who will play an essential role in **the transition to lower carbon business models**. More detail on how public finance institutions can support this cohort of firms can be found in the Barclays report on ***Scaling growth-stage climate tech companies***.[5]

- As policymakers and the market continue to develop frameworks for supporting transition finance, the UK government could consider how to best include transition elements through several avenues, including promotion by governmental institutions through specific financing initiatives and activities. In doing so, this would help increase the flow of transition capital and support capacity building around transition in the market.

- **Carbon markets** will play a crucial role in the transition to a low carbon economy. A balanced regime, encompassing the **UK Emissions Trading Scheme (UK ETS), the forthcoming Carbon Border Adjustment Mechanism (CBAM), and Voluntary Carbon Markets (VCM)**, will allow for deep and liquid markets. This, in turn, will **facilitate financing towards green and transition projects**, driving innovation and investment in sustainable technologies. The UK has the opportunity to be a leader in this area, fostering a dynamic market that supports its ambitious net zero targets and promotes global emission reductions. By creating an interoperable system that **facilitates the transfer of credits between markets**, the UK can **encourage competition, reduce compliance costs, and ensure widespread adoption** across all sectors. This will ultimately contribute to the decarbonisation efforts and position the UK **at the forefront of green and transition finance innovation**.

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[5] Barclays. *Scaling growth-stage climate tech companies*. June 2024.

2. Create a supportive regulatory enabling environment for transition finance to scale

Recommendation 2a: A flexible, broad definition of, or principles for transition finance. Policymakers should support the market in defining terms and concepts relating to transition finance in a way that brings clarity to the market, including on scope, whilst remaining sufficiently flexible to accommodate rapidly evolving markets and technologies.

A clear, unified definition of, or principles for, transition finance would provide a key starting point to build market confidence around its provision, and support the development of the wider ecosystem needed to support the scale of transition finance.

THIS SHOULD:

- **Ensure clear parameters of the scope of transition finance.** Right now the lack of clarity on this presents challenges both for firms accessing transition finance and for financial institutions working to extend or facilitate transition finance.
- **Maintain flexibility** to accommodate rapidly evolving markets and technologies.
- **Be broad,** to support the provision of finance and investment to real economy corporates at different stages of their transition journey and to all parts of the economy, including high-emitting and hard-to-abate sectors. This will facilitate innovation across the sector, as by accommodating various pathways towards sustainability, experimentation and creative solutions from industry are enabled.
- **Learn from the challenges experienced in the EU,** where sustainable finance policy frameworks have proven to be overly restrictive and have unintentionally restricted the flow of capital towards green and other sustainability-orientated initiatives.

There is a lack of clarity concerning the definition of transition finance, which exacerbates growing concerns around greenwashing. This means financial institutions remain cautious about allocating or facilitating capital into transition activities – or identifying such financing as transition-focused – and also affects corporates looking to raise transition finance.

We recommend a market-led approach to establish a clear definition or principles for transition finance, which policymakers can then endorse and embed into their own policy frameworks. This has been a key area of consideration for the Transition Finance Market Review, which has been engaging extensively with industry, and we recommend the government reflects on the propositions and principles put forward by the Review.

Alongside, government also has a role to put forward a **clear statement of support for the role that transition finance can play in reducing carbon emissions across the economy and reaching net zero goals.** If transition finance is not clearly and consistently supported by policymakers as a credible means to meeting net zero ambitions and transitioning towards a lower carbon economy, there are concerns that financial institutions may be disincentivised from financing for high-emitting sectors or activities most in need of support for transition. This will require grappling with the reality that, over the short term, increasing genuine transition finance may, in some cases, result in a short-term increase in financed emissions. Having well-understood parameters on the scope of transition finance, including its dynamic nature, can help support the scale up of transition finance and mitigate concerns of perceived greenwashing.

"Having well-understood parameters on the scope of transition finance, including its dynamic nature, can help support the scale up of transition finance and mitigate concerns of perceived greenwashing."

