Unleashing Sustainable Finance in Southeast Asia

WORLD BANK GROUP
Inclusive Growth & Sustainable Finance Hub in Malaysia

IFS INSTITUTE OF FINANCE AND SUSTAINABILITY
北京绿色金融与可持续发展研究院

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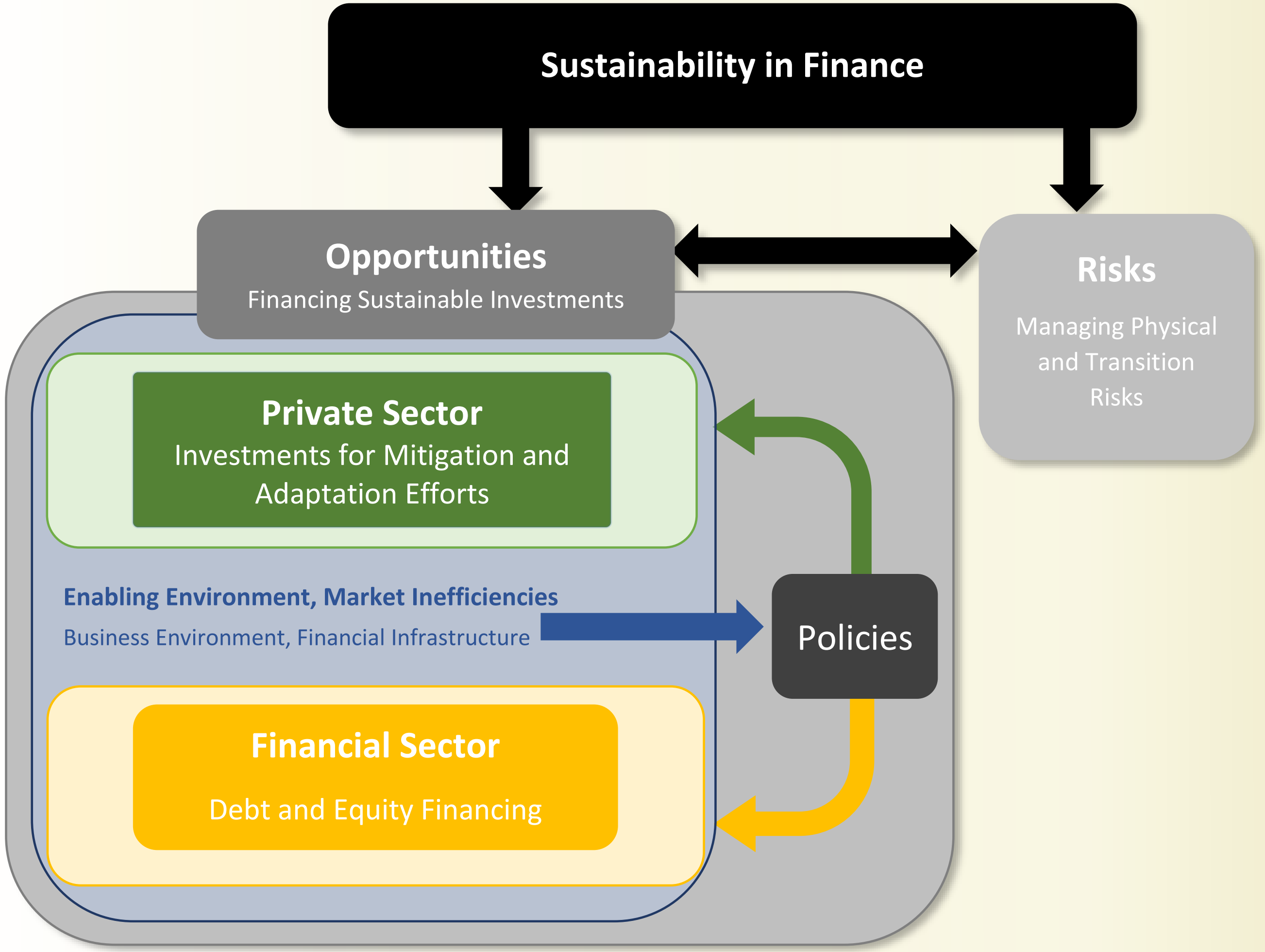
Financial Sector: Critical Role in Scale Up Financing

- Climate change mitigation and adaptation efforts urgently needed across Southeast Asia
- Large needed investments will require private capital, supported by public financing
- Financial sector: critical role supporting countries towards greater resilience and sustainability
- But it must adapt to do so effectively:
    - *Risks:* Build stronger resilience to physical and transition risks
    - *Opportunities:* Catalyze private capital and efficiently allocate to sustainable investments
- This report puts the spotlight on the *Opportunities*, focusing on the financial sector
    - Malaysia, Indonesia, Philippines, Thailand, and Vietnam (referred to as ASEAN-5)



Terminology

Definitions in used for sustainable finance markets

Sustainable Finance

Sustainable and Responsible Investment (SRI)

Green/Environmental Finance

Social Finance

Governance

Sustainability

Blue, Wildlife (Rhino)

Transition

Climate Change Adaptation & Mitigation

Biodiversity

Other Environmental

GHG Mitigation
“low-carbon”

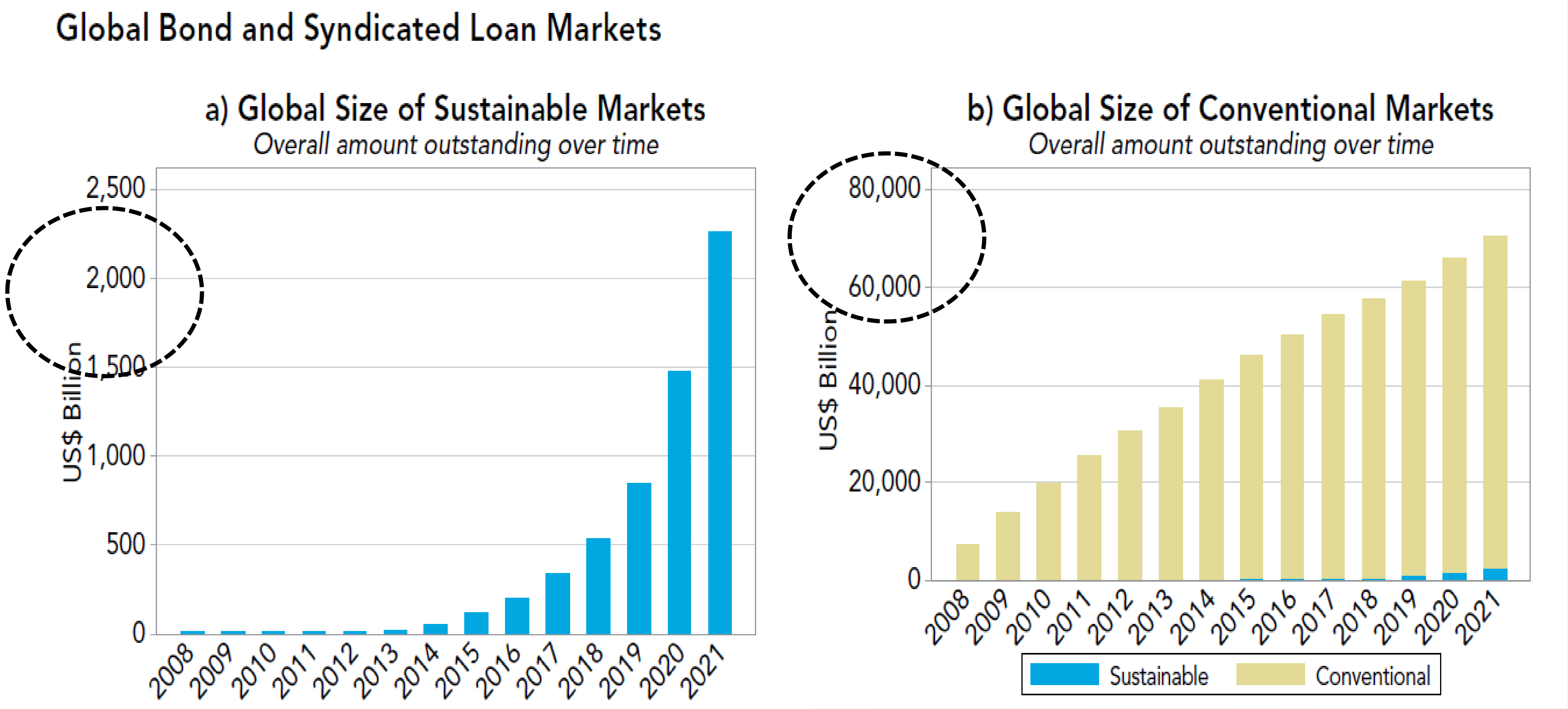
“Climate”

“Nature”

Use of Proceeds bonds
(*ex ante* commitment on the use of funds)

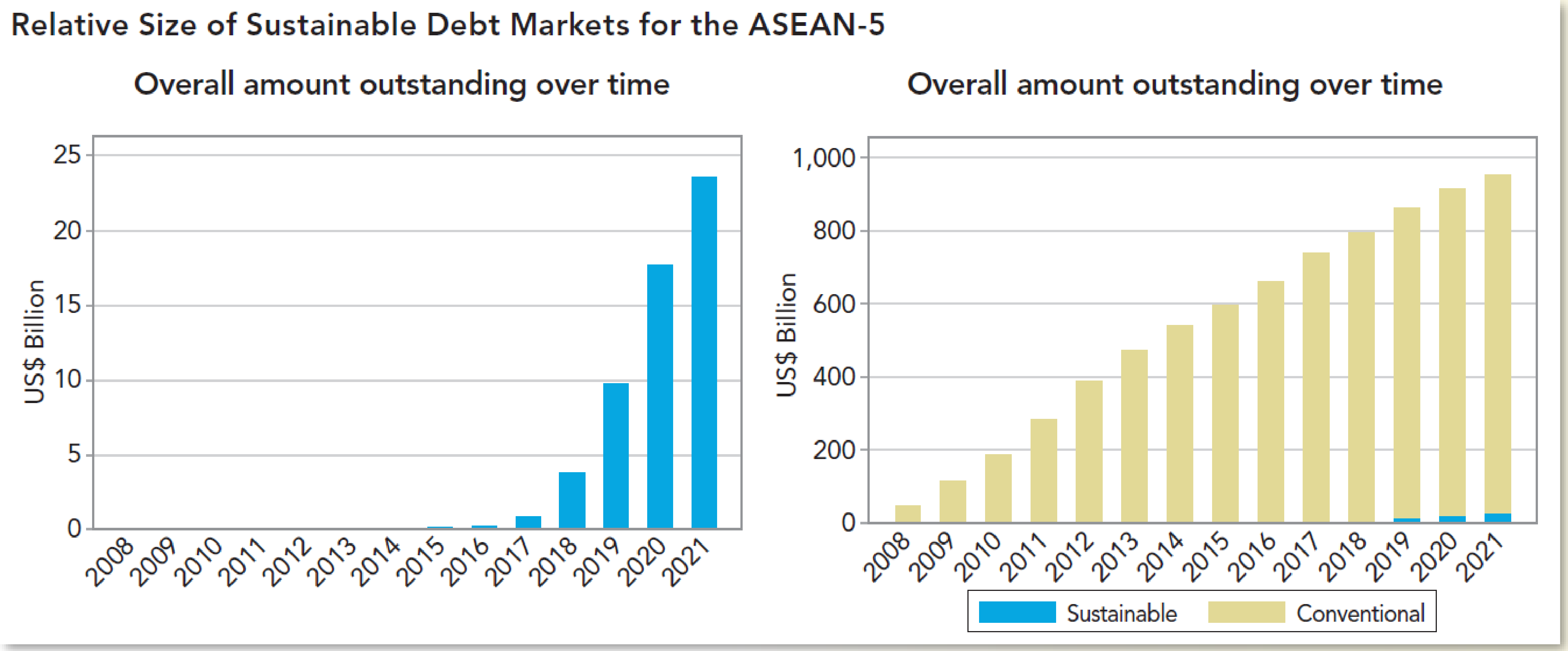
Performance-linked bonds
(*ex post* financial terms of the bond are linked to performance on pre-determined sustainability indicators)

