



BACKGROUND NOTE

Developing Infrastructure and Ecosystem for Asia's Green and Social Finance Market

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DEVELOPING INFRASTRUCTURE AND ECOSYSTEM FOR ASIA'S GREEN AND SOCIAL FINANCE MARKET

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The Asian Development Bank (ADB) estimates that developing Asia will need to invest \$26 trillion from 2016 to 2030, or \$1.7 trillion per year, if the region is to maintain its growth momentum, eradicate poverty, and respond to climate change (climate-adjusted estimate). Sixty-one percent (61%) of this amount has to be financed by the private sector as the region is transitioning towards a sustainable development path.¹

The financial market could play a key role in channeling private sector funding to support the much-needed climate-resilient infrastructure investment in developing Asia. Despite the recent growth in the Association of Southeast Asian Nations (ASEAN) green bond market in 2019 which was almost doubled, reaching US\$7.8 billion in 2019 from US\$4.1 billion in 2018, more than two-thirds of the proceeds were allocated only to two sectors, namely buildings and energy; and were primarily issued by entities based in countries with more developed capital markets such as Malaysia, the Philippines, Singapore, and Thailand.² Similarly, more than 90% of social bonds issued in Asia between 2017 and 2020 were dominated by high-income countries, particularly Japan and the Republic of Korea. Therefore, it is important for the Asian policymakers, especially those from emerging countries where infrastructure development is most needed, to develop an accommodative regulatory environment for sustainable development of the financial systems that can efficiently mobilize private sector financing, while at the same time take into account climate risks that the region is facing which may impact the stability of the financial system.

Given the dominance of the banking sector in emerging Asia, active involvement of financial institutions in sustainable finance is an integral part of the ecosystem for financing Asia's sustainable development, while at the same time allowing financial institutions to better manage financial risks that have emerged as a result of climate change. Several banking associations in

¹ <https://www.adb.org/sites/default/files/publication/227496/special-report-infrastructure.pdf>.

² https://www.climatebonds.net/system/tdf/reports/cbi_asean_sotm_2019_final.pdf?file=1&type=node&id=47010&force=0.

ASEAN have introduced voluntary sustainable lending guidelines³ that set out minimum expectations on sustainable lending practices, taking into account ASEAN members' sustainability strategies and business models. Financial institutions are in a good position to tap the capital markets through the issuance of thematic bonds to support smaller projects that generate positive environmental and social impacts, e.g., asset-backed securities backed by a portfolio of green and social assets, e.g., green loans, and concessional loans to small and medium-sized enterprises. In ASEAN, almost 30% of total green bonds issued in 2019 were financial corporates, while almost half of cumulative issuance in Japan was issued by financial corporates.

Meanwhile, ASEAN central banks and monetary authorities have worked together to develop the ASEAN Central Banks' Agenda on Sustainable Banking,⁴ which was welcomed by the ASEAN finance ministers as it would provide meaningful implications for ASEAN central banks in formulating the way forward to safeguarding financial stability while supporting the transition to a low-carbon economy region.⁵ As part of the agenda, ASEAN central banks and monetary authorities will work closely as a region to communicate ASEAN's common interests and unique circumstances, where appropriate, at international platforms. This initiative is aligned with discussion at the global level under the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) in which majority of the ASEAN central banks and monetary authorities are members of.⁶ The NGFS recently developed the NGFS Climate Scenarios to provide a common starting point for analyzing climate risks to the economy and financial system⁷, as well as environment risk analysis that could be undertaken at the financial institution level⁸.

³ For example, the Association of Banks in Singapore (ABS) introduced the ABS Guidelines on Responsible Financing in June 2018, while the Thai Bankers' Association published the Sustainable Banking Guidelines - Responsible Lending in August 2019.

⁴ <https://asean.org/storage/2020/10/Annex-ASEAN-Central-Banks-Agenda-on-Sustainable-Banking-002.pdf>.

⁵ https://asean.org/storage/2020/10/AFMGM6_JMS_Final-003.pdf.

⁶ According to its Charter, NGFS is a group of Central Banks and prudential supervisory authorities willing, on a voluntary basis, to exchange experiences, share best practices, contribute to the development of environment and climate risk management in the financial sector, and to mobilize mainstream finance to support the transition toward a sustainable economy. Its purpose is to define, promote, and contribute to the development of best practices to be implemented within and outside of the Membership of the NGFS and to conduct or commission analytical work on green finance. ADB participated in NGFS as an observer since July 2020.

⁷ NGFS Climate Scenarios for central banks and supervisors.

https://www.ngfs.net/sites/default/files/medias/documents/820184_ngfs_scenarios_final_version_v6.pdf

⁸ Overview of Environmental Risk Analysis by Financial Institutions.

https://www.ngfs.net/sites/default/files/medias/documents/overview_of_environmental_risk_analysis_by_financial_institutions.pdf

The lack of supply of sustainable bonds in many countries keeps awareness of green bonds low, and discourages investment banks from developing green bond underwriting capabilities and institutional investors from developing green bond assessment skills. Public issuances may expand the supply of local currency green bonds, provide a demonstration effect about how green bonds are issued, and signal the importance of green bonds to national policy objectives.⁹ From the market participants' point of view, clear policy guidance from governments and regulators are often desirable. For example, Indonesia was the first ASEAN country to implement a regulation on the issuance and terms of green bonds,¹⁰ and to issue the first sovereign green sukuks in 2018, 2019 and 2020. In August 2020, Thailand has issued the first ASEAN sovereign sustainability bond with technical support from ADB. Another example worth noting is the issuance of the first sovereign bond to support the economy in recovery from the coronavirus disease (COVID-19) pandemic by the Government of Bhutan. The transaction was well-received and resulted in an oversubscription of 300%. This example shows that even countries with underdeveloped financial infrastructure could issue sovereign bonds as a tool for economic recovery and capital market development.¹¹