Recommendation 2b: Deliver a balanced regulatory and policy framework. Implement an integrated green and transition finance policy framework, balancing all elements without overemphasising any singular aspect.

Many existing frameworks and policy tools to support sustainable finance have been tailored towards green finance, which do not necessarily work in the context of transition finance, given the dynamic nature of transition, as well as its role supporting companies' move from high carbon to lower carbon business models. Government therefore needs to consider the way that the regulatory and policy environment addresses transition finance.

Any transition frameworks should sit comfortably alongside green finance frameworks as well as within the wider UK sustainability-related policy framework, to avoid introducing unnecessary complexity.

IT SHOULD ENSURE:

A BALANCED APPROACH

Policymakers should view the various policy frameworks as **complementary elements of the same overall solution.** This means maintaining **a balanced approach to the individual elements of the transition finance and broader sustainability-related policy framework**, without placing undue emphasis on any single aspect or unintentionally duplicating requirements. For instance, the EU is currently experiencing challenges **due to the significant legislative weight assigned to its Taxonomy**. This has rendered the framework cumbersome amidst a rapidly changing external environment. It has also potentially limited the usefulness of other financial frameworks, **including the EU Green Bond Standard for transition finance**, due to the need for use of proceeds to be aligned with the EU Taxonomy. Conversely, a range of Asian taxonomies, **particularly Singapore, ASEAN and Australia**, have involved the growing inclusion of specific transition activities with clear sunset dates.

PROPORTIONALITY

Government should acknowledge that transition activities and finance inherently present a degree of ambiguity, and **require an adaptable and measured regulatory framework that recognises the complexities involved**. Frameworks that are overly restrictive or narrow will unintentionally restrict the flow of capital. As such, government should ensure **proportionality** in application of the various tools and frameworks, including being cognisant of **the higher impact of requirements on SMEs**. For example, the overall reporting burden may be quite substantial and, to mitigate this for SMEs, we would support a **modular transition plan framework** whereby in-scope companies (including SMEs) will have to disclose against basic (or simplified) standards, while larger companies should have proportionately more detailed requirements.

COHESION ACROSS INITIATIVES

Policymakers should work to ensure that there is **close linkage and co-working between different regulatory imperatives,** supporting market adoption and usage. Particular focus should be given to **cohesion between Sustainability Disclosure Requirements and TCFD compliance, the TPT Disclosure Framework, and the application of the UK's Green Taxonomy Advisory Group's (GTAG) taxonomy principles**.

INTEROPERABILITY

In developing new regulatory frameworks, policymakers must retain a **recognition of the global operating environment**, and the importance of interoperability between **the frameworks and policies of different jurisdictions**. Policymakers across government and the regulators should ensure they consider close linkage and co-working **between different regulatory imperatives across key jurisdictions and in international forums**, and – where appropriate – drive forward cohesion and consolidation in frameworks.

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Recommendation 2c: International leadership. The UK should maintain and strengthen its international leadership in transition finance, helping set standards for integrity, and innovating in enabling financial products and services.

Transition finance is a real opportunity for the UK to reassert international leadership, helping to set standards for integrity and innovation in financial products and services. The UK has traditionally been a leader in global financial services forums, and a credible and strong voice in shaping and pushing forward agendas at the international level. This has included no green and sustainable finance issues, such as its engagement with the International Sustainable Standards Board (ISSB), the Network of Central Banks and Supervisors for Greening the Financial System (NGFS), and international groups including the G20 and the International Monetary Fund (IMF). The International Financial Reporting Standards (IFRS) Foundation assuming responsibility for the disclosure-specific materials developed by the TPT is a prime example of this.[6]

The UK should continue to build on this strength to play a leading role in the emerging shape of transition finance at the international level, pushing for the interoperability and flexibility in frameworks and standards that will be essential to enable global capital flows to support the transition, and support greater allocation of finance to transition activities, in particular in the global south and emerging markets and developing countries. The UK has a strong starting point to play this role, given the world-leading work of the TPT, that is already shaping transition plan thinking globally. The Government should continue to build on this cooperation with international partners and regulatory authorities in different jurisdictions and at the supranational level.