Impressive Growth in Sustainable Finance, But Untapped Potential

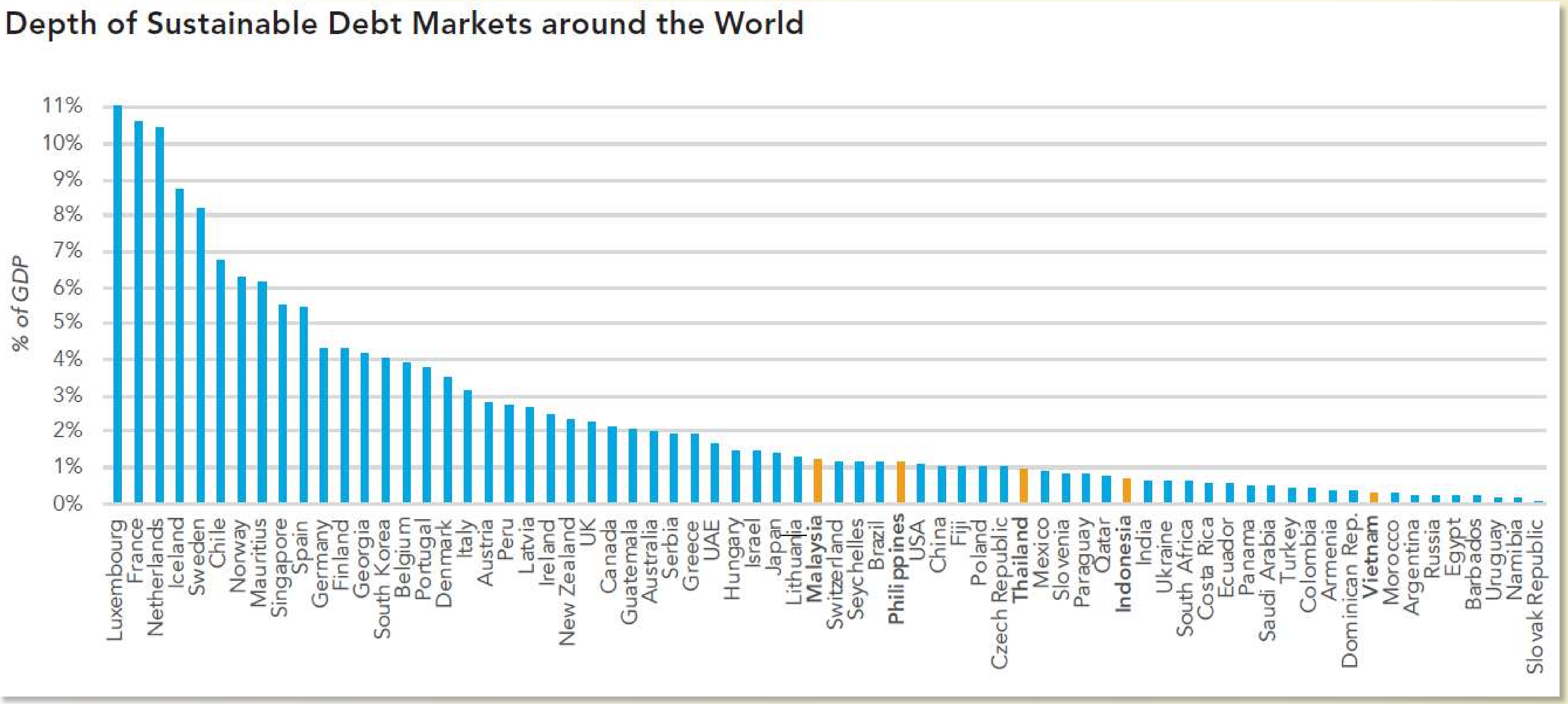


Impressive Growth in Sustainable Finance, But Untapped Potential

- Sustainable financial markets: impressive growth over the last 5 years
  - Sustainable debt markets: 2.5% of conventional debt markets (2021)
  - Private equity markets: investments in climate and clean technologies represent 5% of total PE/VC (2017-2021)
  - Malaysia is ranked 36th and Thailand 46th out of 76 economies with sustainable debt (2017-2021)



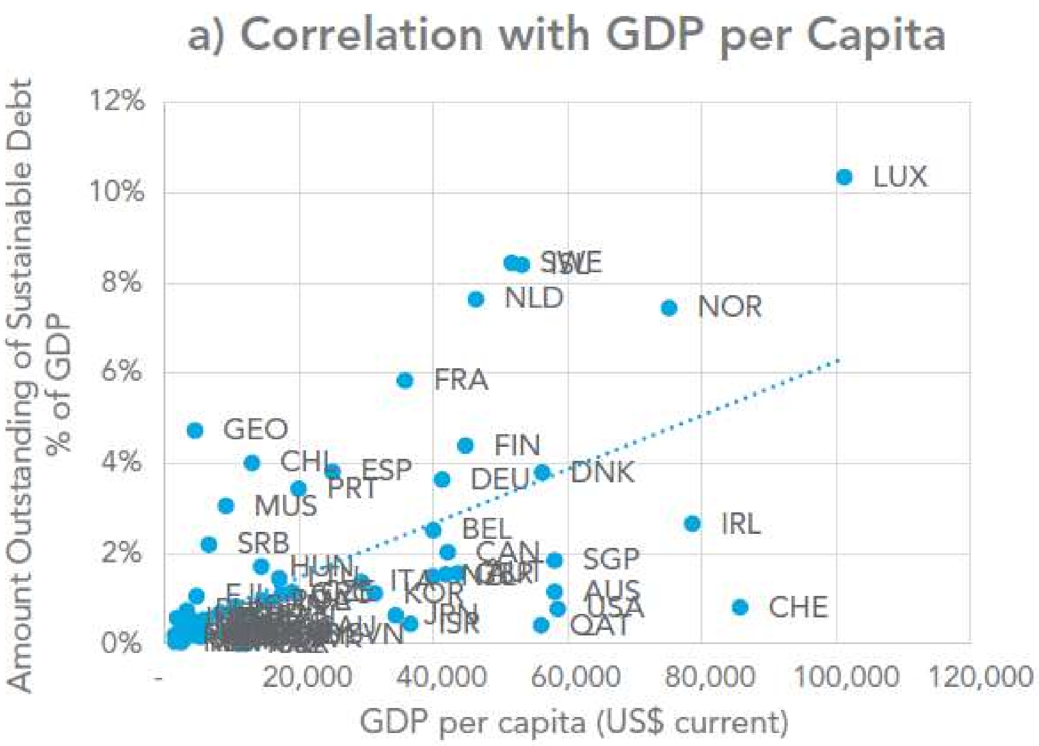
Large Untapped Potential for Sustainable Finance in the ASEAN-5

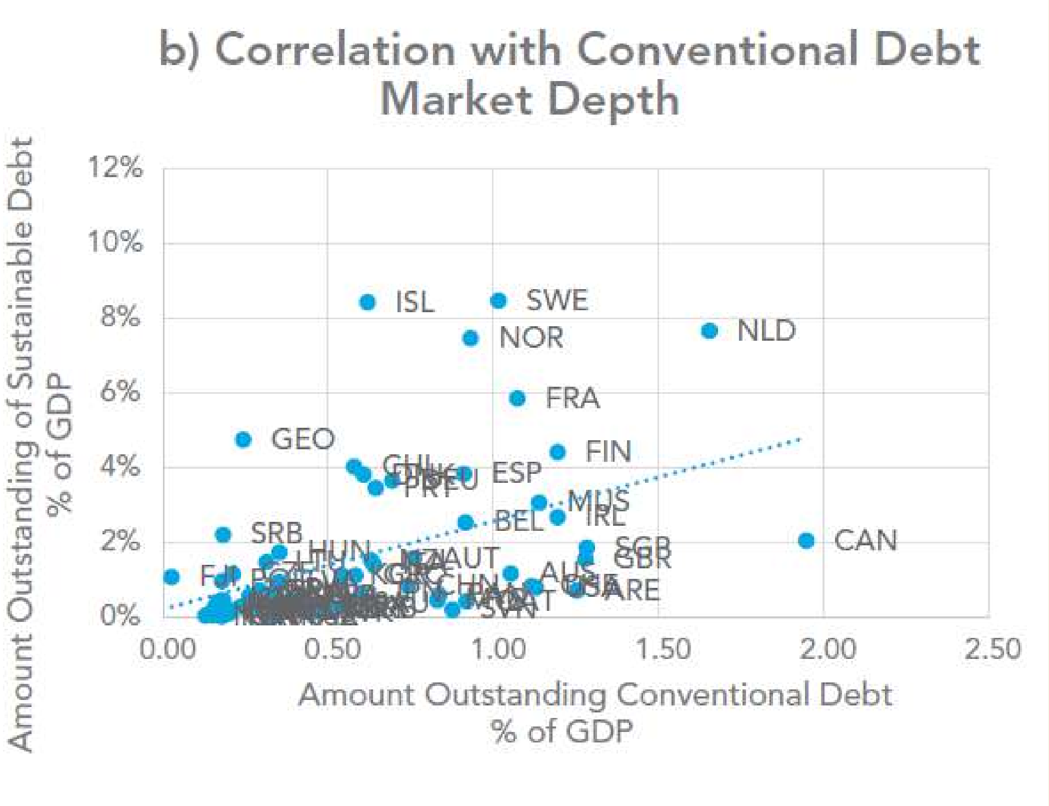


Impressive Growth in Sustainable Finance, But Untapped Potential

Across EMDEs:

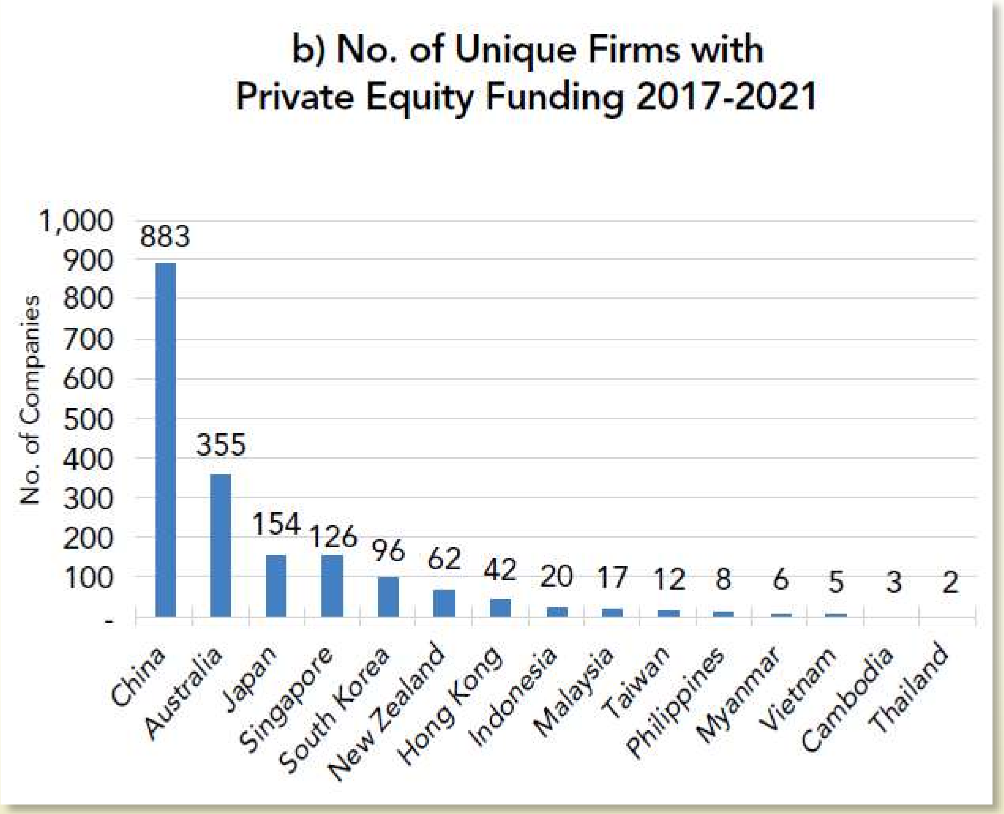
less developed countries and with shallower debt markets = lower sustainable debt issuances



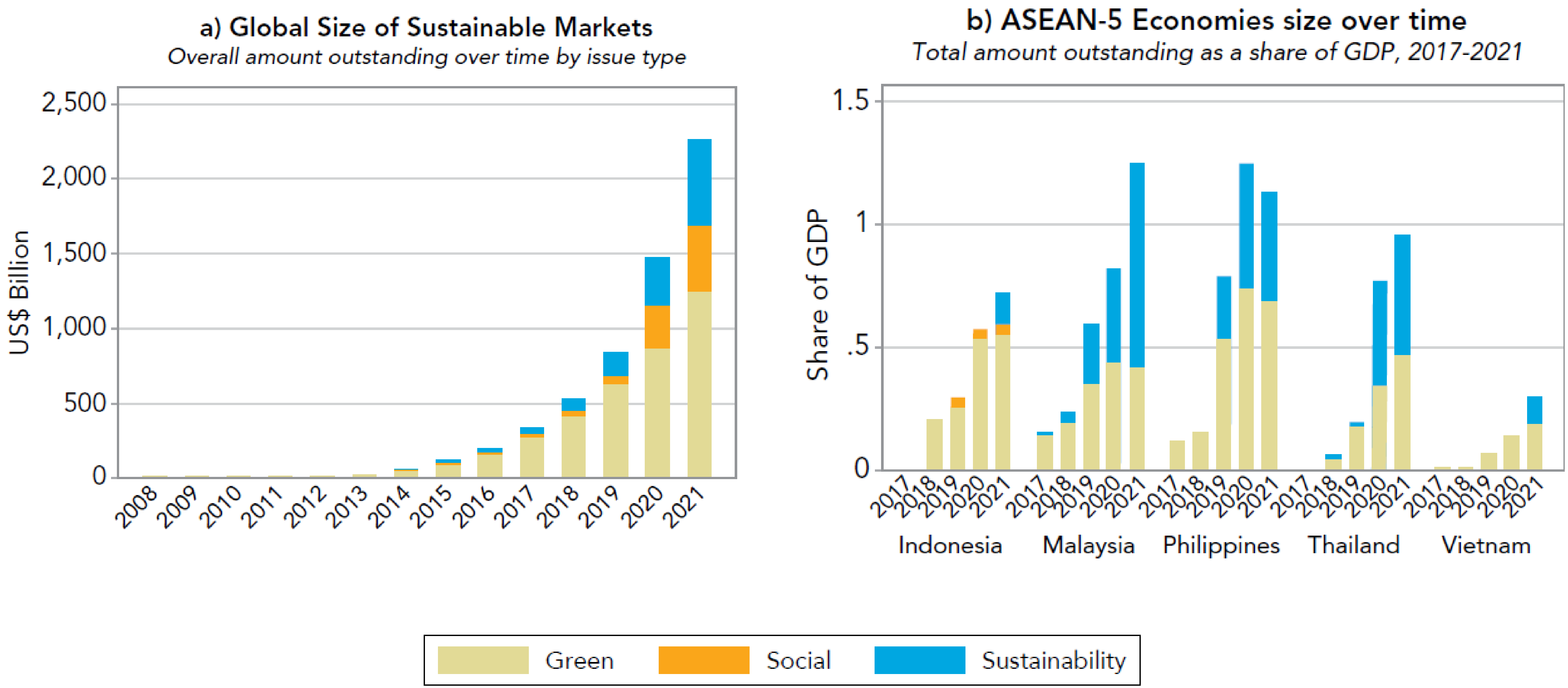


Sustainable Finance Has Limited Reach: Across Firms

- Few firms in the ASEAN-5 have raised capital in sustainable debt markets during 2017-2021
    - < 100 firms (excl. financial firms) in sustainable debt and equity markets (2017-2021)
    - Issuers are “medium firms” that typically do not have an investment grade rating
    - All issuances in Thailand were certified by a 3rd party
- Private equity markets: greater reach, but smaller volumes than debt markets
- Overall, sizeable gaps for SMEs



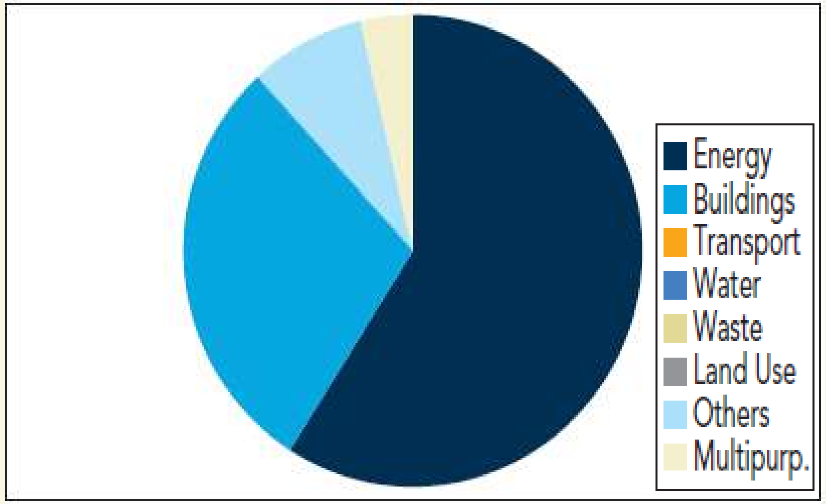
Sustainable Finance Has Limited Reach: Across Sectors



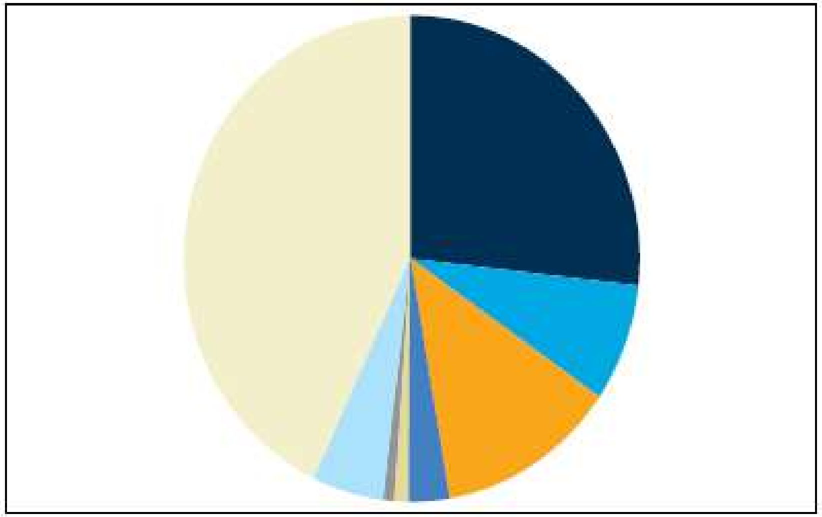
Sustainable Finance Has Limited Reach: Across Sectors

