

CATALYSING GREEN BONDS IN ASEAN+3 COUNTRIES TO MOBILIZE FINANCE FOR ENERGY MARKET TRANSFORMATION

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Overview

The Paris Agreement brought together developed and developing countries in a common attempt to keep global average temperature rise well below 2°C above pre-industrial levels (and strengthening this limitation to 1.5°C) by the end of the century. As a primary source of production, energy is one of the central pillars of achieving these temperature goals. Additionally, energy efficiency is a critical measure to make a contribution to the transition towards low carbon and climate resilient economies. Enabling energy markets to support the shift towards a sustainable energy paradigm is therefore essential.

Nowadays, traditional oil and gas energy industries are facing multiples challenges. From rising competitiveness of renewable energies thanks to lower upfront costs, to an increased engagement of institutional investors in climate change policies and subsequent rising concerns over the sustainability profile of conventional energy companies' business models, the traditional energy sector is currently under pressure. Furthermore, the global energy demand is expected to grow by 30% in the next twenty years and, as a consequence, an annual investment of USD 2.7 trillion in energy supply and energy efficiency to 2040 will be required to meet the increased demand for energy¹. Building sustainable energy infrastructure required for a 2°C scenario is also expected to cost around USD 25 trillion over the coming 15 years². The urgency to tap new sources of capital to live up with the ambitious goal of transforming energy markets therefore has never been so clear.

Southeast Asia energy demand, which increased by 60% in the past fifteen years, is expected to further rise by two-thirds over the next twenty years, thus accounting for one-tenth of global energy demand by 2040³. The investments needed to meet a growing energy demand in the ASEAN region will call for the mobilisation of both the public and the private sector. In Southeast Asia, while the banking sector has traditionally played the major financing role, stricter capital adequacy requirements and maturity mismatches may have constrained lending. It is therefore imperative to explore new and innovative financial instruments to engage the private sector and consequently expand the investment base. Capital markets can complement bank financing and provide an alternative intermediation mechanism between investors and project developers for climate and SDG aligned projects.

Green bonds are a debt capital market instrument to connect investors seeking impact investments to projects in emerging countries. Currently accounting for USD 120.2 billion compared to USD 92 billion of total issuance last year, the global green bond market is set to grow. Present trends show increasing issuance as well as the emergence of a variety of market participants, many of them from developing countries, with Nigeria, China and India taking the lead⁴. Although still relatively quiet, the market for green bonds in Southeast Asia is also reporting some activity. The issuance of the first green sukuk by Tadau Energy and the recently released ASEAN Green Bond Standards are clear steps towards the development of a rich and dynamic regional green bond market.

Given the potential of green bonds to contribute to the transition towards sustainable energy markets, this paper aims to address the following questions:

1. How to ensure a good balance between allowing flexibility to enable the green bond market to grow and at the same time enforcing harmonized standards to prevent green washing?
2. Are there any best practices or recommendations that could help developing countries, in particular in the ASEAN region, to take advantage of the green bond market to address climate change challenges?

Methods

As a starting point, we conducted literature review aiming at collecting background information on green bonds, in order to understand their relevance as a financial instrument to raise low-cost capital for green projects in the ASEAN+3 region. Our literature review examined a diversity of documents, from various guidelines for green bonds (including the Green Bonds Principles, the Climate Bonds Standards, ASEAN Green Bond Standards, Japan's Green Bond Guidelines 2017), to reports from international financial institutions and organizations, including the WB, IFC, OECD, UNEP, and the ADB. We then proceeded on to stakeholder mapping in selected

¹ *Energy Investment for Global Growth*, International Energy Agency (IEA), 2016.

² *The Sustainable Infrastructure Imperative: Financing for Better Growth and Development*, New Climate Economy, 2016.

³ *Southeast Asia Energy Outlook 2017*, World Energy Outlook Special Report, International Energy Agency (IEA), 2017.

⁴ *Green Bonds Market Summary: Q3 2017 Update*, Climate Bonds Initiative (CBI), 2017.

