EGM on Public Debt and Sustainable Financing in Asia and the Pacific

Session 6: How can countries access more private sources of sustainable finance?

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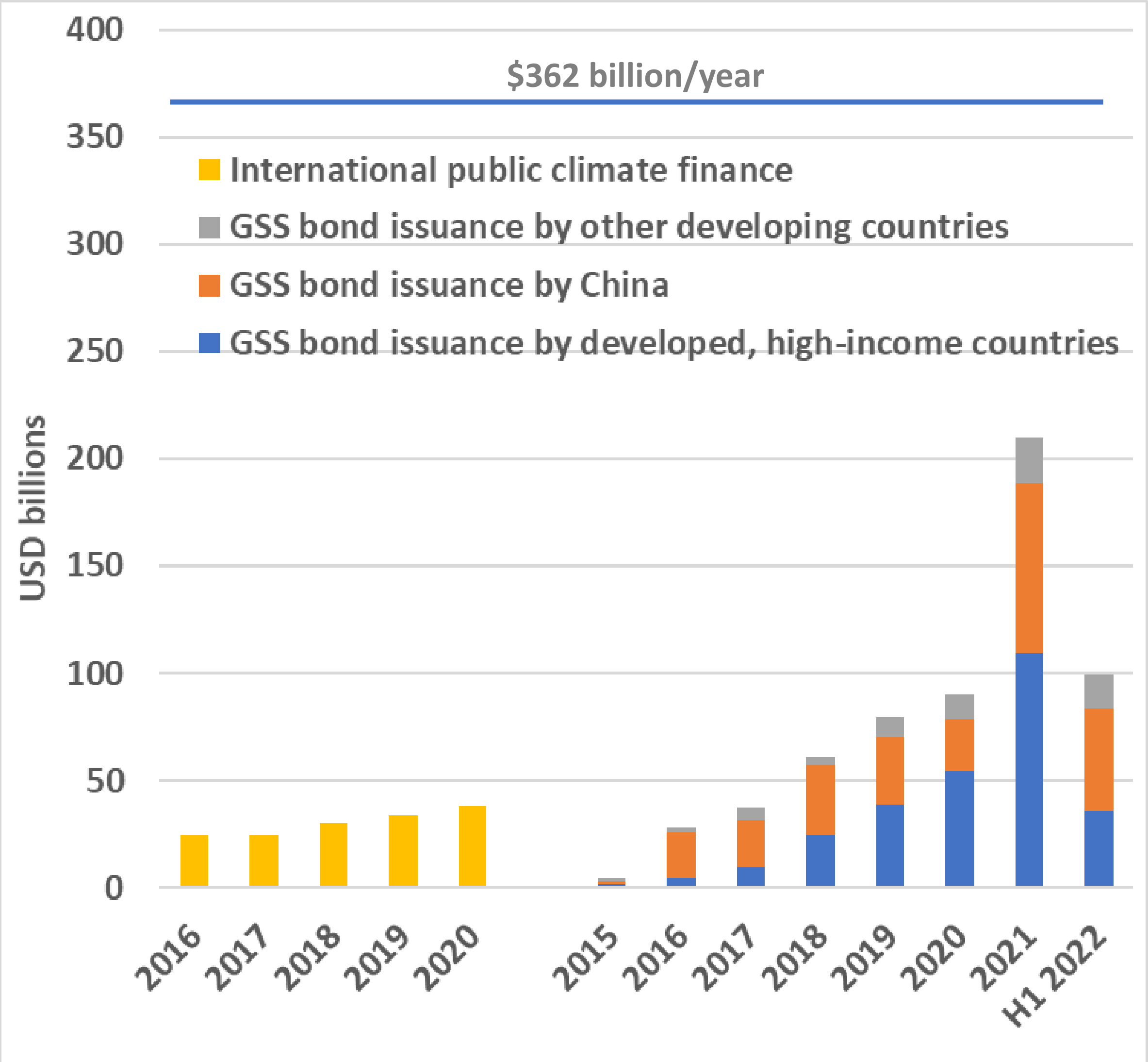
Asia and the Pacific Is Not on track to Meet Any of the 17 SDGs

- **SDG 13 (climate action):** Worse performance in 2022 than in 2015 in all subregions
- **Very low progress in SDGs 12** (Responsible consumption and production) **and 14** (Life below water)
- **Largest challenges in the Pacific subregion**: Regressed in SDGs 6 (Clean water and sanitation), 10 (Reduced inequalities), 11 (Sustainable cities and communities), and 16 (Peace, justice and strong institutions)
- **Better progress in SDGs 1** (No poverty), **3** (Good health and well-being), and **9** (Industry, innovation and infrastructure)
- **Top performers: East and North-East Asia and South-East Asia** – 7 of the 17 SDGs above 50 per cent of being on track

