

Sustainable finance

How will COVID-19 reshape key Australian industries?



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How 2020 changed sustainable finance

The outbreak of a global pandemic and its widespread economic impact has driven a shift in emphasis for sustainability-related assets in the Asia Pacific.

COVID-19 has turned issuers' attention towards the social component of ESG – in particular pandemic relief and recovery – with less concentration on the climate compared to previous years.

The rapid shift reveals both the agility of the sustainable finance sector and the increasingly important role it plays in economic resilience—the latter was a clear theme that came through late last year when Westpac initially commissioned the EIU to explore the state of the Asia-Pacific market for our report, *Financing sustainability: Asia Pacific embraces the ESG challenge*, published in February 2020.

Back then, the outlook was decidedly positive with a strong leaning to green bonds.

Despite a tumultuous year, the future for sustainable finance continues to look strong as our latest research—a survey of CEOs across the Asia Pacific by the EIU—indicates.

In a matter of months, business leaders across the region report they have increased their focus on ESG due to the pandemic and they intend to increase issuance of sustainable instruments in the future, a move that will be welcomed by a market eager for more investment opportunities.

In this article, *Resilience amid crisis: Sustainable Finance in the Asia-Pacific*, we draw on some of our recent survey findings, explore the changing attitudes and strategies for sustainable investment through the insights of major stakeholders, and highlight the necessary areas for this fast-evolving sector to address in order to promote future growth.

Westpac has a strong track record of helping organisations transition to a more sustainable future. Should you require further insights or information, please don't hesitate to be in touch.



Resilience amid crisis: Sustainable finance in Asia-Pacific

Awareness that sustainability means more than reducing carbon emissions is mounting in Asia-Pacific. Evidence to the fact shows in the response of the region's sustainablefinance market to the global pandemic.

In late 2019, the market was bullish. Asia's sustainability-related assets under management looked set to grow appreciably, and most investors saw those holdings performing better than traditional equivalents.¹

Then covid-19 struck.

The crisis might have been expected to stop the market's growth in its tracks. Volumes have indeed decreased this year, but a shifting of issuances toward sustainability areas in dire need of attention—pandemic relief and recovery points to a market capable of adapting quickly to unexpected shocks.

To assess covid-19's impact on sustainable finance in Asia-Pacific, we consulted representatives from key stakeholders —an issuer, an industry association and a large investor. Their consensus for longerterm development is positive, but they underscore the need to address two current inhibitors in the market: a continuing shortage of supply from issuers, and insufficient clarity around definitions and reporting.

Moving beyond green

Prior to 2020, green bonds accounted for the lion's share of sustainable financing issuances in Asia-Pacific. By mid-2020 that picture had changed considerably, mirroring a trend visible in Europe and other markets—a stark decline in green bond issuance combined with accelerated growth in social bonds.² Matthew Kuchtvak, assistant vice president, ESG & Sustainable Finance at Moody's Investors Service, attributes the decline in green bonds largely to reduced Chinese issuance. The pandemic-driven growth of social bonds, meanwhile, boosted that category's share of green, social and sustainability (GSS) bond issues from 7% in the full year of 2019 to 31% in the first half of 2020, according to Moody's data.³

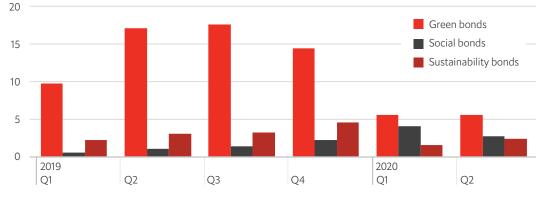


Figure 1: Markedly altered market in 2020 Issuance of green, social and sustainability bonds in Asia-Pacific, 2019 and 2020 (US\$ bn)

Source: Moody's Investors Service

1 These were among the findings of a report written by The Economist Intelligence Unit, *Financing sustainability: Asia Pacific embraces the ESG challenge*, published in February 2020. https://www.westpac.com.au/corporate-banking/westpaciq/financing-sustainability-report/

2 Green bonds are used to finance or refinance projects or assets having environmental objectives, in areas such as clean energy and low-emission transport. Social bonds fund projects having social objectives, related for example to health, education or employment. Sustainability bonds target projects that combine social and environmental objectives. See *Financing sustainability*, page 8, for descriptions of the different types of sustainable finance instruments.