ASEAN+3 countries (Thailand, the Philippines, Malaysia, Singapore, and Japan). Exploring national stakeholders' landscape led us to conduct in-depth analysis of national policy frameworks for green growth and, where relevant, the guidelines for green bonds. Based on stakeholder mapping, we successfully conducted 15 interviews with major stakeholders in the green bond market.

The ultimate goal of our project is to identify regional stakeholders that may be interested in engaging in green bonds activities but lack knowledge or capacity. We are focusing on the following four types of stakeholders:

- Issuers: We will identify 2 interested institutions in ASEAN developing capital market and 2 in the mature market to transfer knowledge on green bonds and offer tailored one-on-one structural advisory support for exemplary green bond issuances.
- Policy makers and regulators: We will support the adaptation and enhancement of a regulatory framework by advising on international standards while considering country-specific conditions.
- Investors: We will provide in-depth knowledge and tailored advice on the risks and opportunities offered by green bond as an asset class for investment.
- Domestic second opinion providers: We aim to enable domestic institutions to deliver second opinions based on international best practices to ensure environmental integrity.

Results

In 2017, the climate-aligned bonds universe reached the total value of USD 895 billion, with labelled green bonds accounting for only 25%⁵. The potential of growth of the green bond market is therefore tremendous. However, ensuring a good balance between flexibility and harmonized standards is the necessary pre-condition for the successful development of the green bond market.

Responsible investors are becoming increasingly aware of the environmental benefits of green bonds, specifically to address financial gaps in emerging economies. In response to rising demand for green investment opportunities, there is currently increasing issuance of green bonds from a diversity of stakeholders, with sovereign and sub sovereign entities expected to drive the growth of the market in the upcoming years. Accounting of different national capacities and circumstances, including debt capital market development as well as climate policies and targets, the development of the global green bond market is not homogeneous. While China is very active and released multiple sets of local and national guidelines for green bonds, most Southeast Asian countries haven't engaged in any green bond related activity yet. Consequently, enhanced flexibility is needed to answer different stakeholders' financial needs and adapt to distinct national contexts.

Greater flexibility and heterogeneity however may hinder the green credentials and thus the expected environmental benefits of green bonds. Specific issuance criteria have therefore to be met to avoid greenwashing. Among them, it appears that a specific project pipeline to channel proceeds from green bonds is of critical importance. Issuers with a dedicated project pipeline are not only able to ensure the greenness of the bond, they also avoid double counting of proceeds allocation and increase transparency and accountability, thus enhancing investors' trust in the green credentials of the issuers. The sustainability profile of the issuer also plays a crucial role to the extent that it provides investors with details on the issuer's environmental commitments. Given the need for harmonized standards to ensure comparability and allow the market to grow, issuers are highly encouraged to align their green bond framework to the most commonly used international guidelines such as the Green Bond Principles (GBPs). The GBPs outline clear recommendations on the use of proceeds. While stressing the importance of reporting and monitoring requirements to ensure disclosure and avoid greenwashing, these guidelines also encourage issuers to get external verifiers' review to assess the quality of their green bond framework.

Currently, there is a consensus among market actors on the need to develop harmonized guidelines for green bonds. However, stakeholders also recognize that flexibility is key to allow the market to grow without hindering its natural development by imposing strict standards. On the path towards zero emissions societies every country has a different starting point but since there is a common objective, every step in that direction should be appreciated. It is vital to support different approaches and modalities while encouraging the engagement of the widest number of actors in order to contribute to the growth of a voluntary and self-regulated green bond market.

Conclusions

ASEAN countries have now the opportunity to leapfrog from carbon-intensive development paradigms to greener and more resilient economies. Due to increasing demand and the urgency to ensure sustainable and affordable access to energy for everyone, energy markets play a key role in supporting the pathway towards zero emission societies. Green bonds, as an innovative financial tool to fund climate-smart projects, provide the traditional energy sector with the opportunity to shift their investments towards a greener portfolio. Ensuring enough flexibility while encouraging the development of green bond guidelines is therefore of vital importance for the development of an active market, allowing the energy industry to tap into the full potential of green bonds, thus enhancing the transformation of global energy markets targeting cleaner and more responsible investments.

⁵ *Bonds and Climate Change: The State of the Market 2017*, Climate Bonds Initiative (CBI), commissioned by HSBC, 2017.