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Defining Green and Transition Activities with the Singapore-Asia Taxonomy and Accelerating Coal Phaseout with Transition Credits at COP28

Introduction

The landscape for attaining net zero by 2050 has been met with challenges, particularly in Asia. Coal-fired power plants ("**CFPPs**") in Asia account for one-sixth of the global greenhouse gas ("**GHG**") emissions and needs to be phased out ahead of their usual run-time to avoid exhausting the carbon budget aligned with the Paris Agreement. Climate-friendly transition activities across the economy also face financing hurdles in the face of greenwashing risks and narrowing bankable capacity. These issues were addressed at the COP28 Singapore Pavilion Finance Day on 3 December 2023 with Monetary Authority of Singapore ("**MAS**") launch of the first version of the Singapore-Asia Taxonomy for Sustainable Finance ("**Singapore-Asia Taxonomy**") and a Transition Credits Coalition ("**TRACTION**"), among other transition financing initiatives.

The present Singapore-Asia Taxonomy is finalised following four rounds of public consultations, since January 2021, and focuses on climate change mitigation, which is one of the five environmental objectives intended to be addressed. It sets out detailed thresholds and technical criteria for defining green and transition activities in eight focus sectors: Energy, Real Estate, Transportation, Agriculture and Forestry/Land Use, Industrial, Information and Communication Technology, Waste/Circular Economy, and Carbon Capture and Sequestration.

In addition, the Singapore-Asia Taxonomy provides a credible framework to phaseout CFPPs, by setting out both entity and facility-level criteria that are aligned to a 1.5 degree Celsius scenario. Such criteria include that the electricity generated from the phased-out CFPP has to be fully replaced with clean energy within the same electricity grid and the CFPP must have a just transition plan.

This Update gives you a snapshot of the key features of the Singapore-Asia Taxonomy and salient highlights of Singapore's coal phaseout plan using transition credits. To help you better navigate the nuances of this significant development, please contact our multi-disciplinary specialist teams at Rajah & Tann Singapore's Sustainability Practice who are well-poised to advise you on the adaptation of your business to take into account sustainability and ESG (environmental, social and governance) issues.

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Singapore-Asia Taxonomy

What is unique about the Singapore-Asia Taxonomy is that it is the world's first taxonomy to comprehensively define transition activities across eight focus sectors. The ASEAN Taxonomy for Sustainable Finance Version 2[1] that was developed in parallel is the only other taxonomy known to include definition of transition activities in the energy sector.

Guiding principles

The Singapore-Asia Taxonomy is developed based on the following guiding principles:

(i) **Science-based**, to serve as a direct bridge between climate science and the financial sector;

(ii) **Singapore-based** activities, metrics, and thresholds are main considerations for specific decarbonisation pathways (where available);

(iii) **Economic activity structure** that is based on ISIC codes. Higher resolution is given to activities in the three sectors of energy, transport, and buildings, due to their importance to the Singapore and regional economy, impact on GHG emissions, and activity selection in the ASEAN Taxonomy; and

(iv) **Globally interoperable**, to mirror the global use of capital and to enable interoperability with other international taxonomies particularly the EU Taxonomy and the ASEAN Taxonomy.

Transition screening

Transition activities are comprehensively defined through the two new approaches explained below.

(i) **Traffic light system** that classifies economies activities and projects as Green, Amber (transition), and Ineligible based on their contribution to climate change mitigation, determined by their performances against and compatibilities with a 1.5°C pathway.

Amber (activity) denotes activities that will move to Green over a defined period of time or facilitate significant emissions reduction in the short-term. To qualify as Amber, activities must meet strict thresholds and criteria by a sunset date. The category is not applicable to new projects unless otherwise stated.

(ii) **Measures-based approach** to boost capital investments into decarbonisation measures or processes that will help reduce the emissions intensity of activities and enable the activities to meet the Green criteria over time.

[1] Refer here for our related Client Update on "ASEAN Taxonomy V2: Enabling a Just Transition Towards Sustainable Finance Adoption by ASEAN".

Amber (measures) denotes activities that provide options at a point in time that are greening the activity even though it may not meet the Amber (activity) criteria.

For details (including technical screening criteria for each activity etc.), please refer to the Singapore-Asia Taxonomy available at this link here (on the MAS website).

Voluntary basis

At the time of publication, the Singapore-Asia Taxonomy is not mandatory nor contained in any regulation. For now, it is intended for use on a voluntary basis.

Target and potential users and uses

Primary users include Singapore-based financial institutions ("**FIs**") providing debt and/or equity capital, including both public and private capital as well as asset managers that provide financial products that are aligned with the Singapore-Asia Taxonomy activities. Secondary users include companies, industry regulators and policymakers.

The plan is that FIs can use the Singapore-Asia Taxonomy to report on the degree to which their investments, products or range of transactions are aligned with the Singapore-Asia Taxonomy and the environmental objectives to which the undertaking contributes. In the process, FIs can assess the alignment (or percentage alignment) of the activity or issuer being financed, aggregate these alignments to the portfolio or product level, and disclose aggregate alignment accordingly.

In the initial phase, FIs can identify investments that are eligible under the Singapore-Asia Taxonomy classifications and then determine whether they are aligned with the different Singapore-Asia Taxonomy classifications (Green, Amber and Ineligible). This will be partly dependent upon company reporting. Over the next few years, investors are recommended to report eligibility and alignment of their investments with the Singapore-Asia Taxonomy using the activity classification for eligibility and additional data, where available, for alignment. Where investors do not have the source information from the underlying investee company, they can use the terms "potentially aligned" or "estimated aligned". Over the long term, as companies begin to report activity-level financial data and metrics on the alignment of their activities using the technical screening criteria, investors should report both eligibility and alignment of their investments with the Singapore-Asia Taxonomy.