Based on our discussion with potential sustainable bond issuers in developing Asia, the presence of a local external reviewer who possesses an in-depth understanding of the local context, regulatory environments, and market practices was seen as beneficial, especially in the region with varying levels of economic development and diverse cultures. An external reviewer or approved verifier under the Climate Bonds Standard and Certification Scheme, based in the same jurisdiction, and speak the same language as the issuer, would be able to help issuers to issue thematic bonds, or sustainability linked products that are aligned with international practices, while at the same time bring about international good practices into the local market. Some regulators, for example, the Securities and Exchange Commission of Thailand has included the establishment of a local verifier in its Strategic Plan 2020 – 2022.¹² Locally approved verifiers in countries like Japan, Malaysia, and the People's Republic of China are also playing an important role in helping

⁹ <https://www.adb.org/sites/default/files/publication/410326/green-lcy-bonds-infrastructure-development-asean3.pdf>.

¹⁰ Financial Services Authority Regulation Number 60 /POJK.04/2017 on the issuance and the terms of green bond. <https://www.iced.or.id/wp-content/uploads/2018/02/English-SAL-POJK-60-Green-Bond.pdf>.

¹¹ <https://www.unescap.org/news/bhutan-issues-first-sovereign-bond-meet-increasing-fiscal-financing-needs-fighting-covid-19#:~:text=The%20Royal%20Government%20of%20Bhutan,pandemic%20while%20diversifying%20financial%20sources.&text=Exploring%20sustainability%20oriented%20bonds%20and,investment%20should%20be%20explored%20further.>

¹² <https://www.sec.or.th/EN/Documents/AboutSEC/strategicplan-2020-2022.pdf>.

local entities to issue thematic bonds that are aligned with local, regional, and international standards.

The long-term sustainability of any market requires a balance between supply and demand. In emerging Asian markets, while most domestic institutional investors are not explicitly seeking investment opportunities in sustainable bonds, they often have a strong demand for high-rated fixed-income securities. Public sector investors, e.g., pension funds, social security funds, can play a key role in creating demand for local currency bonds as part of their investment policies. The Government Pension Fund of Thailand (GPF) published the “GPF Thailand Environmental, Social, and Governance (ESG) Weight and Score: Asset Valuation Methodology” document¹³ to provide a detailed description of how GPF analyzes and weights environmental, social, and governance (ESG) factors at the sectoral and at the company or issuer level, and how these factors are incorporated into asset valuation and pricing. The Government Pension Investment Fund of Japan (GPIF) has also expanded GPIF that disclosed a comprehensive assessment of climate change-related risks and opportunities across all major asset classes in GPIF's portfolio based on the recommendations of the Task Force on Climate-Related Financial Disclosures.¹⁴

Further, fund managers often require reliable ESG indexes or sustainable bond indexes as their benchmark to assess their investment performance. Some index providers are already providing ESG indexes for equity securities. Given the limited number of sustainable bonds issued in emerging Asia (excluding the People's Republic of China), it may be difficult to develop a reliable and transparent index for local currency sustainable bonds. As the Secretariat of the Asian Bond Markets Initiative, ADB will explore the feasibility of establishing an ASEAN+3 sustainable bond index to help the fund managers in constructing investment products to facilitate intra-regional investment in the region. This activity is part of the regional technical assistance to create ecosystems for green local currency bonds for infrastructure development in ASEAN+3.¹⁵ It is also important to take into account activities that are being carried out by relevant regional forums, including the ASEAN Capital Markets Forum, to further promote sustainable asset class in

¹³ <https://cfl.gpf.or.th/Files/Viewer/?fileName=8cc627de-48a5-428e-ac5b-ba4a3ef20f32%2FGPF-Environmental-Social-and-Governance-Weight-and-Score-Asset-Valuation-Methodology.pdf&fbclid=IwAR1Scw38mm1VfQq3eaFpRvNUsGRGYUAZuh3AL33QJhDbUC28OrVOZyEfpMo>.

¹⁴ https://www.gpif.go.jp/en/investment/esg/gpif_publishes_the_analysis_of_climatechange-related_risks_and_opportunitiesin_the_gpif_portfolio.html.

¹⁵ <https://www.adb.org/projects/53300-001/main>.

ASEAN based on the ASEAN green, social, and sustainability bond standards to international investors. The ASEAN green, social, and sustainability bond standards were developed in alignment with the International Capital Market Association's Green and Social Bond Principles, and Sustainability Bond Guidelines.

To broaden institutional investors base, and to facilitate intra-regional investments, ADB has also developed a dedicated sustainable finance information platform on the AsianBondsOnline information portal to provide comprehensive information on the development of sustainable finance in ASEAN+3 member countries¹⁶.

Given the diversity of economic and financial market development in Asia, policymakers need to work together to develop market practices that are relevant to the Asian context and to promote sustainable finance as a regional agenda. Despite recent growth in the sustainable finance market in Asia, there are remaining issues that need to be addressed based on the ethos and priorities of countries. Sharing of experience among relevant policymakers and stakeholders within the Asian region is highly desirable. To attract international investors into ASEAN markets and promote their regional commitment, it is important that regulators and relevant stakeholders from within the region, irrespective of their level of capital market development, have already established confidence among each other.

¹⁶ <https://asianbondsonline.adb.org/green-bonds/index.html>