Current Financial Needs for Climate Action Exceed Available Resources

- Based on current NDCs the developing countries of Asia and the Pacific need **$362 billion per year for climate action.**
- But the ambition of these NDCs is insufficient to keep global warming below 1.5 to 2 C → **Significantly more financing likely to be needed**
- Yet, as of 2020 the region's developing countries received **only $38 billion from international official sources** (bilateral donors, MDBs, and climate funds)
- China and 9 other developing countries, mostly emerging market developing countries, **issued $101 billion in green, social and sustainability (GSS) bonds in 2021**
- Capital invested in **ESG Asia ex-Japan funds** amounted to $70 billion in Q4 2021; dropped to $50 billion in 2022



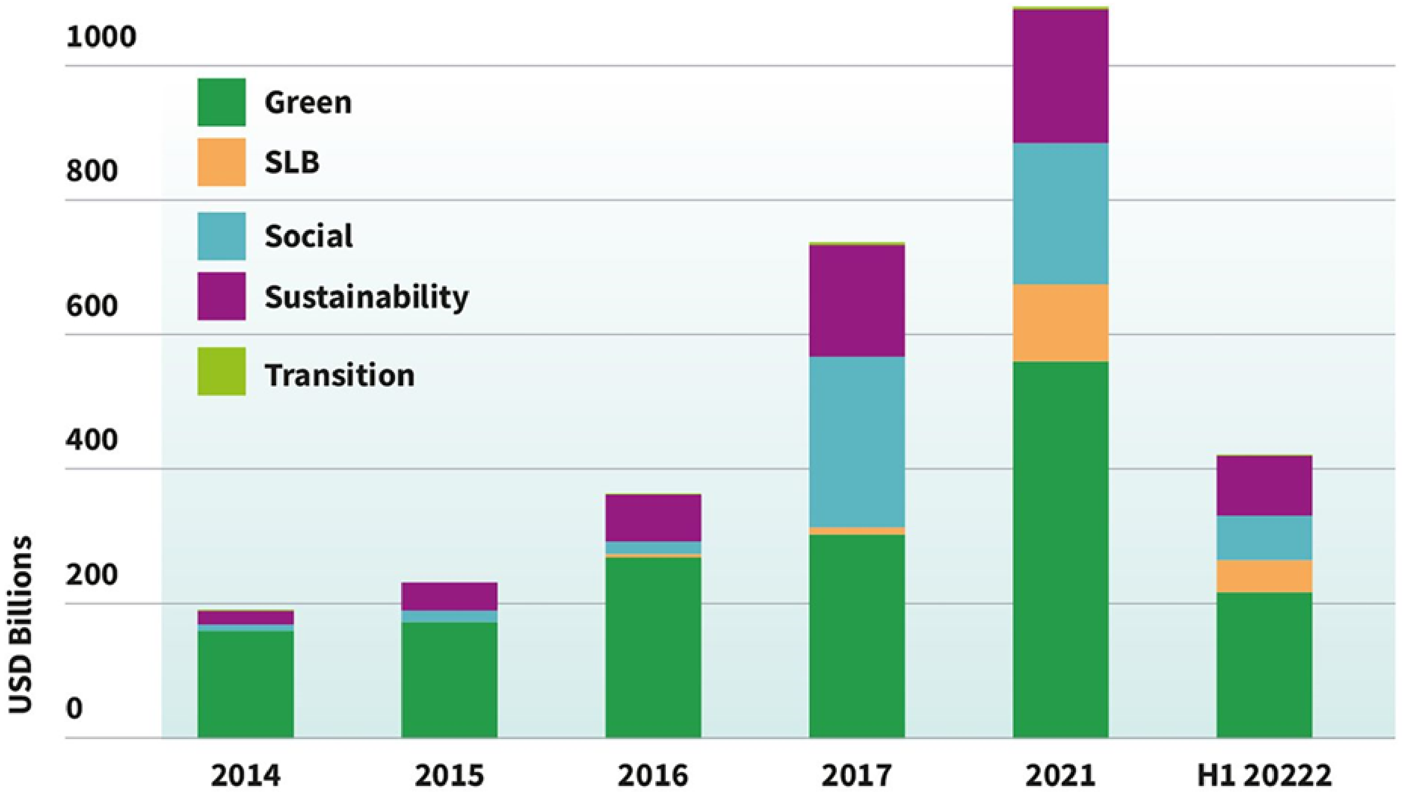
Need to Mobilize More Finance from Private Sources to Bridge the Gap

- **How much more? $362 is clearly insufficient – it is only for climate, and it is not enough to reduce GHG emissions to keep global warming under control**
- The recent report of the Independent High-Level Expert Group on Climate Finance issued in November 2022 estimates **additional financial needs increasing from 1.9 per cent of GDP in 2025 to 4.1 per cent in 2030** for a broader, transformative global investment package
    - For the developing countries in Asia-Pacific, this would amount to **$532 billion per year by 2025 and $1.2 trillion by 2030**
- But **how** countries in Asia and the Pacific, and in particular developing countries, can **scale up sustainable financing**?

