KDB Bank *Financial Engine of Korea's Green Transformation Takeoff*

# The Role of Transition Finance to Achieve Net Zero: Evidence from the Korea's Policy Bank

**The Korea Development Bank (KDB) | GCF Accredited Entity (Re-accredited in May 2022)**

***Presenter***


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# Ⅰ. What is Transition Finance? (1)

## ■ Definition

☐ **"<u>Transition finance</u> is intended for economic activities that are emissions-intensive, do not have a viable green substitute but are important for socio-economic development."**

**- 『Transition Finance : Investigating the state of play : A stock take of emerging approaches and financial instruments』, August 2021, OECD –**

☐ **"<u>Transition financing</u> refers to a financing means to promote long-term, strategic GHG emissions reduction initiatives that are taken by a company considering to tackle climate change for the achievement of a decarbonized society"**

**- 『Basic Guidelines on Climate Transition Finance』, May 2021, Japanese Government -**

## ■ Transition Finance Eligibility Criteria(OECD)

☐ **Substitutability :** Not have a credible de-carbonization pathway or viable green alternatives at this time.

☐ **Demonstrable commitment to a trajectory :** Used for predefined low-carbonization trajectory to long-term climate goals

☐ **Avoiding unwanted path dependency :** Must not prevent green alternatives viable in the future

# Ⅰ. What is Transition Finance? (2)

## ■ Transition Finance Features (OECD)

□ Issuer premium/yield discount at issuance

- Transition instruments, regardless of the format, are typically priced at a premium to others.

□ Penalty mechanism

- All transition instruments structured as SLBs(Sustainability-Linked Bonds) include a penalty mechanism that is triggered in the event of non-compliance with pre-stipulated SPTs(Sustainability Performance Targets)(trigger event).

  * SPT examples : Improve use of (i) recycled materials by 30%, (ii) reduce scopes 1 and 2 emissions by 20%, and (iii) reduce scope 3 emissions by 10% by 2025 compared to 2017 baseline.

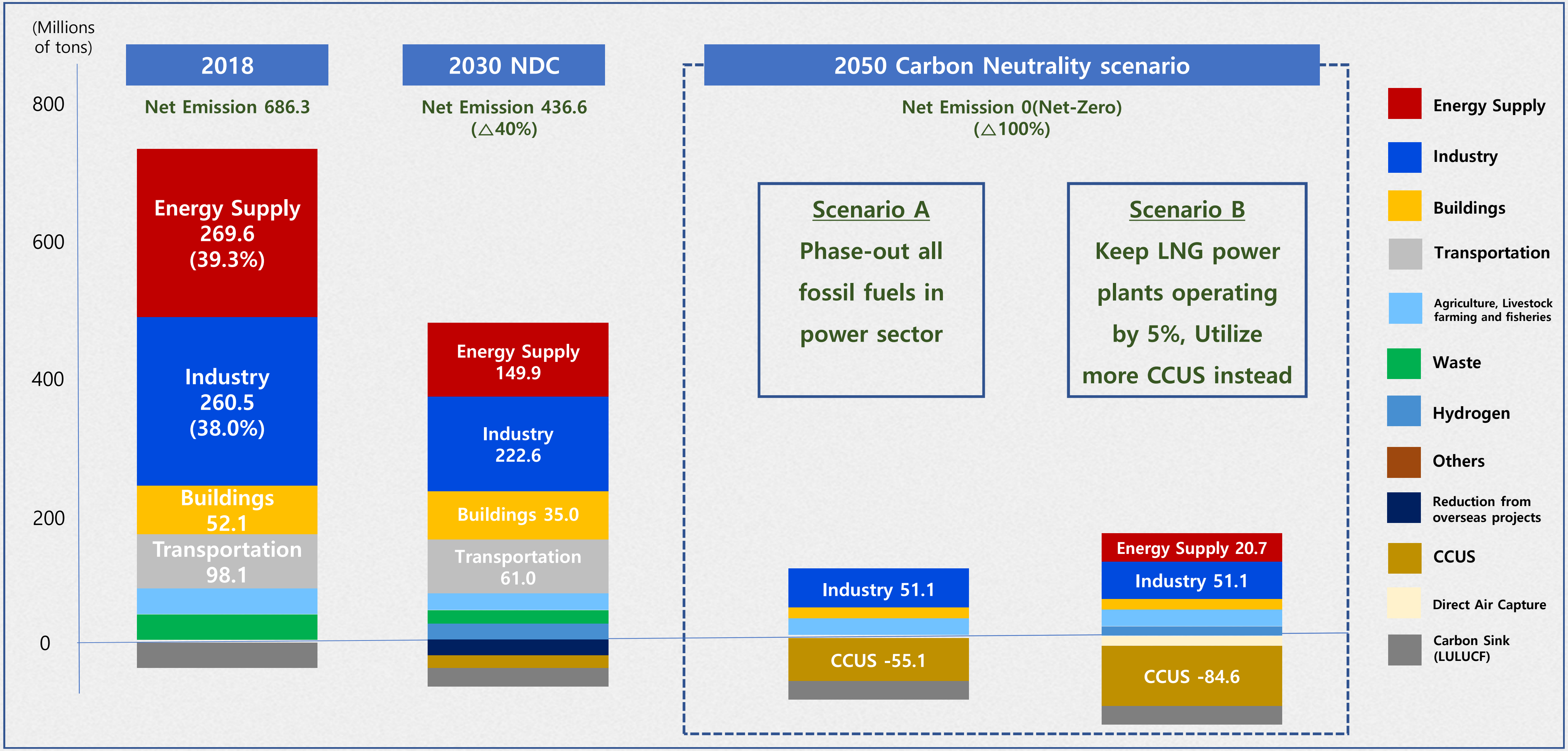
※ Three types of penalty mechanisms

(i) coupon step-up (most common),

(ii) premium payment upon maturity set as fixed percentage (set in basis points) of redemption amount

(iii) obligation to purchase offsets to meet the SPT calculated as a percentage (set in basis points) of the nominal amount.