For a summary of the users and uses, refer to Table 16 (page 126) in the Singapore-Asia Taxonomy.

Future iterations

At this nascent phase, the application of the Singapore-Asia Taxonomy to financial markets, debt instruments such as green bond/ loan, corporate disclosure regulations as well as its voluntary or mandatory status have not yet been decided nor put forth for public consultation. Further study is to be conducted on its use, mandatory/voluntary nature, for disclosure guidance/ regulation purposes, for debt financing purposes such as green bond/loan, and expectations on frequency of reporting and compliance.

Criteria and thresholds for four other environmental objectives (i.e., climate change adaptation, protect healthy ecosystems and biodiversity, promote resource resilience and circular economy, and pollution prevention and control) may be addressed in future versions.

The exact review time periods have not yet been finalised and will be shared in due course. The Singapore Sustainable Finance Association (SSFA), convened by MAS, is in charge of future iterations of the Singapore- Asia Taxonomy and taxonomy maintenance.

Interoperability with global taxonomies to facilitate cross-border financing flows

MAS is mapping the Singapore-Asia Taxonomy to the International Platform for Sustainable Finance (**"IPSF"**)'s Common Ground Taxonomy (**"CGT"**), which currently covers the EU Taxonomy and the People Bank of China's ("**PBOC**") Green Bond Endorsed Project Catalogue. When this mapping is complete, financial institutions and market participants will be able to refer to a common set of definitions under the CGT. This will increase taxonomy-aligned financing solutions and facilitate sustainable development in markets which the CGT covers. Additionally, MAS is collaborating with the PBOC to promote the uptake of financial products that reference the China Green Bond Catalogue and the Singapore-Asia Taxonomy, and eventually the CGT once mapping is completed.

Incentivising Coal Phaseout with Transition Credits

To incentivise decarbonisation and support coal phaseout, MAS launched a coalition of ecosystem players to help identify barriers and potential solutions to develop transition credits as a viable market solution, the Transition Credits Coalition ("**TRACTION**").

Transition credits refer to high-integrity carbon credits aligned with globally recognised standards[2] that are generated from the emissions reduced through retiring a CFPP early and replacing this with clean energy sources. They serve as a complementary financing instrument to reduce the economic gap for the early retirement of CFPPs.

[2] Such as the Core Carbon Principles (CCPs) set out by the Integrity Council of Voluntary Carbon Market (ICVCM), and other Article 6 integrity requirements, as mandated by UNFCCC. MAS will explore ways for transition credits to align with the CCPs, in consultation with the ICVCM.

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Under Singapore's carbon tax regime, the Singapore government is prepared to offtake the use of transition credits as long as they meet Singapore's standards of environmental integrity. This means that qualifying transition credits can be used by carbon tax liable corporates in Singapore to offset up to 5% of their carbon tax liabilities. See our related Client Updates on "Amendments to Carbon Pricing Act 2018 Come into Force on 1 Jan 2024" and "Prescribed Criteria for International Carbon Credits under Singapore's Carbon Tax Regime".

Whole-of-system approach

With close to 30 members and knowledge partners (from carbon credit services, energy financing, project development and risk management), TRACTION will, over a two-year period:

(i) Identify system-wide barriers and develop solutions for transition credits to be utilised as a credible financing instrument. These include identifying robust crediting approaches that can be applied to regulated and deregulated electricity markets, mitigating risks of non-delivery of credits, and exploring avenues to build buyers' confidence in transition credits.

(ii) Develop investors' confidence in transition credit; and

(iii) Study possible standardisation approaches to address differing market circumstances incorporating insights from pilot transactions.

Pilot projects to test practicality of different approaches in integrating high-integrity transition credits in the early retirement of CFPPs in collaboration with:

(i) ACEN Corporation and Coal-to-Clean Credit Initiative, to accelerate the retirement of the South Luzon Thermal Energy Corporation coal plant in Philippines. Climate Smart Ventures, an advisory firm focused on energy transition, will be coordinating the project; and

(ii) The Asian Development Bank (ADB), which is advising the Government of Philippines over the retirement of a coal plant in Mindanao under its Energy Transition Mechanism.

Other references you may find useful include:

- Glasgow Financial Alliance for Net Zero ("**GFANZ**") Asia Pacific Network's finalised report (available on the GFANZ website) for financing the early retirement of coal-fired power plants. The report provides guidance to financial institutions on assessing the credibility and impact of a coal phaseout plan, as well as internal coal policies and case studies on financing mechanisms.

- Working paper published by MAS and McKinsey on the use of transition credits (available here, on the MAS website) The paper sets out the conditions for generating transition credits and for developing a high-quality market to exchange the credits.

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Our Comments

The finalisation of the Singapore-Asia Taxonomy sets the ground as an important precursor for actionable transition plans to be formulated in the sectors covered. The emphasis on science-based and accommodation of global-local sensitivities require economic actors to adopt best practices where they can and to minimise significant harm where possible. The development of high-integrity transition credits for CFPPs to come highlights the need for innovative financing instruments that can help the transition.

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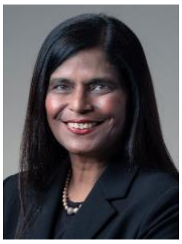

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