3 Data provided to The EIU by Moody's Investors Service on September 18th 2020.



Sovereign funds, multilateral institutions and banks have taken the lead in raising funds through social and sustainability bonds (the latter encompass both social and environmental objectives), primarily in response to the pandemic. Notable examples include the Indonesian government's US\$4.3bn "pandemic bond"⁴ and a US\$500m sustainability bond from South Korea's Kookmin Bank, both issued in April 2020.⁵ In June 2020 a Singaporeheadquartered food and agri-business company, Olam International, launched a US\$250m sustainability-linked loan tied to the achievement of several social and environmental key performance indicators, its third sustainability-linked facility in two years.⁶ N Muthukumar, the company's managing director and chief financial officer, aims to increase the share of sustainabilitylinked instruments in its overall debt portfolio from 12% to 20-25% in the next 12-24 months. "We will do this using a diverse set of instruments, not just green bonds," he says.

Social and sustainability bonds have partly filled the gap in sustainable finance left by the retreat in green bond issuance, particularly by corporates. Mushtaq Kapasi, Asia-Pacific managing director with the International Capital Market Association (ICMA), an industry body, says that Asia-Pacific issuance of social bonds has more than quadrupled in the first three quarters of 2020 relative to the same period last year, with sustainability bond issuance up more than 40%.

He notes that while the region's green bond issuance for 2020 remains behind its pace

in 2019, this is largely because green bond volumes are now highly correlated with those of the overall bond markets. Globally, Mr Kapasi says, green bond issuance has already bounced back along with the overall market, and green bond issuance so far this year has surpassed that in the same period of 2019.

Australia presents a slightly different picture compared with other Asia-Pacific markets, according to Damian Graham, chief investment officer at Aware Super, a not-for-profit superannuation fund.⁷ His and other super funds have been attracted to sustainability bonds in 2020 in addition to social and green bonds. Issuance of sustainability instruments in Australia had already accelerated before the pandemic, as governments and banks sought to fund infrastructure spending both to address the bushfire devastation of late 2019 and early 2020 and also to support a greater corporate focus on sustainability. Australian social bonds issued during the pandemic have tended to be small in size, says Mr Graham, and thus less attractive to large super funds.

One constant feature of regional finance markets, past and present, is a stark mismatch between investor demand for sustainable debt instruments and their supply. "In Asia, there are never enough such instruments to meet investor demand," says Mr Kapasi. Although this is unlikely to change in the near term, a hopeful sign is that 69% of Asia-Pacific CEOs in a range of industries (surveyed in July and August 2020; see Figure 2) say they are considering issuing some form of sustainable finance in coming years.⁸

^{4 &}quot;Indonesia sells Asia's first 50-year dollar bond to fight pandemic", The Jakarta Post, April 7th 2020. https://www.

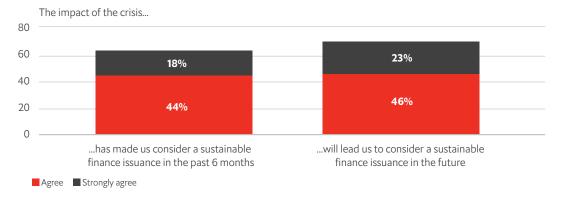
thejakartapost.com/news/2020/04/07/indonesia-sells-asias-first-50-year-dollar-bond-to-fight-pandemic.html 5 "Kookmin Bank prices Covid-19 response sustainability bond", *The Asset*, April 24th 2020. https://www.theasset.com/articleesg/40261/kookmin-bank-prices-covid-19-response-sustainability-bond

 [&]quot;Olam International secures US\$250m sustainability-linked loan", The Business Times, June 18th 2020. https://www. businesstimes.com.sg/companies-markets/olam-international-secures-us250m-sustainability-linked-loan

⁷ Prior to September 2020 it was known as First State Super.

⁸ A report incorporating this survey result, also written by The EIU and commissioned by Westpac, will be published in November 2020.

Figure 2: Covid conviction The pandemic's impact on corporate approaches to sustainable finance



Source: The Economist Intelligence Unit

Awareness builds...

Businesses in Asia-Pacific may have higher priorities at the moment than tapping sustainable debt markets (and many are put off by the complexities involved in issuance), but they know they must continue to burnish their sustainability credentials for investors. In the aforementioned survey, 72% of CEOs say the crisis has led them to intensify their focus on improving their firms' environmental, social and governance (ESG) performance. This is more than lip service, believes Mr Kapasi. "ESG is definitely on the executive agenda in the region." In the past, he says, treasurers had to be convinced to push ESG initiatives, whereas now the pressure is coming from the top. "Executives here understand that ESG is now part of companies' normal conversations with investors, whatever type of finance is under discussion." Mr Muthukumar adds that companies also have a clearer idea now about how to articulate their ESG credentials to investors.