Composition of Green Debt Issuances across Sectors, 2017-2021

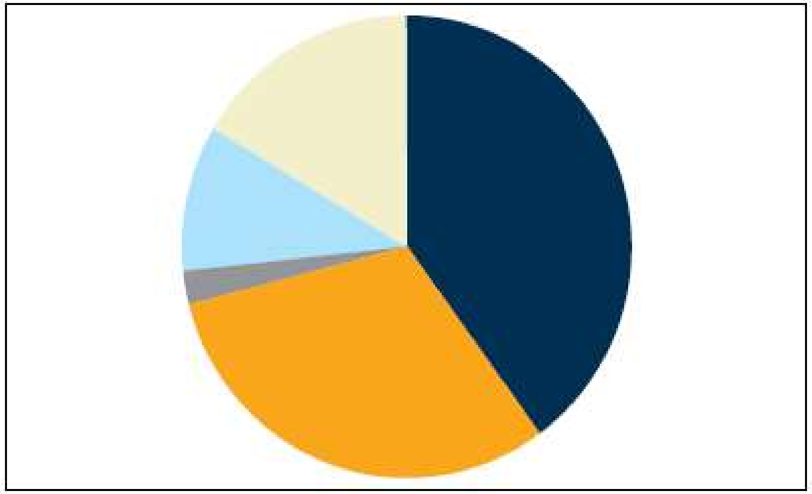
MALAYSIA



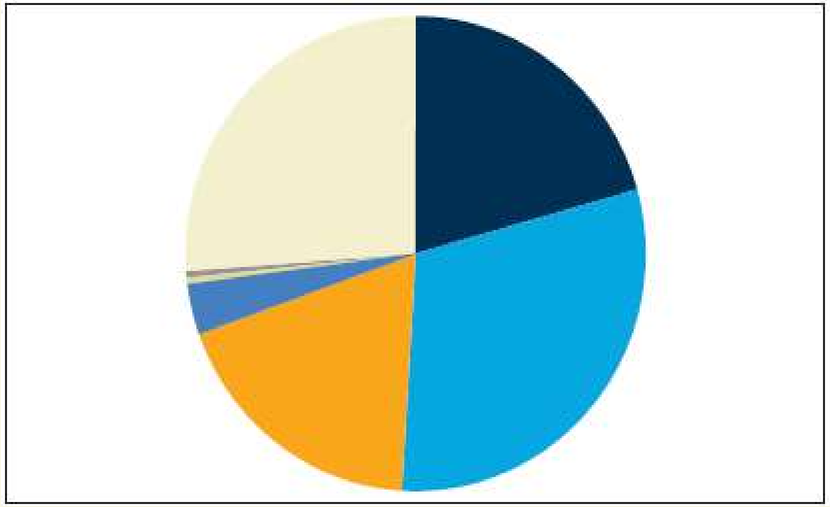
CHINA



THAILAND



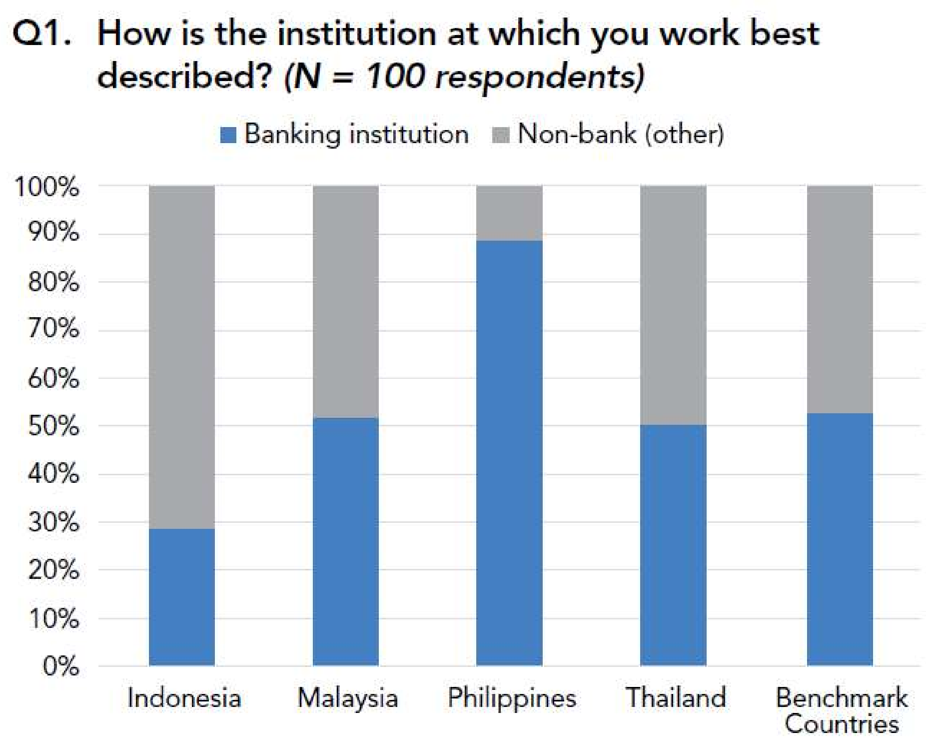
JAPAN

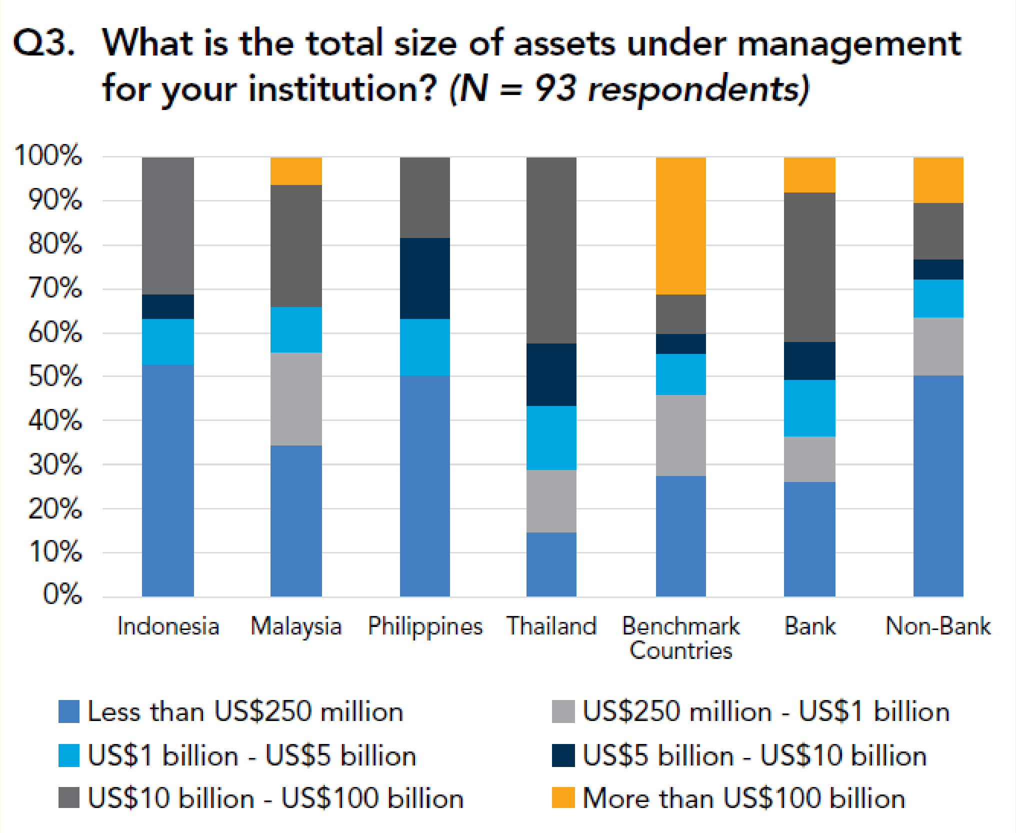


What is Holding Back Sustainable Finance in ASEAN Countries?

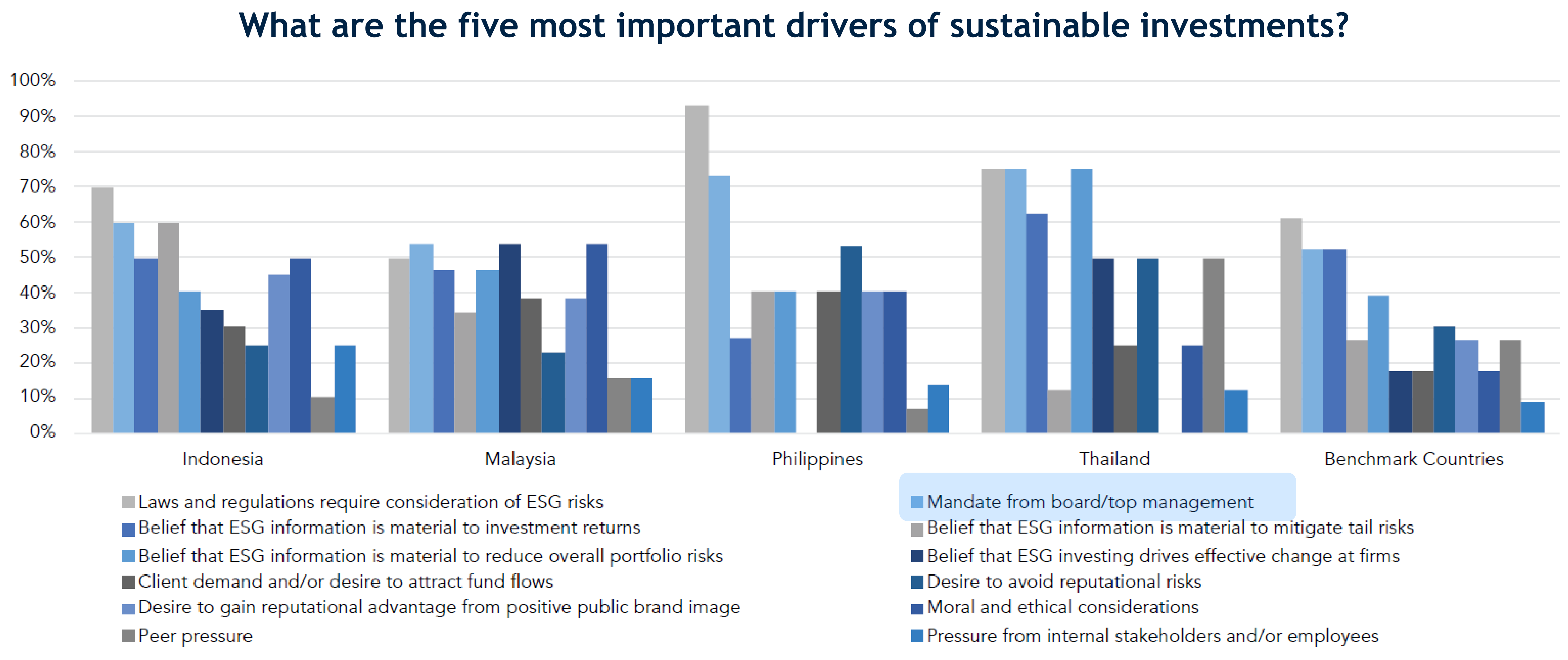
Financial Sector Perspectives on Sustainable Finance

