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Policy Brief

# THE SUSTAINABLE FINANCE MARKET IN ASEAN+3: DEVELOPMENT, OPPORTUNITIES AND FUTURE STEPS

*Task Force 9*

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# Abstract

Member states of the Association of Southeast Asian Nations (ASEAN) are still in the early stages of developing their sustainable finance markets. Challenges such as a lack of talent pool and a limited supply of and demand for sustainable finance products need to be addressed. The Group of 20, which includes developed countries in the region, can play a critical role in helping emerging markets develop practical sustainable finance ecosystems.

This policy brief offers concrete suggestions for addressing these problems while emphasising the importance of regional cooperation and collaboration with the private sector and multilateral development banks.

# Challenges

As highlighted in the G20 Sustainable Finance Roadmap, private capital can play a vital role in supporting sustainability goals, and sustainability should be considered at every stage of financing (G20, 2021). In particular, capital markets can play a critical role in directing private investment towards a low-carbon, resource-efficient, climate-resilient and inclusive economy.

In the wider ASEAN+3[1] region, the People's Republic of China (PRC), Japan and the Republic of Korea have led the development of sustainable financial markets, while sustainable finance markets are still developing in all ASEAN economies with the exception of Singapore. While some countries' markets are more advanced than others, the region still faces several common challenges:

1. **Talent and capacity shortages for environmental, social and governance (ESG) investment and financing.** Over 40 percent of institutional investors in Asia say they are being held back from more ESG investing by a shortage of expertise and/or qualified staff (HSBC, 2021). Meanwhile, the number of ASEAN's institutional investors that have endorsed the United Nations-supported Principles for Responsible Investment is only 90 of the nearly 5,000 signatories worldwide (Principles for Responsible Investment, 2022).[2] Given the critical role investors can play in monitoring and pressuring issuers to improve in key ESG areas; it is crucial for the Group of 20 and multilateral development banks (MDBs) to take a proactive role in developing the talent and capacity of all stakeholders if sustainable finance instruments are to be more accessible and affordable, particularly in emerging markets.

2. **Unclear policy guidance, definitions and requirements for sustainability disclosure.** This could restrain the growth of the green, social and sustainability (GSS) bond market as capital market participants are uncertain whether their activities are consistent with authorities' regulatory objectives. The absence of a locally relevant taxonomy can create uncertainty for issuers as to whether the underlying projects and expenditures are "green enough" or "social enough" while also exposing impact investors to potential reputational risks. In addition, approaches to sustainability reporting can vary from company to

[1] ASEAN+3 includes members of the Association of Southeast Asian Nations (ASEAN) plus the People's Republic of China (PRC), Japan and the Republic of Korea.
[2] Out of the region's 90 signatories as of 31 May 2022, 65 were from Singapore.

company and industry to industry, making it difficult for issuers and investors to analyse and quantify the impacts of their investments.

3. **GSS bond issuance incurs additional upfront costs and requires a longer time to market.** From the issuer's perspective, issuing GSS bonds entails immediate additional costs – such as the resources required to prepare and manage information and accounts, and fees related to an external review or certificate – with limited immediate and direct benefits, particularly in emerging markets where the GSS bond market is still in an early development stage. Unlike the stock market, where a stock's price reflects the entity's future value, a bond's price is determined by the risk-free market rate. Thus, issuers prefer to issue conventional bonds because they offer more pricing certainty and faster market access.

   While these challenges are common among emerging markets, collective action among G20 members and MDBs can play a critical role in assisting all economies in accelerating the development of their sustainable markets.

# Proposals for G20

The objective of this policy brief is to assist the G20 Sustainable Finance Working Group (SFWG) in making sustainable finance instruments more accessible and affordable to all stakeholders and to highlight how the G20 can support global efforts in transitioning to net-zero, particularly in emerging economies. This goal is aligned with the communique of the G20 Finance Ministers and Central Bank Governors Meeting, held in February 2022, requesting that the SFWG develop a voluntary, nonbinding policy toolbox highlighting ways to scale up sustainable finance instruments, in cooperation with other relevant G20 working groups and with a focus on improving accessibility and affordability (G20, 2022).

The following actionable recommendations seek to support the development of a sustainable finance ecosystem and mainstream private capital, including financial intermediation through financial institutions, to support Sustainable Development Goal (SDG) investments.

**Develop a talent pool for ESG investment and financing**

The G20, in collaboration with MDBs, can play a critical role in expanding the region's talent pool to create greater demand for and supply sustainable finance products.