"The UK has traditionally been a leader in global financial services forums, and a credible and strong voice in shaping and pushing forward agendas at the international level."

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[6] IFRS. ISSB delivers further harmonisation of the sustainability disclosure landscape as it embarks on new work plan. June 2024.

3. Transition in a just way

Recommendation 3: Just transition. Recognising the importance of a just transition, policymakers and standard setters should look to articulate the principles of a just transition more clearly, as well as provide more detailed guidance to real economy companies on how to operationalise these.

A just transition means addressing the negative impacts of the transition on workers and communities – such as job losses and initial higher costs of energy – while ensuring the social and economic benefits of the transition are accessible and equitably distributed. This is both a key consideration as companies in the real economy transition to lower carbon business models, but also an opportunity for finance to support such efforts. There is scope for UK policymakers and standard setters to articulate the principles of a just transition more clearly, as well as to provide more detailed guidance to real economy companies on how to operationalise these.

This might include policymakers setting out clear, practical guidance on:

Anticipating, assessing and addressing the adverse social impacts.

Identifying and enabling the social opportunity of the transition.

Ensuring meaningful dialogue with affected stakeholders on how negative social impacts are mitigated and positive opportunities are enabled.

Having clear, central guidance from government will support companies and financial institutions to navigate this area, providing a credible framework for disclosure and conversations. There are a number of internationally accepted frameworks that provide guidance on how to do this that the UK could build on.[7]

An additional benefit of this approach is also an opportunity to provide clarity and reassurance to businesses and workers in vulnerable industries, which have played an essential role in delivering energy security over the past decades. Public-private collaboration to understand and manage impacts on affected sectors, industries and regions will be essential. Clear just transition guidance could not only help with the reskilling and transition of jobs to lower carbon industries, but also help build support at local levels for the development of infrastructure critical for net zero, which has been facing increasing opposition at the planning stage. A 2024 study found 70 councils had opposed planning applications for renewables projects that would have generated 4.4GW of power. Perceived negative impacts (including visual impacts, loss of biodiversity, and decommissioning of farmland), as well as perceived insufficient local economic benefits (including lack of jobs for locals and limited social investment) are common drivers of opposition. Overcoming local challenges will also be essential for driving wider investment in the transition and de-risking this finance.

Given the complexities, we recommend the government engage closely with industry groups in the development of its guidance, to consider how such guidance can be operationalised and delivered in practice.

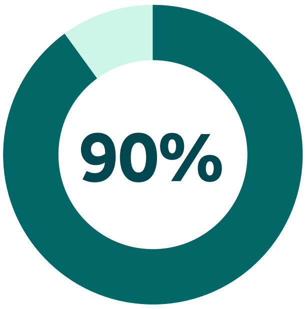
"A just transition means addressing the negative impacts of the transition on workers and communities – such as job losses and initial higher costs of energy – while ensuring the social and economic benefits of the transition are accessible and equitably distributed."

[7] These include the United Nations Guiding Principles on Business and Human Rights (UNGPs), the International Labour Organization (ILO) Guidelines for a Just Transition, and the United Nations Environment Programme Finance Initiative (UNEP FI) guidance for banks and insurance companies on supporting a just transition.

SMEs

> "For SMEs, there is a shared acknowledgment that navigating the world of decarbonisation can be extremely complicated. For those at the very beginning of their journey, simply knowing where to start can often feel overwhelming."[10]

SMEs make up over 90% of private sector businesses in the UK.[11] It is well understood that mobilising SMEs will be critical to ensuring a resilient transition to net zero.



SMEs make up over 90% of private sector businesses in the UK.[8]

Yet SMEs can face barriers to accessing finance for transition activities.