- *Survey of 100 financial institutions in ASEAN-5 and frontier countries conducted in 2022*
- *Benchmark countries: EU, China, Australia, USA, Singapore*



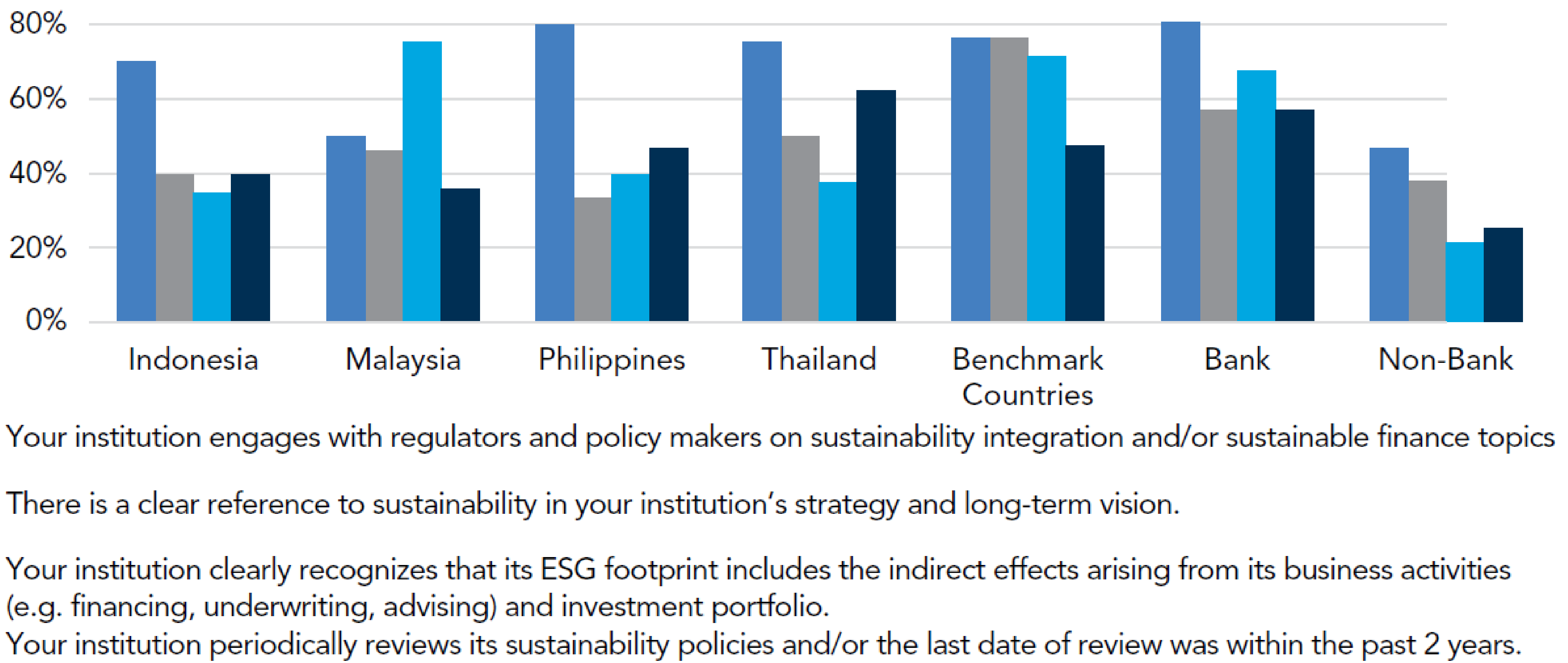


Incentives from the Top Matter



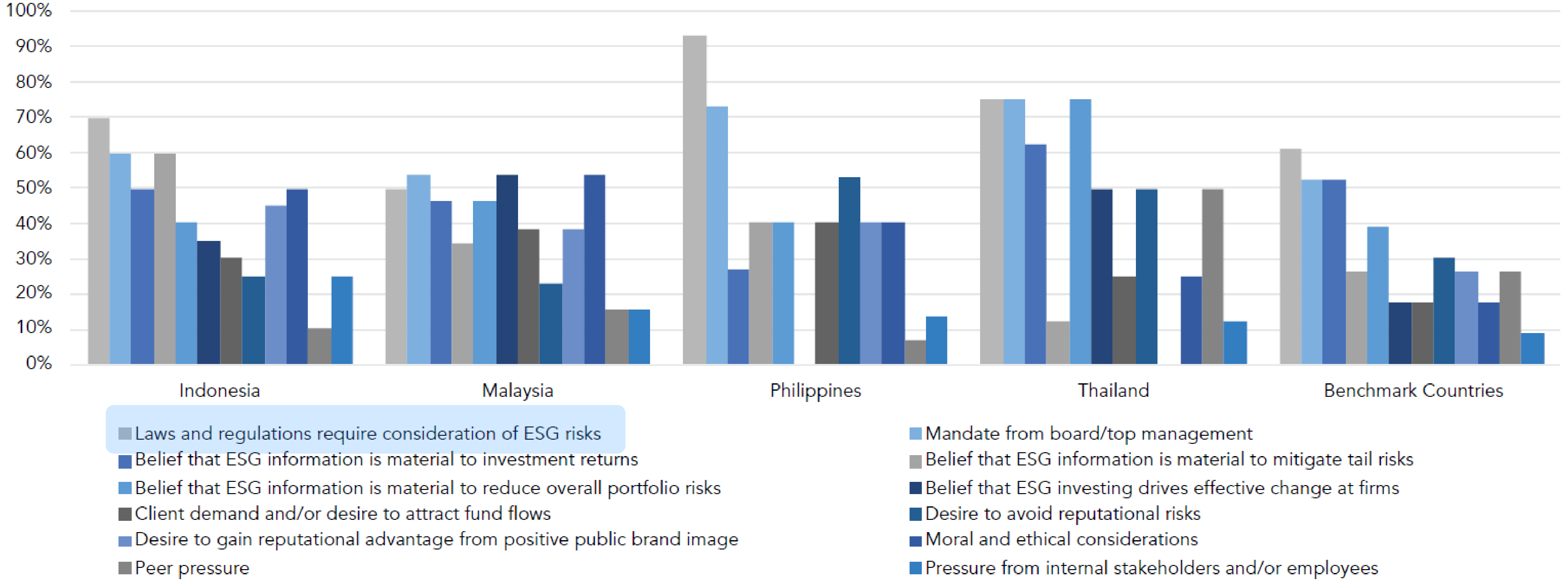
Lack of Incentives from the Top

Q8. Do you agree with the following statements regarding your institution's sustainable finance strategy and its engagement with others active in this space? *(N = 96 respondents)*

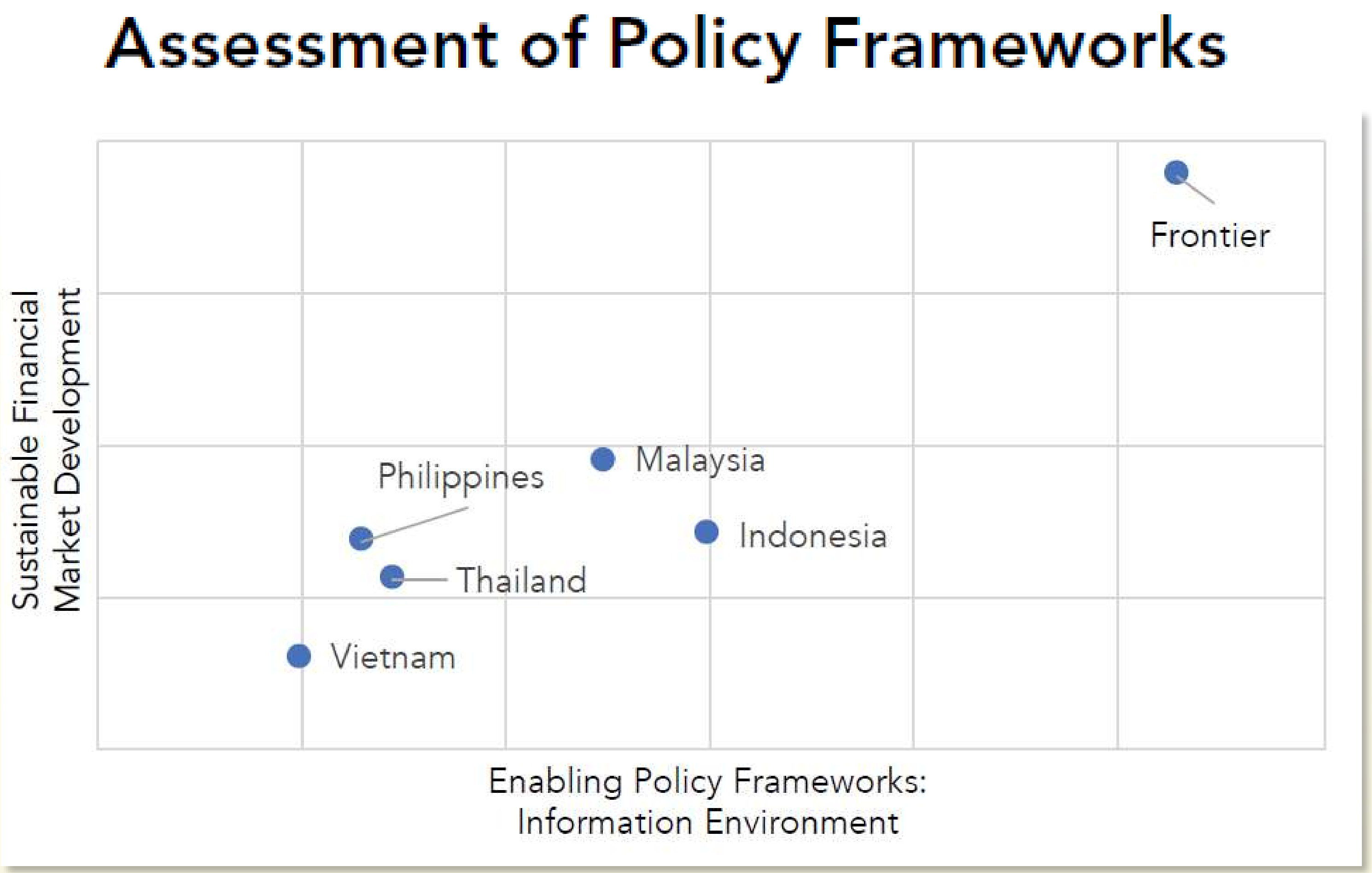


The Importance of Laws and Regulations

What are the five most important drivers of sustainable investments?