**On the demand side**, local institutional investors, particularly long-term investors like public pension funds and insurance companies, should integrate SDGs as part of their investment strategies. It is obvious that climate and social risks will have a long-term impact on corporate activities and their performance. Thus, investors' investment strategies should also account for these risks. Meanwhile, asset management companies should introduce ESG-themed investment vehicles such as exchange-traded funds and mutual funds to increase accessibility, particularly for retail investors wishing to contribute to environmental and social development. More than 60 percent of millennials indicated that ESG issues were important in their investing decisions, while the corresponding shares were 54 percent among Generation X and 42 percent among boomers (Allianz Life, 2019).

International insurers and asset managers, particularly those with headquarters in G20 member countries, have the potential to compel investees to act more responsibly to attract investment. This would contribute to the diversification and expansion of the domestic investor base, particularly in emerging markets, while also putting pressure on local institutional investors to strengthen their ESG investment capabilities to remain competitive. According to one survey, while there is a high awareness of ESG investing, only 31 percent of surveyed Asian investors have an ESG policy statement in place and Asian asset owners only allocate an average of 10 percent of their portfolio to ESG-related strategies (Willis Towers Watson, 2021).

Meanwhile, development partners can act as anchor investors for GSS bond transactions, demonstrating ESG investment practices to local investors. These investors will gradually build their capacity and experience to independently assess the ESG aspects of underlying securities. For instance, the Asian Development Bank (ADB) has invested THB3 billion (US$81,358.14) in Energy Absolute's first green bond issuance, out of a total issue size of THB10 billion. The bond proceeds support the long-term financing of the company's 260-megawatt Hanuman wind farm in Thailand and contribute to Thailand's renewable energy objectives and its ongoing efforts to reduce carbon emissions (ADB, 2019).

**On the supply side**, the G20 can provide concessional financing to reduce the risk associated with ESG-themed infrastructure projects and make them more financially viable to attract private capital. The ADB estimates that between 2016 and 2030, ASEAN will require $210 billion per year, or 5.7 percent of members' aggregate annual gross domestic product (GDP), to support investments in climate-resilient infrastructure (ADB, 2017). Clearly, the region's infrastructure financing requirements far exceed regional governments' annual budgets, and private capital must be mobilised to meet these needs. To enable the financial viability and bankability of infrastructure projects, mechanisms such as a de-risking facility and credit enhancements are necessary. The establishment of the ASEAN Catalytic Green Finance Facility (ACGF) in April 2019, an initiative of the ASEAN Infrastructure Fund, is one example of how the G20 and ADB can collaborate to accelerate green infrastructure investments. Development partners such as Agence Française de Développement, the European Investment Bank, the KfW Development Bank and the Government of the Republic of Korea have already pledged their support to the ACGF. In 2021, four additional partners—the European Union, the Green Climate Fund, Italy's Cassa Depositi e Prestiti and the Foreign, Commonwealth and Development Office of the United Kingdom—pledged $665 million towards the ACGF's activities as part of a Green Recovery Platform launched at the 26th UN Climate Change Conference of the Parties in Glasgow (ACGF, 2022). This model can be replicated in other regions as needed.

To increase the accessibility and affordability of financing for small and medium-sized enterprises (SMEs), financial institutions can play a critical role by providing finance to SMEs through "green loans" or "social loans" to support their environmentally and socially responsible investments. Financial institutions can raise funds for this purpose by issuing GSS bonds and by offering green or social deposit schemes, thereby increasing the supply of sustainable products and making them more accessible to relevant stakeholders (e.g., borrowers, depositors and/or investors).

Additionally, MDBs are well-positioned to serve as trusted knowledge partners for emerging economies. For instance, the ADB recently published a handbook on green bond issuance, which is available in several ASEAN member languages and explains the process and critical factors to consider when issuing green bonds (ADB, 2021). This document enables local underwriters and advisors to offer innovative products to clients. Medium-sized issuers will have greater access to the GSS bond market as more underwriters become familiar with these products.

As Secretariat of the ASEAN+3 Asian Bond Markets Initiative (ABMI), the ADB facilitates regional dialogue and experience sharing among ASEAN+3 member countries on sustainable finance and the development of local currency bond markets. Other regions can establish similar platforms with the support of governments and MDBs. As climate change and social issues transcend national boundaries, they are not a matter for any single country.

**Establish policy guidance, definitions and guidelines for sustainability disclosure**

Governments and regulatory authorities should establish a policy framework for fostering the development of sustainable finance in their respective jurisdictions. These recommendations highlight the important role that governments can play in promoting a sustainable finance market.