# Ⅱ. Korean Government's Target for Carbon Reduction



# Ⅲ. Why is Transition Finance so important in Korea? (1)

■ **Carbon intensive industrial structure in Korea**

□ **Heavily dependent on fossil fuels in power generation**

- According to Scenario A in “2050 Carbon Neutrality“, By 2050, New & Renewable Energy will account for over 70% of total power generation in Korea, which was only 6.6% in 2020, whereas Fossil Fuels will be zero, which is currently over 60%.

□ **Industrial Sector takes up 38% of total emission in Korea (as of 2018).**

- Most carbon intensive industries like Steel, Cement and Petrochemicals account for 59% of total emission in the industrial sector.

■ **Necessities of Transition Finance, especially from the KDB’s perspective**

□ **Urgent need to support emission reduction in high-emitting and hard-to-abate sectors**

- Transition financing aims to offer funds to high-emitting companies committed to shift toward a greener operation.

□ **Public financial institutions like KDB should play a pivotal role in transition finance areas.**

- Most of Private financial institutions are reluctant to provide transition finance for the fear of an increase of carbon footprints in their investment portfolio.

# Ⅲ. Why is Transition Finance so important in Korea? (2)

■ **Transition Activities in K-Taxonomy**

□ According to the K-Taxonomy, green economic activities consist of the "green sector" and the "transition sector" .

□ The "transition sector" is classified into five economic activities:

(i) greenhouse gas reduction activities at SMEs,

(ii) energy production based on liquefied natural gas or mixed gas*

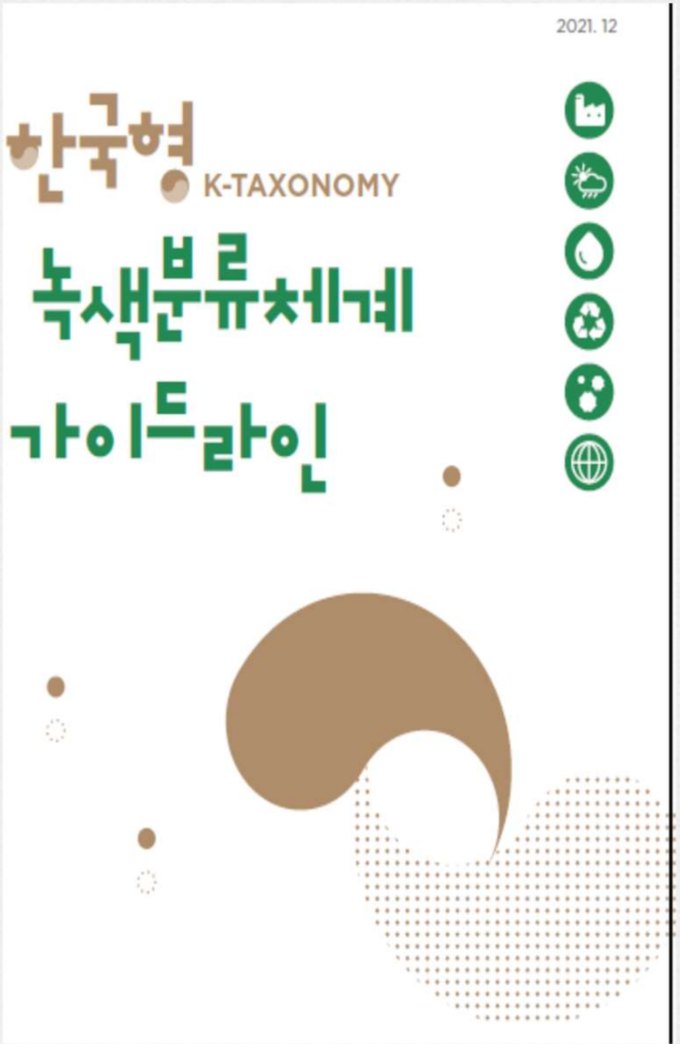
* i.e., the gas that is a mixture of two or more gases including biogas, hydrogen, ammonia, by-product gas and liquefied natural gas

(iii) liquefied natural gas-based hydrogen (blue hydrogen) production,

(iv) eco-friendly* shipbuilding

(v) eco-friendly* ship transportation.

* Above Level 3 out of 5, under the National Eco-friendly Ship Certification



# Ⅳ. KDB's Special Product for Transition Finance

■ **Under the KDB's Green Finance Framework, "Carbon Finance Program" is a prime example of Transition Finance.**

□ **A special lending product to facilitate a low-carbon transition of carbon intensive industries.**

□ **Pricing benefits to companies whose business activities are verified in terms of mitigation impacts.**

- **prime rate up to 2.6% depending on level of GHG emission reduction.**
- **Mitigation impact is strictly verified by third-party.**
- **If fail to achieve target reduction, the saving amounts by prime rate should be refunded.**

## Work Flow

**Consultation on planned facilities** (Borrower ↔ KDB) → **Pre-assessment on mitigation impact** (Third-party) → **Credit Review and Lending Execution** (KDB) → **Post-assessment on mitigation impact** (KDB & Third-party) → **If failed, Penalty mechanism** (KDB)

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# Thank You