Regulations Matter, But Effective Implementation is Critical



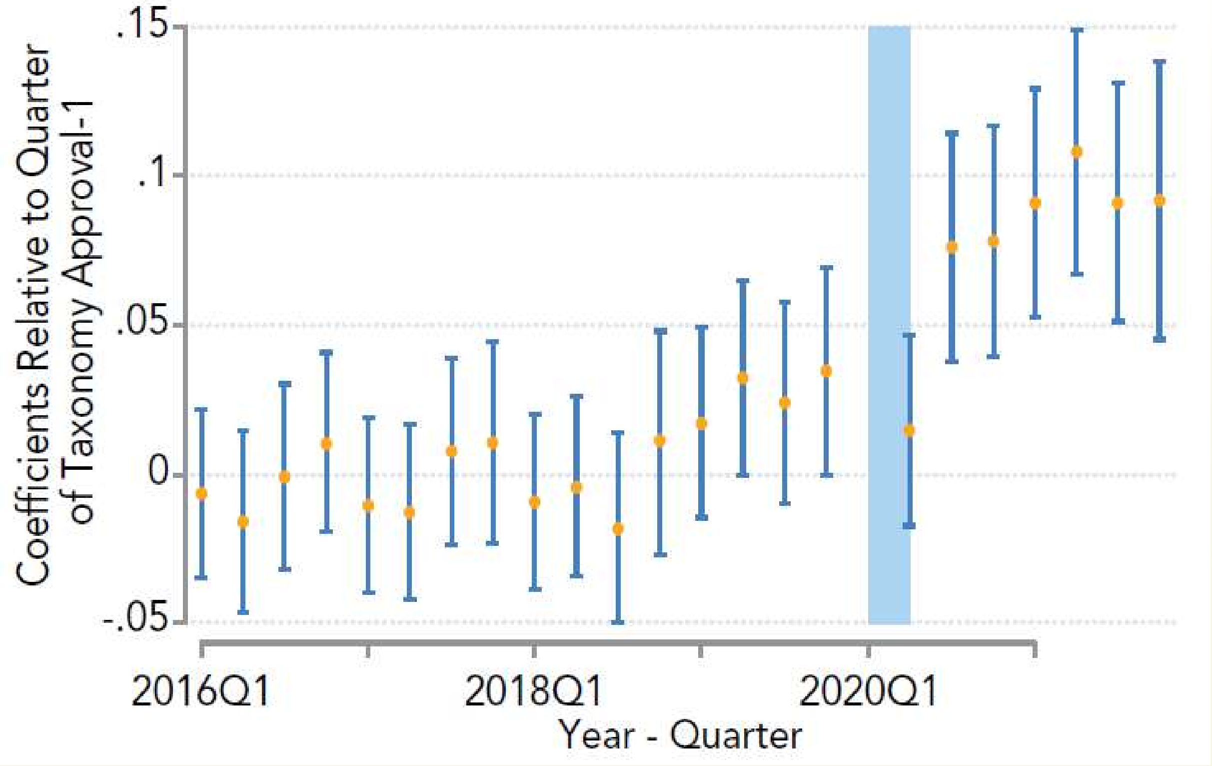
Frontier Countries: China, Japan, Republic of Korea, Singapore, and the EU

- **Quantitative Assessment of Enabling Policy Frameworks** focuses on best practices for scaling up sustainable finance, drawing from multiple national and international frameworks
  - G20 Sustainable Finance Working Group (SFWG) provided a set of high-level principles for scaling up sustainable finance
  - Network for Greening the Financial System (NGFS) published the Dashboard on scaling up green finance
- **Assessment is based on publicly available information**
  - 76 indicators across 6 pillars

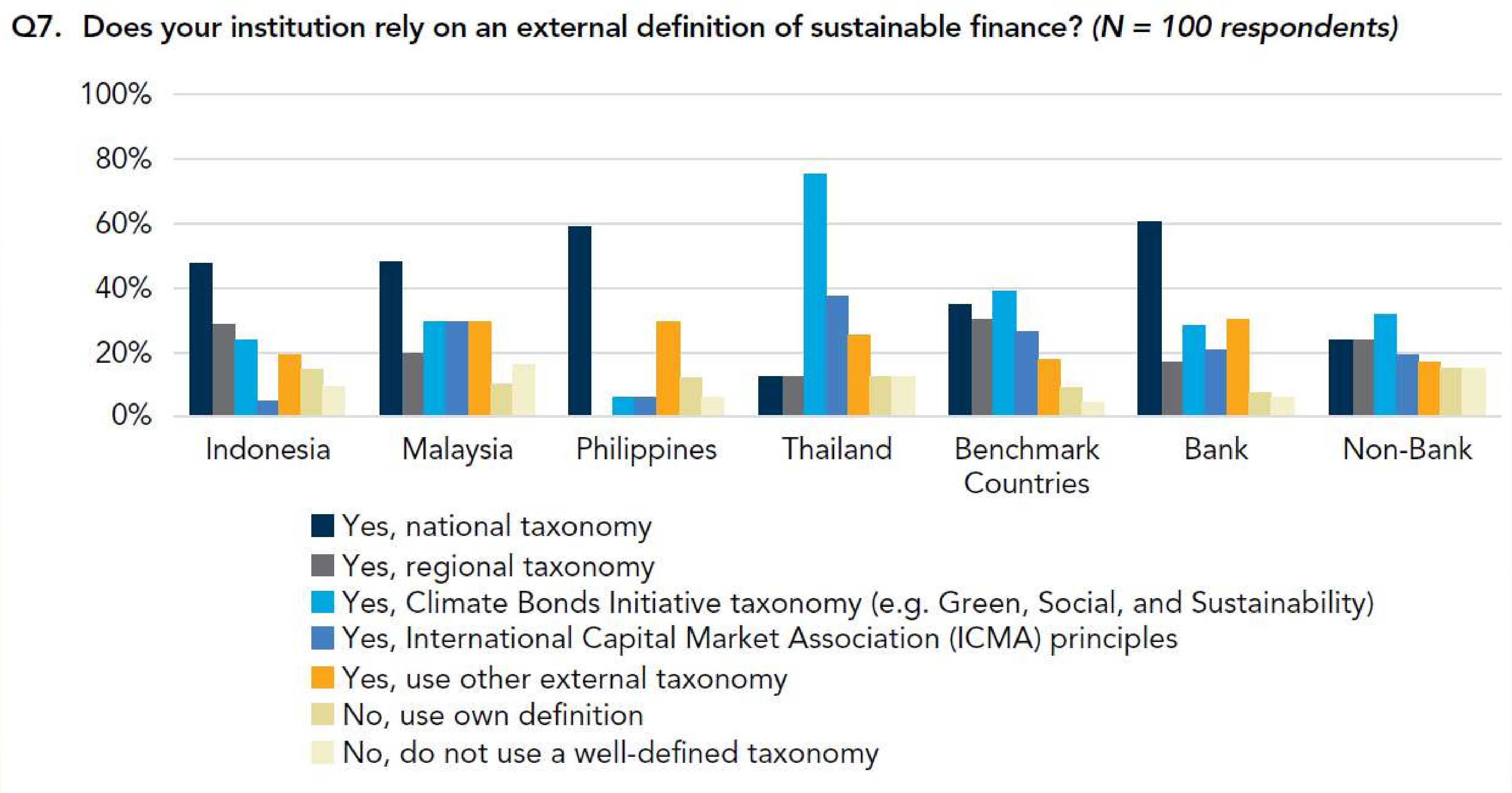
The Importance of Setting Standards through Taxonomies

- **A taxonomy offers a uniform, harmonized, and often centralized way of identifying sustainable activities**
- **Comparability, interoperability, and consistency in setting standards helps minimize transaction costs and risks such as greenwashing**
    - They also reduce fragmentation resulting from market-based initiatives
    - Taxonomies are tools to align investments with sustainability goals

Estimated Probability of Green to Conventional Debt Issuance



The Importance of Setting Standards



Implementation Challenges: Lessons Learned from the EU

The EU Taxonomy was one of the earliest implemented taxonomies and remain at the frontier. Some lessons learned:

- **The importance of a taxonomy being flexible and adaptable over time** so as to reflect on new insights on what is sustainable and what is not.
  - While the EU taxonomy in its first version was mainly focused on environmental sustainability and climate considerations, it could be broadened to include other sustainability criteria (e.g. social aspects).
- Not limiting the taxonomy to green or sustainable economic activities, but also laying out a framework for **unsustainable activities**
  - Better for the identification of potentially riskier assets
  - Incentivize transition activities
- A taxonomy should be detailed and granular enough to provide clarity
- A taxonomy can be **incorporated into regulations** in order to formalize the labeling for sustainable finance products and provide a basis for enforcement