**Lead by example.** To lead by example and set good practices, governments can demonstrate their commitments by regularly issuing GSS bonds in the local currency to support the development of the domestic bond market. Regular issuance helps shape the yield curve and enables corporate issuers to more precisely price and calculate risk premiums on their GSS bonds. Not only would the issuance of GSS bonds increase government transparency regarding public spending, but it would also provide clear guidance to the private sector on eligible green projects and/or social categories. Some ASEAN countries have already set an excellent example. In 2018, Indonesia issued Southeast Asia's first sovereign green *sukuk* (Islamic bonds) (Bahuet, 2018), and the region's first sovereign SDG bond in 2021 (UN Development Programme 2021). With support from the ADB, Thailand also issued the region's first sovereign sustainability bond in 2020 as part of its COVID-19 recovery programme (Ministry of Finance, Thailand, 2020), while Malaysia issued the world's first sovereign US$-denominated sustainability *sukuk* in April 2021 (Ministry of Finance, Malaysia, 2020). The Philippines became the latest ASEAN country to issue a green bond, raising $2.25 billion through its first-ever global green bond issuance in 2022, and also issued the country’s first sustainability samurai bond in Japan (Bureau of Treasury, Philippines, 2022).

Meanwhile, central banks and financial regulators can set a good example by publishing their own sustainability reports and committing to ESG investments. In June 2021, the Monetary Authority of Singapore (MAS) published its inaugural sustainability report, the first of its kind by an Asian central bank (Bloomberg, 2021). The MAS also committed to investing $1.8 billion in climate-related investment opportunities (Channel News Asia, 2021). In the context of Asian financial markets, where banks play a greater role in assisting SMEs, central banks should consider green bonds and finance as preferred collateral. Additionally, Malaysia's Employees Provident Fund (EPF) announced its Sustainable Investment Policy, which explains the EPF's overall approach to sustainable investing and the integration of ESG factors into its investment processes (EPF, 2022). As part of this initiative, the EPF will introduce a sustainable savings option to allow members to manage their investments according to their personal values (*The Edge,* 2022).

**Define "green" and "social" bonds.** Developing a definition of what constitutes "green" and "social" is essential from the perspective of investors and issuers. These definitions must be contextually appropriate for the country while adhering to global practices. This is extremely important because different countries are vulnerable to different types of extreme weather and are disproportionately affected by climate change. Similarly, social needs vary from one country to another country. For instance, the construction of a bridge over a river may improve traffic conditions, reduce carbon emissions, and facilitate commuting. This may be considered an eligible green or social project in countries with severe traffic conditions, but not in countries without this issue. Therefore, country-specific definitions that align with global climate and social objectives are essential for the domestic sustainable finance market to develop. The Financial Services Authority (OJK) of Indonesia published the Indonesia Green Taxonomy in January 2022 to help financial institutions better understand and classify green activities as they develop their financial product and/or service portfolios and transition Indonesia to a low-carbon economy (OJK, 2022).

Additionally, these definitions should account for orderly, just and affordable transitions to a low-carbon, climate-resilient economy. While some businesses may operate in carbon-intensive industries, their decarbonisation and transition efforts should be facilitated and recognised.

**Promote sustainability disclosure.** It is important to promote sustainability disclosure as it enables investors to evaluate issuers' exposure to climate-related risks and opportunities, as well as the sustainability policy of ESG products when making investment decisions.

Some countries, such as Malaysia, have announced that financial institutions will be required to make climate-related financial risk disclosures that align with the Task Force on Climate-related

Financial Disclosures beginning in 2024 (Bank Negara Malaysia, 2021). Thailand's Securities and Exchange Commission has issued regulations for fund managers to follow the disclosure standards for sustainable and responsible investment funds to widen access for retail investors. This allows investors to compare mutual funds with similar sustainability mandates and, as a result, be able to make informed investment decisions.

Regulators and corporations in emerging countries, on the other hand, require additional assistance from more advanced countries and development partners. To promote greater disclosure, issuers must have sufficient capacity to quantify, evaluate and disclose their exposure to climate-change-related risks and opportunities. The G20 and MDBs can work with local regulators to assist issuers and investors in developing their capacities, share experiences and, where possible, participate in pilot transactions to support market development. The ADB has developed the *AsianBondsOnline* portal to provide information on the development of the ASEAN+3 GSS bond market and to serve as a repository for ADB-organised training materials and knowledge products for stakeholders in the region. This can also serve as a model for other regions seeking to develop their local currency bond markets.