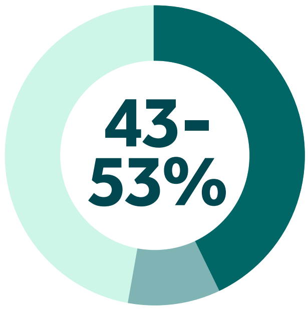
Our earlier insight discussed the importance of establishing clear pathways and definitions for transition finance, as well as addressing greenwashing risk. This will require some information sharing and data provision aligned to financing – which is likely to place a higher burden on SMEs. The British Business Bank has found that 65% of SMEs consider that current emissions reporting standards are too complex and that they would be more likely to engage if standards were tailored and simpler.

Due to the lack of SME-specific standards of reporting greenhouse gas emissions (GHG), SMEs face increasingly divergent data requests from financial institutions and large corporates, with increasing supply chain pressures due to regulatory pressures on larger firms. Due to this, SMEs struggle to determine which topics are relevant and applicable to their business. Where SMEs currently report climate-related data, the provided information is often inconsistent and varies significantly in quality. Scaling up the provision of transition finance across the economy, including to support SME decarbonisation, needs to consider what is appropriate with respect to the requirements placed on SMEs to access the finance, whilst ensuring the credibility and integrity of the finance is maintained. SMEs will need access to tools and resources that enable them to accurately measure and report their environmental and social impact.

Further non-finance specific barriers also create challenges for SMEs in making this transition, and seeking finance to do so:

- SMEs face information barriers and higher financial risk of adopting any net zero solutions which are not adopted more broadly.
- The burden of proof on smaller SMEs also remains outsized, particularly if the incentive of SMEs building their green credentials for the benefit of larger corporates that they supply is not equally applicable for smaller business banking and retail customers.
- Implementing more sustainable practices and transition activities can involve significant upfront costs for SMEs, making it challenging to justify the investment without adequate financial support. Many SMEs have limited financial resource and capacity available to them to support the transition. With the current economic challenges businesses face, and steady increase in the cost of living, many SMEs place short-term financial goals over long-term transition objectives, making it a challenge to allocate resources towards transition initiatives that may not yield desired, and increasingly required, immediate returns. According to the British Business Bank, c20% of SMEs are prepared to access external funding if this improves their sustainability credentials, but they want to see an immediate benefit.
- Many SMEs lack the know-how to translate the theory into real-term practical solutions for their operations. There needs to be wider transition resources available to SMEs e.g., trustworthy websites or case studies broken down to regional and sector level where available, such as the materials available on the UK Business Climate Hub.

> "I feel like there's always a shed load of paperwork anyway… and if I then have to prove how many emissions we've reduced, that's a lot more effort."[12]
>
> Green Loan Considerer, Real Estate, <£500k Turnover



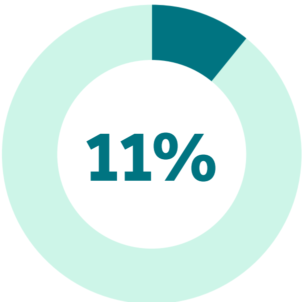
SME contribute to UK business GHG emission[9]

[8] Federation of Small Businesses. UK Small Business Statistics. 2023.
[9] British Business Bank. *Smaller businesses and the transition to net zero*. October 2021.
[10] Barclays research on the SME road to net zero. October 2023.
[11] Federation of Small Businesses. UK Small Business Statistics. 2023.
[12] Barclays research on unlocking the future of SME green lending. June 2024

Agriculture

> **"The cost of moving towards net zero is far beyond the reach of many farms."**[16]

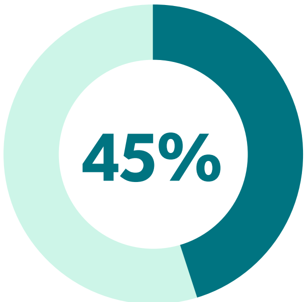
The agriculture sector contributes 11% to UK GHG emissions; supporting decarbonisation efforts across the sector will therefore be critical in meeting net zero goals.[17] But 45% of Barclays-surveyed farmers cite cost of machinery/equipment as one of the biggest challenges to progressing towards achieving net zero, with 28% highlighting lack of access to appropriate financing/lending.[18]



Sector's contribution to UK GHGs[13]

There are several contributing factors driving transition financing provision challenges:

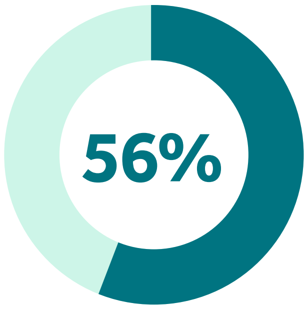
Definitions. As in other sectors, there continues to be debate around what transition financing is for the agriculture sector. For example, the Climate Change Committee classes 'low carbon farming' as a lever, however this is a very broad term and specifics are not captured in the pathway. Absent better definitions for what viable transition finance looks like for the sector, and financing for nascent or emerging transitionary activity could come under scrutiny for potential accusations of perceived **greenwashing**; a challenge also heightened by the wider absence of a demarcation between 'transitional' and 'sustainable' labelling when considering 'green' products. Not only does this mean that activity is financed under business as usual and therefore not recorded as green/sustainable/transition, but also that opportunities for specific financing for transition activities can be limited.



of respondents say the cost of machinery/equipment is one of the biggest challenges to achieving net zero[14]

Data and measurement. For transition finance to be credible, there is also considered to be an important role for data and measurement, to be sure financing can be linked to evidenced reduction in emissions and/or aligned with transition plans and goals. This role and requirement for data and measurements present challenges for the agriculture sector. Impact measurement of specific transition levers in the agriculture sector remains nascent, creating a lack of clarity on the applicability, evidencing and labelling of transition products. For example, regenerative farming is difficult to measure when it comes to soil carbon, where dividends may not show for some time, or regenerative activity undertaken may fail due to weather. This creates a conflict between financing actions that might deliver an immediate tangible emissions benefit, vs seeing an improvement in emissions over a longer time period.

Common frameworks. Evidence-based industry frameworks, using agreed standardised metrics, are required to enable non-competitive assessment of transitional credentials/benefits. **The absence of agreed frameworks creates uncertainty over the relative benefits of transition finance applicability and impact assessment,** escalating the credit risk to consumers and creating barriers to adoption. This is particularly true in agriculture which, due to the number of sector business and emissions variables, is particularly vulnerable to variations in impact assessment/benefits measurement.



An average of **56%** of surveyed farmers believe government is not providing enough support[15]

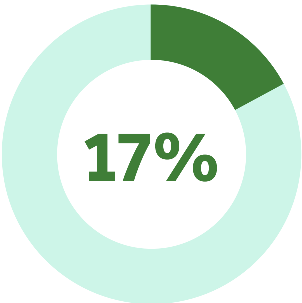
Lastly, there are a host of **farming-specific challenges when it comes to the provision and measurement of transition activity and therefore credible transition finance**. One challenge in particular is around how to address proof of disposal of a prior asset that a new asset replaced through transition finance. Without guidance and agreement around this, there is a risk of incremental uptick in emissions facilitated by transition finance, e.g., buying a new tractor with a lower footprint than the prior asset, but if the old asset is not retired appropriately, or if it's just sold, there's still an incremental uptick in emissions.

[13] Department for Environment, Food & Rural Affairs. *Agri-climate report 2023*. January 2024.
[14] Barclays insights, generated from engagement with agriculture clients over 2023 and 2024.
[15] Barclays insights, generated from engagement with agriculture clients over 2023 and 2024.
[16] Barclays insights, generated from engagement with agriculture clients over 2023 and 2024.
[17] Department for Environment, Food & Rural Affairs. *Agri-climate report 2023*. January 2024.
[18] Barclays insights, generated from engagement with agriculture clients over 2023 and 2024.

Built environment

> "Decarbonising the built environment is a complex challenge that will require widespread engagement, tailored approaches to building stock, and systemic change."

Buildings contributed 17% of total UK GHG emissions in 2022, the second highest emitting sector, primarily from the use of oil and gas in heating.[21] Decarbonising the built environment is a complex challenge that will require widespread engagement, tailored approaches to building stock and systemic change. Whilst a key driver in the transition to net zero is the decarbonisation of the UK electricity grid, clients and customers can contribute by switching to low carbon heating and improving the energy efficiency of existing buildings by adapting the fabric of the building and adopting other energy efficiency measures in how they operate within it.



