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[HKGFA Webinar]

Approach to Transition Investing - Assessing Risks and Opportunities

Summary

Anticipated growth and scale in transition investing include greater investor awareness, increased uptake and issuances, and enhanced standardization.

The HKGFA Asset Owners and Asset Managers Workstream's webinar on "Approach to Transition Investing: Assessing Risks and Opportunities" shared industry expert perspectives and practical considerations in approach.

Key Takeaways

1. Defining Transition Investing

- Transition investing lacks a single definition, which presents a significant challenge in the industry.
- The focus is on identifying risks and opportunities as sectors transition from brown to green.
- This includes both labeled financing (e.g., transition bonds) and assessing companies through transition planning.
- A critical aspect involves combining green technologies with market opportunities, such as comparing car ownership and electric vehicle (EV) penetration in Malaysia vs. the Philippines.
- Time horizon and outcome-driven; clear objectives, such as 2030 targets, are essential as transition cannot be happening forever.

2. Sector Attractiveness

- Returns are derived from two main sources:
  a) Growth of green markets supported by underlying technologies.
  b) Carbon pricing and taxes.

- Identifying transition leaders across sectors is crucial, particularly in high-emission industries where technological pathways for decarbonization are evident (e.g., utilities, energy, real estate, transport).
- Companies are assessed on transition risks, while also considering the broader value chain, including intermediate products and raw materials.
- Understanding the impact of technologies is vital, particularly their contribution to greenhouse gas (GHG) emissions reduction and the extent of scope 3 reductions.
- New mobility and energy, along with the necessary infrastructure (e.g., power grid and energy storage) are fast growing sectors that are also significant drivers of economic growth, with green sectors contributing notably to China's GDP and digitization.

3. Investment Criteria, Framework, and Approaches

- Assessment varies by sector and supply chain, distinguishing between scope 1/2 emissions and scope 3 emissions for downstream players.
- Forward-looking metrics include:
    - Disclosures
    - GHG reduction targets
    - Green CAPEX / green revenue plans
    - Carbon reduction performance and expected emissions reductions
    - Management quality and governance, including compensation and KPIs linked to climate targets
    - Cash flow analysis to support CAPEX
- Assessment also varies by asset classes, particularly for labelled bonds and issuances, focusing on the use of proceeds and the magnitude of impact generated.

4. Challenges in Transition Investing

- A myriad of frameworks and taxonomies exists today, alongside risks of greenwashing and issues with disclosure quality and transparency.

- Carbon lock-in risks are particularly relevant for infrastructure projects, necessitating careful lifecycle emissions assessments.
- There is a need for broader financing channels and diverse types of capital.
- Supporting regulation plays a key role, especially in:
    - Standard setting (taxonomies, disclosures)
    - Policy direction (carbon pricing, supporting technologies, sustainable finance market)

5. Success Stories

- Climate solutions, such as energy storage systems, are growing alongside the rise of renewables, contributing positively to the future energy mix.
- Traditional high emitters, like gas pipeline companies, are transitioning into green markets, such as hydrogen.
- Transition planning is increasingly viewed as a strategy for companies to develop long-term business models.

6. Role of Financial Investors Engagement

- Financial investors are essential in helping companies, particularly SMEs, in forming ESG frameworks and engaging with the global financing system.
- Sharing sector best practices helps support companies in formulating targets and plans.

7. Role of Technological Innovation

- Interest is growing in scalable technologies / products, including hydrogen, biofuels, and carbon capture.
- IEA research indicates that much of the emissions reduction can be achieved with proven technologies, with only a small portion reliant on unproven technologies.

- Investors / companies should consider the long-term business model and what technologies could fit into that (e.g., a real estate firm aiming for net-zero buildings should consider innovations in energy efficiency and building materials).
- Supporting policies are crucial for fostering the growth and adoption of these technologies.

8. Challenges for SMEs

- Investors can help identify the merits of technologies and provide resources and capital to scale them, including support in talent acquisition, ESG frameworks, financing, and networking.

9. Time Horizons and Approaches

- Many issuers and asset owners are setting 2030 or other mid-term targets, with engagement efforts aligned to this timeframe.
- A combination of quantitative assessments (from frameworks like the Net Zero Investment Framework) and qualitative insights (from engagements) is essential.

10. Future of Transition Investing

- Anticipated growth and scale in transition investing include greater investor awareness, increased uptake and issuances, and enhanced standardization.
- More comparable data and analysis available for investors.
- The maturation of transition financing (with reference to green bond market); yet the greatest returns often arise from early market growth.
- Technological advancements will accompany market maturation, as evidenced by the rapid decline in levelized costs of renewables.
- Innovations in financing types, such as blended finance and impact investing, are expected to emerge