**Streamline the issuance process and shorten the time to market**

MDBs, in collaboration with local regulators, can play a critical role in establishing a sustainable finance ecosystem. With the right policies in place and a healthy domestic sustainable finance ecosystem, the process of issuing GSS bonds could be streamlined, issuance costs could be reduced, and time to market could be shortened to enable greater pricing certainty.

**Establish local green bond verifiers.** The establishment of local green bond verifiers with in-depth knowledge of local contexts, regulations and market practices could be a key driver for sustainable bond issuance. Local reviewers who operate in the same country, work in the same time zone and speak the same language as issuers will help reduce issuance costs, as their fees are generally lower than those charged by international reviewers. This would make it more accessible and affordable for smaller issuers as they progress in the GSS bond journey. Currently, the ADB is collaborating with Thailand's TRIS Rating, Malaysia's RAM Sustainability and Viet Nam's Fiin Group on pilot verifications of the Climate Bond Standards**.** Given the infancy of ASEAN's sustainable bond market, it is challenging to identify entities interested in serving as local green bond verifiers. Local credit rating agencies that are familiar with existing bond issuers in their respective local markets are well suited to provide this service. In addition, public universities with expertise in sustainability assessment can provide external review services to jumpstart market development in their countries.

**Providing advisory support.** Development partners can offer advisory support to entities wishing to issue GSS bonds. While several regulators are promoting sustainable bond markets through various incentive schemes such as grants and tax incentives, there is a lack of advisory support to assist potential issuers by, for example, enabling them to apply for such grants. This is important, particularly for medium-sized firms that wish to create positive environmental and social impacts but do not have the necessary capacity to do so. MDBs are well-positioned to provide advisory support to potential GSS bond issuers—including determining eligible assets, projects and expenditures; developing bond frameworks; establishing internal systems and facilitating discussions with external reviewers. Local underwriters should take part in this process to gain on-the-job experience.

**Standardise bond documentation.** Standardised bond documentation that enables the issuance of GSS bonds to professional investors in multiple jurisdictions would significantly streamline the issuance process and promote intraregional bond issuance and investment. One example is the use of the ASEAN+3 Multicurrency Bond Issuance Framework (ABMIF), a policy initiative under the ABMI. Under this framework, an issuer from AMBIF-participating markets can issue local-currency-denominated GSS bonds to finance its operations in other participating markets using the same bond documentation.[3] As AMBIF targets only professional investors, AMBIF bonds can be issued in a more flexible and timely manner because professional investors do not require the same level of investor protection as retail investors.

**Implement a "green lane."** To shorten the time to market, regulators can provide a "green lane" to expedite approval processes for SDG-themed financial instruments. This scheme can also be implemented to streamline the cross-border issuance of financial instruments and facilitate intraregional capital flows.

Given the global nature of climate change and other key social issues, funding environmental and social activities must be affordable and accessible to all stakeholders. The G20's SFWG can undoubtedly play a critical role in establishing an ecosystem for sustainable bond markets in ASEAN+3, especially among emerging economies. The role of the G20 in supporting the development of a regional sustainable finance market is summarised in the box below.

[3] Current AMBIF-participating markets included Cambodia; Hong Kong, China; Japan; Malaysia; the Philippines; Singapore; and Thailand

**Box: Key recommendations for the G20 in supporting the development of the sustainable finance market in ASEAN+3**

The G20 can lead the development of a sustainable finance market in ASEAN+3, particularly among ASEAN's emerging economies, by supporting the following:

1. **Strengthen the capacity of relevant stakeholders.** The G20 can provide capacity-building support to relevant stakeholders in emerging markets. This can take the form of workshops, seminars or participation in international training programmes. In addition, insurance companies with headquarters in the G20 should provide training to their local staff so that expertise is available in the local market.
2. **Increase demand for GSS bonds.** Institutional investors from G20 members, such as pension funds and insurance companies, should increase their investments in GSS bonds, particularly those denominated in the local currencies of ASEAN+3. Due to the efforts of local regulators, many local currency bond markets in ASEAN+3 have developed significantly in breadth and depth over the past few years. Some regional markets are now larger than some European markets in terms of bond market size relative to gross domestic product, but international investors still often overlook them.
3. **Provide concessional financing to support de-risking and create more bankable projects.** It is evident that governments cannot shoulder the entire burden of infrastructure financing and that the region has massive infrastructure financing needs. The G20 can provide concessional financing to reduce the risks of infrastructure projects, make them more bankable and build a project pipeline to attract and mobilise private capital. The establishment of the ASEAN Catalytic Green Finance Facility under the ASEAN Infrastructure Fund can serve as a model for other regions.

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