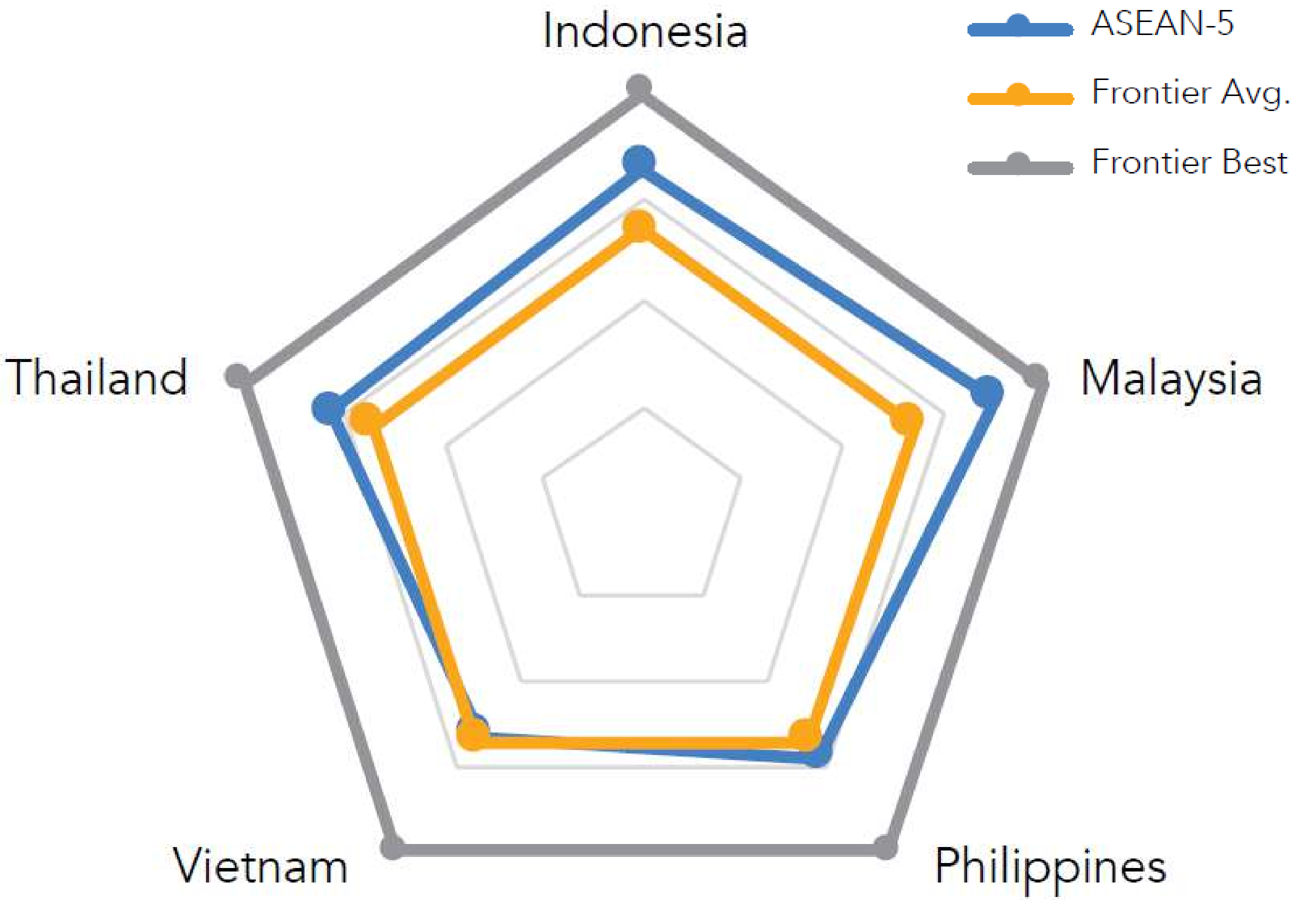
Improving Transparency with Disclosures Requirements

- Goal: improve market transparency and support the decision-making processes of financial market participants, the private sector, and policy makers
- Access to information is crucial to foster risk pricing, develop risk management practices, mitigate greenwashing risks, and monitor impact and outcomes

There have been clear efforts from regulators across all ASEAN-5 economies towards enhancing sustainability-related disclosure frameworks

- all ASEAN-5 economies have mandatory sustainability reporting requirements in place targeting listed companies

➢ While some of the essential building blocks for an effective informational environment to support sustainable finance are in place, many of these policies are at an early stage of implementation



Implementation Challenges: Disclosures Requirements

- <u>Indirect impact of disclosure requirements for FIs</u>: There are potential risks that these additional reporting requirements negatively impact financing to under-served segments such as SMEs, exactly because of their opacity

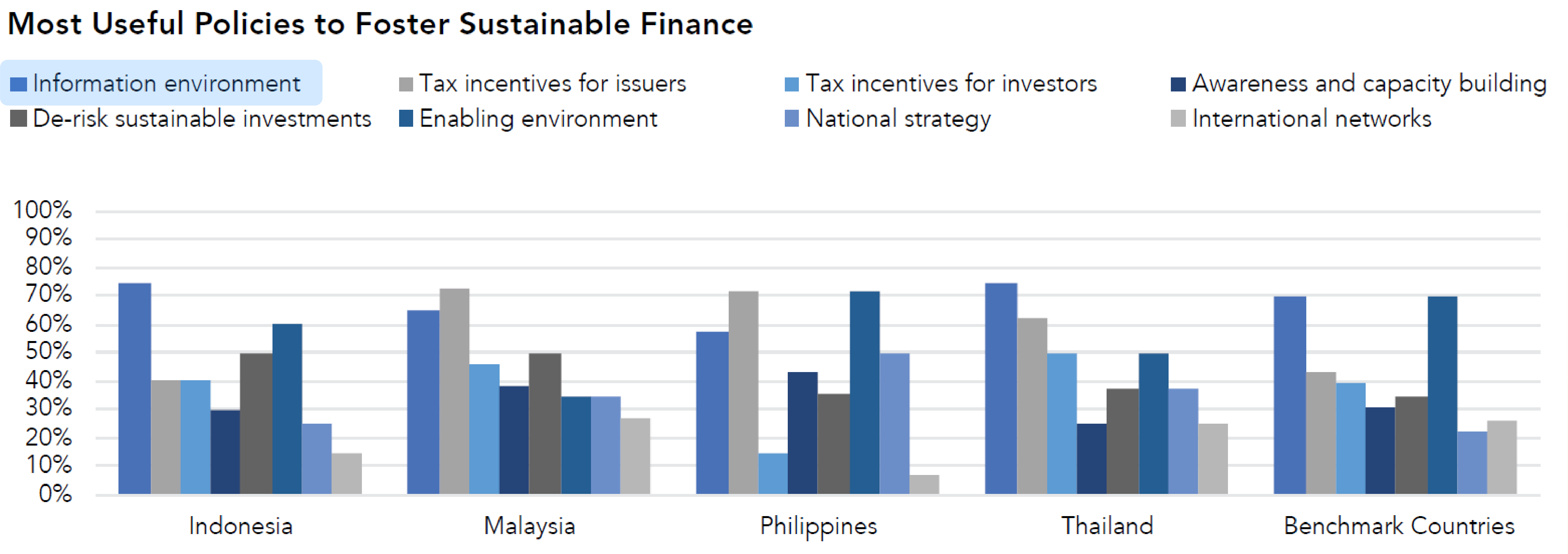
- To the extent that FIs would need to gather this information from their clients, they may retreat from financing firms where they are unable to adequately gather information and monitor climate-related risks for example

- For firms, especially SMEs, the need for the additional climate-related reporting would mean greater costs of compliance in order to obtain financing from regulated FIs

- These issues can be particularly challenging when firms' capabilities and financial literacy are already in need of strengthening

Close monitoring of the impact of "new" regulatory and supervisory frameworks on lending to under-served segments, such as SMEs

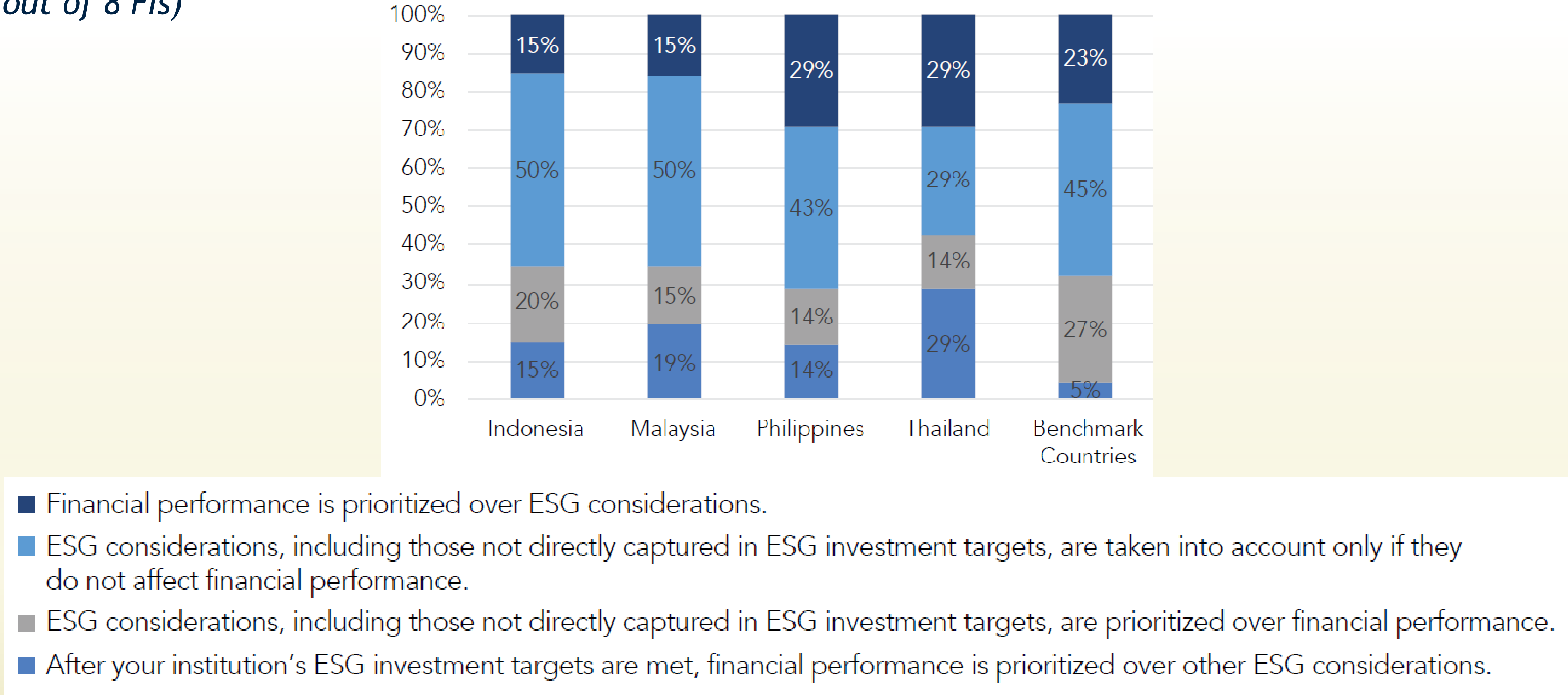
Market Perceptions of Key Areas for Policy Action