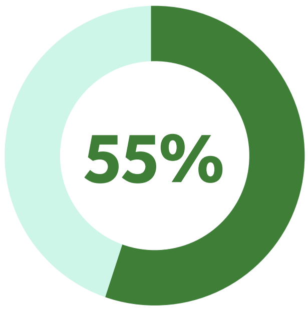
Contribution of buildings to total UK GHG emissions in 2022, the second highest emitting sector[19]

Creating clarity on the horizons for Minimum Energy Efficiency Standards or other regulation is anticipated to accelerate the transition to net zero by creating a supportive supply chain and ecosystem. Currently, clients and customers are **unclear on what transition work to undertake to deliver future potential milestones and are hesitant to spend**. Key stakeholders in the supply chain are equally **underinvesting in both skills and traditional or innovative products and solutions** which could cause delivery risk once the regulatory landscape is established, although this is minimised as soon as clarity is provided.

The built environment does benefit from entry level data on property characteristics Energy Performance Certificates (EPCs), multiple global standards (BREEM, WELL, LEED, etc.) and Science Based Targets Initiative (SBTI) aligned global pathways enabling larger clients to use green and sustainability labelled financing solutions to finance their transition. Larger clients overlay global and national disclosure requirements to create portfolio views and define investment decisions. However, similar to the corporate SME market, **some landlords are left confused by the noise of multiple standards, pathways and disclosures** and are not able to provide a clean link between investment and improved EPCs. An opportunity exists to lead a centralised data approach providing liquidity and transparency to the market, supported by consistent and comparable standards (such as the Net Zero Carbon Building standards) to help all funding providers (including international investors) understand how UK buildings could adapt to minimise transition risk. With centralised standards and data, clearly aligned to net zero goals and regulation, landlords would be more easily able to articulate mutually beneficial goals of net zero to tenants. Alternatively, regulatory standards that either encourage joint ownership of operating emissions in tenanted buildings (e.g. NABERS) or data sharing (e.g. through the use of increased green leases) could create a more complete and comparable picture of the built environment's operational emissions, driving collaborative investment to deliver transition at portfolio- or building-specific levels (e.g. building passport or property linked financing).

The cost of transitioning has increased as supply of materials and labour have reduced, creating affordability constraints for customers and clients. A perception that new technology prices could fall, or technology will improve is leading to a 'wait and see' approach – even where financing is available. Unfortunately, the clear link between efficient assets and investment performance remains immature with transaction volumes too low to act as a 'carrot' for more investment; currently clients are prioritising the necessary longer-term investment as part of their wider strategies. This is particularly acute in social housing where **demands on capital to respond to cladding issues, managing disrepairs in an aged estate and building more affordable homes are all high capital priorities alongside improving energy efficiency.**

It should be further noted that the current higher interest rate environment has added challenges to affordability for some clients, instead, solutions need to be found within existing lending – but risk and capital appetite is a key consideration for banks. Any private financing partnerships, to provide shorter-term support moves up the risk and therefore capital curve for the banks, and could lead to an increase in the debt servicing burden to the borrower because banks typically provide the lowest cost of debt. Solutions supported by institutions such as BBB and UKIB, providing support on a first loss basis, could be of value across the full built environment, noting the importance of real estate in the real economy.



of homeowners do not feel confident making their homes more energy efficient.[20]

[19] Climate Change Committee. *The Sixth Carbon Budget: Buildings*. 2020.
[20] Barclays. Homeowners put off energy efficiency upgrades due to misconceptions about cost and installation time. July 2023.
[21] Climate Change Committee. *The Sixth Carbon Budget: Buildings*. 2020.

Barclays supports sectors that are significant contributors to global greenhouse gas emissions, including oil and gas companies. Barclays is working to reduce the emissions it finances.
For more information, please visit home.barclays/netzero.

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