... clarity awaits

For the different forms of sustainable finance to flourish, however, considerably greater clarity is needed for both investors and issuers around what kinds of projects qualify as sustainable. Relatively clear and widely accepted frameworks exist for green bonds⁹, but this is not yet the case for the fast-growing category of social bonds. "If you can't standardise definitions then people can't look at the risk/return of instruments on a consistent basis," says Mr Graham. "With social bonds, and to some extent also sustainability bonds, that's unfortunately not the position we're in today. The lack of standardisation is hurting investability at the moment."

Loose definitions and classifications around social bonds could, some observers fear, result in a spate of "social-washing"—a term adapted from the more familiar "greenwashing", which denotes issuers' use of bond proceeds for purposes other than genuinely sustainable aims.¹⁰

⁹ China's approval of updated green bond guidelines, expected by the end of 2020, should mark another step forward for global harmonisation of standards in this area. See "China green bonds on slow boat to global harmonisation", *Financial Times*, June 5th 2020. https://www.ft.com/content/2694584e-9054-11ea-bc44-dbf6756c871a

¹⁰ See, for example, "Rise in Covid-19 bond issuance fans fears over 'social washing'", *Financial Times*, June 30th 2020. https://www.ft.com/content/d35d1abc-0a4e-4e09-a776-154a469ef8de

Mr Kapasi believes clarity in the market is improving, not least due to the ICMA's work in updating its social bond principles. Much of this work, as well as that connected to sustainability-linked bonds, centres on the standardisation of impact and target reporting. An innovation relating to sustainability-linked bonds, for example, is that a company should report on its sustainability targets for the entire organisation and not just for specific projects. This and other guidance, Mr Kapasi believes, "should provide issuers with a solid foundation for reporting transparently on the fulfilment of their sustainability goals".

According to Mr Kuchtyak, a notable feature of the ICMA's June 2020 update to its social bond principles is the expansion of social project categories and the incorporation of guidance for social bonds relevant to the ccovid-19 crisis.

Final word

In Asia-Pacific as elsewhere, the longer-term impact of the covid-19 crisis on sustainable finance is likely to prove beneficial. Mr Muthukumar notes, for example, that the crisis has led central banks and regulators in the region to take a more active role than they have previously adopted in supporting sustainable finance. "This is a very welcome change, creating a more enabling environment for issuers like us," he says. The pandemic's boost to social and sustainability bonds has also created an urgency among market participants about the need to tighten definitions and guidelines applying to these and related instruments. The ICMA is not alone. Three loan market associations published new guidance documents in May 2020 for green and sustainability-linked loans.¹¹ In addition, in June the EU published a Taxonomy Regulation that introduces a classification system for environmentally and socially sustainable activities.¹² Future improvements advocated by some experts could include a "richer taxonomy" that includes many different definitions of what constitutes "green" to encourage emission-intensive companies to transition towards zero carbon.¹³ This and other work will create sound conditions for a further maturing of the entire sustainable finance market.

Although the crisis has distracted corporate issuers for the moment, recognition of the need to meet investors' sustainability criteria is stronger than ever. This applies not just to green criteria but also to social ones, including how companies support their employees, their suppliers and their communities. "Recent events have helped to convince corporates that their 'social licence to operate' must be strong", says Mr Graham. "They know that anything short of this can have a material impact on the long-term value of their business."

dated June 18th 2020, found on the European Commission website. https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1112
 See, for example, the "50 shades of green" speech of September 2019 by the ex-Bank of England governor, Mark Carney: "Remarks given during the UN Secretary General's Climate Action Summit 2019", Bank of England website. https://www.bankofengland.co.uk/-/ media/boe/files/speech/2019/remarks-given-during-the-un-secretary-generals-climate-actions-summit-2019-mark-carney.pdf

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¹¹ The institutions are the Asia Loan Market Association (ALMA), the Loan Market Association (LMA) and the Loan Syndication and Trading Association (LSTA). "Global Loan Market Associations Launch New Guidance Documents to Support the Green Loan Principles and the Sustainability Linked Loan Principles", *Businesswire* [Although "businesswire" (no capital) is its name in logo form, in general writing this company refers to itself as "Business Wire", so it may be more correct to use this form], May 5th 2020. https:// www.businesswire.com/news/home/20200505005622/en/Global-Loan-Market-Associations-Launch-New-Guidance
12 "Sustainable Finance: Commission welcomes the adoption by the European Parliament of the Taxonomy Regulation", EU press release