- What **trends, challenges** and **opportunities** do governments, regulators and private stakeholders such as banks, issuers and investors face?
- What **should** these three groups of stakeholders **prioritize** to **scale up sustainable finance**?

Trend: The Global Rise of GSS Bonds (+ SLB and transition bonds)

- Global cumulative issuance of **$2.9 trillion by end June 2022** (BIS)
- **38 sovereigns** issued these bonds
- **Green bonds** dominated the market, followed by social bonds, sustainability bonds and sustainability-linked bonds
- GSS bonds = **use of proceeds**
- SLBs = **KPIs** or Sustainability Performance Targets (SPTs)
- Percentages of total issuances:
  - Sovereign 5%
  - Corporate 8%
  - IFIs 30%



Source: Climate Bonds Initiative

What Can Governments Do? Challenges and Opportunities

Challenges

- Constrained Fiscal Space
- Low Sovereign Credit Ratings and Local Currency Options
- Fungibility of Fiscal Revenues
- Lack of Investment Ready Projects
- Coordination Challenges to address Policy and Regulatory Gaps
- Large heterogeneity across countries

Opportunities

- **Sovereign issuance raises sustainable bond standards,** with potential positive impact on the number of corporate issuances (corporate issuance with second-party opinions)
- **Sustainability Linked Bonds (SLBs),** to allow direct GHG impact and support decarbonization efforts across diverse sectors of the economy
- **Carbon pricing policies,** including carbon taxes and cap-and-trade systems such as the EU Emissions Trading System (ETS)

What Can Regulators Do: Challenges and Opportunities

Challenges

Lack of robust ESG data required to effectively model ESG (particularly climate) risks

High cost of data compliance, which can result in reduced access to finance

Absence of environmental and social risk management (ESRM) guidance, especially for SIDS and LDCs

Opportunities

Developing national development finance institutions

- DFIs as "centers of excellence" in financing sustainable development

Focus on adaptation finance, particularly in LDCs and SIDS

- Link with financial inclusion and financial stability

What Can Banks, Issuers and Investors Do? Challenges and Opportunities

Challenges

Failure to self-organize (“regulator-led” attitude)

Lack of **uniform climate risk modelling**

Borrowers lacking risk appetite for innovative sustainable business and operating models

Difficulties in implementing ESRM due to perception of heavy regulatory costs

Lack of harmonized green taxonomies and disclosure standards

Low risk appetite of MDBs and bilateral DFIs to provide innovative solutions for SF

Opportunities

Developing sustainable loans

Prospects for Sustainability-linked Loans

Building Sustainable Industry Standards

Embedding Sustainability in the Credit Process

Carbon Offset Markets in LDCs and SIDS

- Aim to enable companies and governments to meet their emission reduction targets by purchasing carbon offsets
- Allow to measure reductions in GHGs based on certified standards
- Strong potential in SIDS and LDCs (focus on nature-based solutions and climate mitigation)

Questions for discussion

The lack of pipelines of bankable projects in developing countries is often highlighted as an important constraint for private investors. What is your experience in this regard? What do you think are the main constraints for countries to improve their project pipelines? What differences there are across countries of different levels of economic and financial development? What solutions could be considered and what roles can various stakeholders – including governments, international organizations, bilateral donors and the private sector – play to implement such solutions?

Questions for discussion

The GSS bond market has increased in volume in recent years and both sovereigns and corporates in developing countries started to tap into this new source of financing. More recently, sustainability-linked bonds (SLB) started to increase in popularity. As financiers and market participants, what is your view on the potential of these markets to significantly scale up sustainable finance in developing countries? What key actions do developing countries that have not issued GSS bonds or SLBs need to undertake to access such markets?

Questions for discussion

In Asia and the Pacific, issuance of GSS bonds has been concentrated in developed and high-income countries and China, but several developing countries such as India, Indonesia, Malaysia, Thailand, and the Philippines have also issued such bonds recently. A common characteristic of these countries is that they have **relatively developed local currency (LCY) bond markets and investment grade credit ratings**. How constraining as these factors for developing countries that do not have developed LCY bond markets and investment grade credit ratings, and what steps can these countries consider to improve their prospects to tap into these new markets?

Questions for discussion

Another segment of the sustainable finance market is ESG funds. According to Morningstar, the total assets invested in sustainable funds in Asia ex-Japan reached $70 billion in Q4 2021, before falling to $50 billion in Q1-Q3 2022. A problematic aspect of this market segment is that the funds in this category are selected on the basis of claims in their prospectuses that the companies included use ESG factors as a central focus of their investment process, which are hard to verify. What prospects to you see for bringing more transparency to this market segment?

Questions for discussion

Coalitions of financial institutions such as GFANZ are playing an important role is supporting global efforts on climate mitigation. How efforts by GFANZ, the UN and the IFIs can be most effectively synergized with the specific aim of supporting the less developed developing countries in accessing sustainable finance, including least developed countries (LDC) and small island developing States (SIDS)?

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