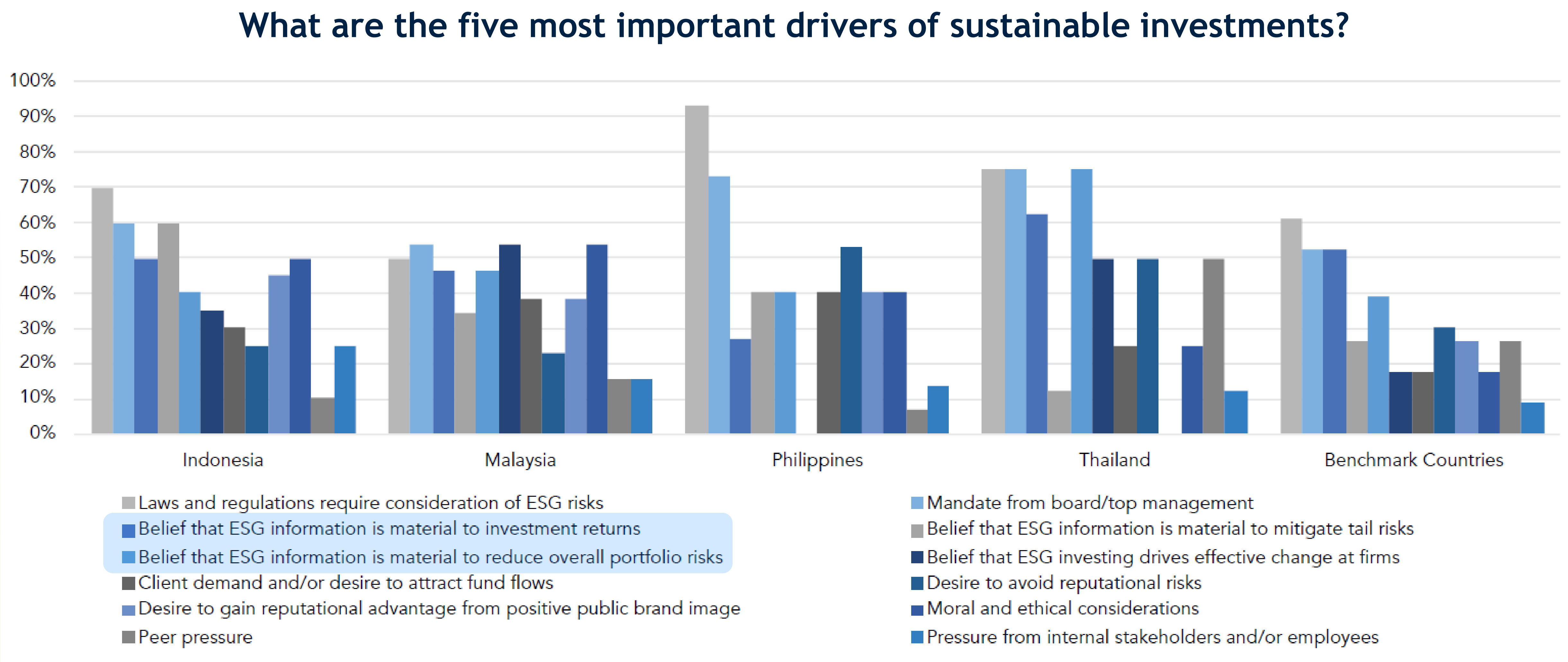
Financial performance often prioritized over sustainability

A majority of the surveyed FIs admitted to prioritizing financial returns over ESG considerations, although they did so to varying degrees

- **Thailand:** uncertainty about persistency of returns in sustainable investments, risk of stranded assets *(7 out of 8 FIs)*



ESG Information is Material to Financial Performance...



But There Are Gaps in Information and Capabilities

Capturing the financial benefits of sustainable investments is not straightforward

- ***Benefits** of mitigation and adaptation investments are often realized **as avoided damages or public goods, rather than direct revenue streams***
- ***Difficulties in accessing and using climate-related information exacerbate this challenge***

GAPS IN CLIMATE-RELATED INFORMATION

- *Data availability and complexity of climate-related information*
- *Lack of comparability across firms*
- *Data quality as reflected in a lack of reporting standards*
- *(Thailand) Lack of definition of sustainable assets*

LIMITED CAPABILITIES

- *Shortage of internal expertise*

➢ ***Increased uncertainty and heightened greenwashing risks***

➢ **Adoption of (*exclusionary*) screening approaches**

LIMITED INVESTMENT OPPORTUNITIES

- Arguably driven by limited pipeline of sustainability projects
- Lack of capabilities in the private sector could partly explain lack of projects

Policy Actions to Mobilize Private Capital to Sustainability

R

Readiness, e.g., by addressing the high riskiness of investments in sustainability

- De-risk investments; foster risk diversification

E

Enabling environment to broaden financial market development

- improving local financial market infrastructure

A

Analytics: Close data gaps and empower the various parties to use data effectively

- Effective implementation of taxonomies and disclosure standards

C

Capabilities: building capabilities and enhancing "sustainable finance literacy"

- Broad-based efforts: financial institutions, policy makers, and private sector

T

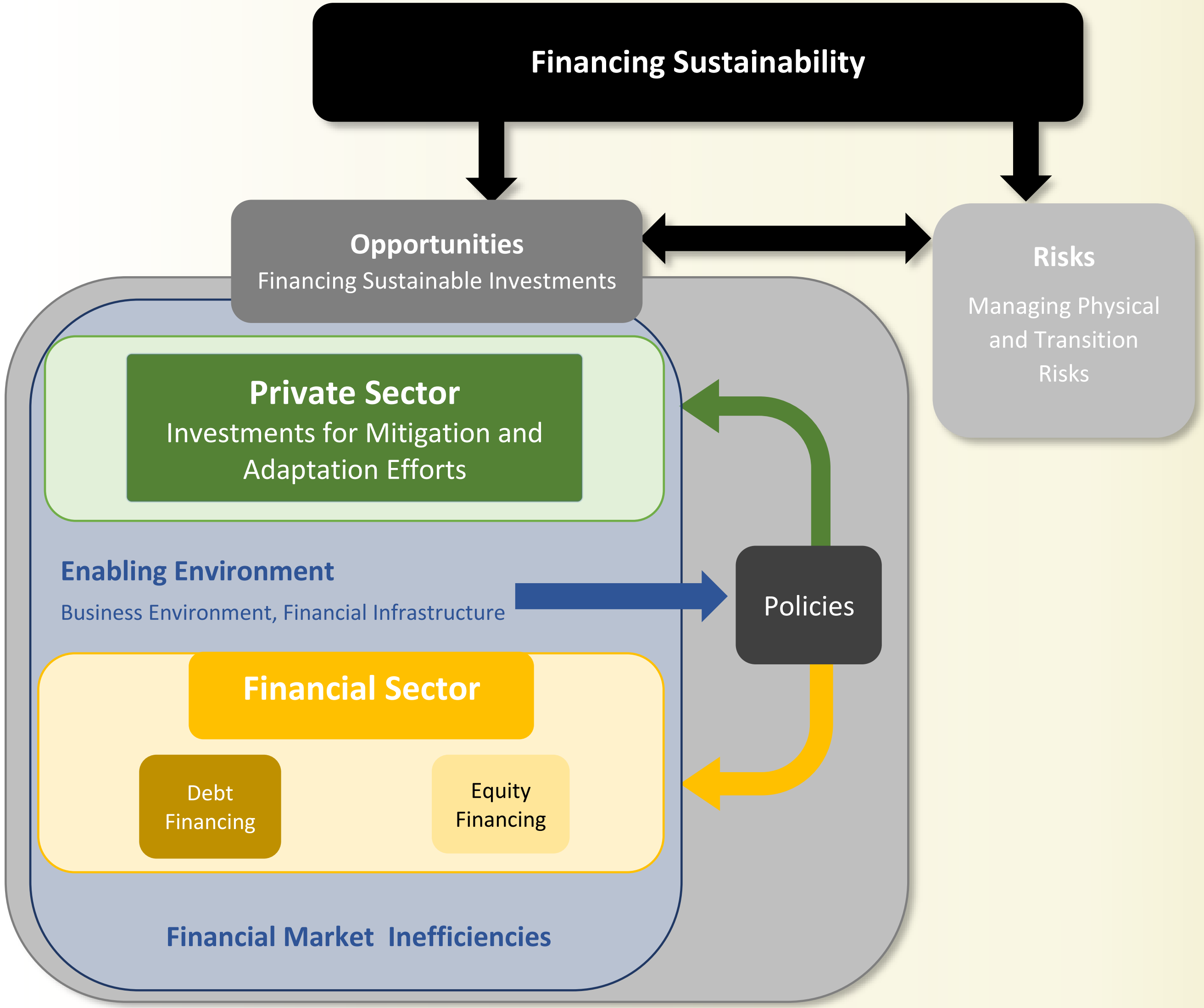
Transition: ensure a 'just transition'

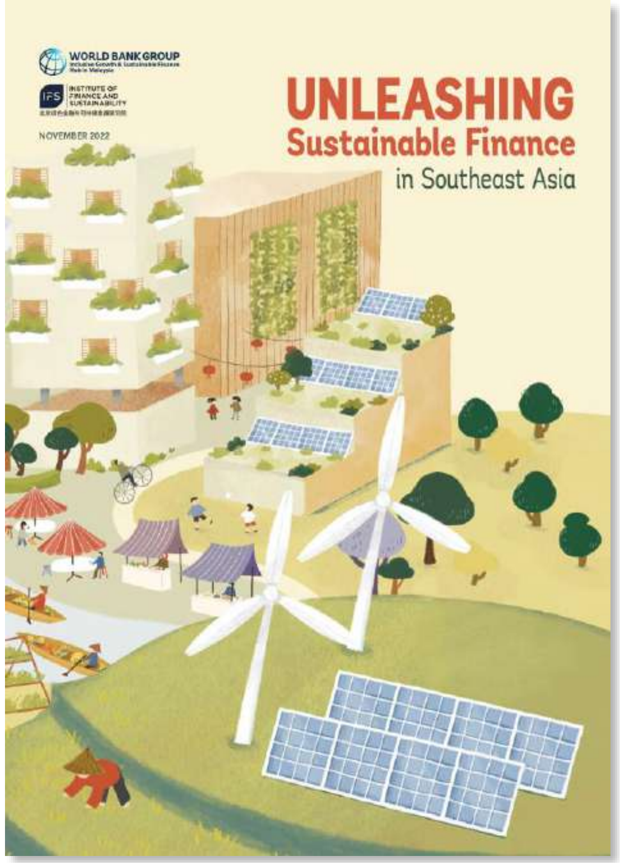
- Segments that may be negatively impacted by the transition toward greater sustainability
- Segments that face greater risks of exclusion from sustainable financial markets

Policy Actions to Mobilize Private Capital to Sustainability

HOLISTIC APPROACH TO POLICY AGENDA

- **SUSTAINABILITY FOR THE PRIVATE SECTOR** as part of complex policy landscape fostering sustainable investments for mitigation and adaption
- **RISK MANAGEMENT POLICIES** as they interact with those aimed at catalyzing private capital
- **POLICY COHERENCE** and coordination across the various policy makers





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