ASIA'S PROGRESS TOWARD GREATER SUSTAINABLE FINANCE MARKET EFFICIENCY AND INTEGRITY

JANUARY 2023

ASIAN DEVELOPMENT BANK

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Foreword

The Asian Development Bank (ADB) invests over USD23 billion per annum in sovereign and non-sovereign projects in developing member countries in Asia and the Pacific, financed by regular ordinary capital resources, concessional ordinary capital resources, the Asian Development Fund, and other special funds. As of 31 December 2021, ADB had a combined sovereign and private sector investment portfolio of about USD118 billion. Sustainability of the asset base is critical from both a financial perspective and that of the regional development bank's development mandate.

Measuring, monitoring, and reporting on the impact of climate change, access to natural resources, and the process of nature degradation on risk in our existing asset portfolio, at the level of sovereign exposure as well as the enterprise and infrastructure asset level, has proven challenging. Contributing factors include a lack of universal standards, incomplete access to data, and insufficient coordination among various internal departments. Similar challenges have arisen in our drive to support the financial sector's development in Asia and the Pacific and channel more investor funds into the sustainable assets and services required for the transition to an inclusive, resilient, and sustainable future for all.

To encourage the continued development of relevant sustainable finance frameworks, understand the differing perspectives of developed and emerging economies, and showcase meaningful ways to progress in an evolving environment, we have summarized the experiences and lessons learned expressed in a three-part webinar by industry leaders, asset managers, and early institutional adopters. This publication provides a good entry point for newcomers to sustainable finance and those interested in a range of views on the topic.

Finally, it was a pleasure working with one of our trusted partners, State Street Global Advisors, on the preparation and execution of the webinar series.

Ingrid van Wees
ADB Vice-President for Finance and Risk Management
(December 2016–December 2021)

Foreword

State Street Global Advisors is pleased to have partnered with ADB on the three-part webinar series, Asia's Progress toward Greater Sustainable Finance Market Efficiency and Integrity. The webinars brought together leading experts to discuss the development of sustainable finance taxonomies across Asia and Europe; the increasing environmental, social, and governance centricity of investors; and the opportunities and challenges of implementing Task Force on Climate-related Financial Disclosures (TCFD) reporting. The discussions were timely, detailed, and informative. We congratulate ADB on the excellent program.

As I wrote in my most recent annual letter to board members on our proxy voting agenda, State Street Global Advisors' focus in 2022 is to support the acceleration of the systemic transformations underway in climate change mitigation and adaptation, and the diversity of boards and workforces. We believe climate change poses a systemic risk to all companies in our clients' portfolios. Managing climate-related risks and opportunities is a key element of our fiduciary responsibilities to maximize long-term, risk-adjusted returns for our clients. As a result, we have a longstanding commitment to enhance investor-useful disclosure around this topic. We have encouraged our portfolio companies to report in accordance with TCFD recommendations since we first endorsed the framework in 2017. Since then, companies have improved the quality and quantity of climate-related disclosure, and investors have matured their expectations.

As the fourth-largest asset manager in the world, State Street Global Advisors has been engaging with companies and investors for many years on both the risks and opportunities of climate change. We will utilize a variety of levers and tools at our disposal, including partnering with our clients to help them achieve their net-zero ambitions, developing and offering climate investment solutions, engaging with portfolio companies to encourage climate-related disclosure, driving them to implement their transition plans, and working with other stakeholders in the market—such as policy makers and index providers—to help drive this transition.

We also must do our part to hold ourselves accountable for progress. Last April, we joined the Net Zero Asset Managers Initiative to work toward our portfolios reaching net-zero greenhouse gas emissions by 2050 (or sooner) and to set interim targets for 2030. We will be announcing our plans—including our interim targets, climate action plan, and our State Street Global Advisors TCFD report—later this year. As I said of addressing climate change when State Street Global Advisors joined the Net Zero Asset Managers Initiative last year: "It won't be easy, but it is doable. And the alternative is too dire to contemplate. If we learned anything ... from the race to develop effective vaccines for COVID-19 in record time, it is that the coalescence of science, technology, human ingenuity, and sheer resolve can accomplish extraordinary results."

Finally, as demonstrated by our close collaboration on this webinar series, State Street Global Advisors supports ADB's efforts to serve its stakeholders as a credible third party with established regional infrastructure able to facilitate market development. ADB's commitment to disclosure will help facilitate better disclosure and reporting standards in the region.

Cyrus Taraporevala
CEO, State Street Global Advisors
(2017–2022)

Acknowledgments

This report was prepared by Jason Mortimer, head of sustainable investment–fixed income and senior portfolio manager at Nomura Asset Management, based on knowledge sharing at the series of webinars jointly organized by the Asian Development Bank (ADB) and State Street Global Advisors. The development of the report benefited hugely from generous help and support by Peixian Lye and Andrew Wold from State Street Global Advisors, and Annika Seiler, Genna Alcasabas-Bantaya, Satoru Yamadera, Kosintr Puongsophol, Donghyun Park, Shu Tian, and Mai Lin Villaruel from ADB. The report's production was supported through ADB's technical assistance project, Enhance AsianBondsOnline as the Primary Bond Information Platform in ASEAN+3, which is sponsored by the Investment Climate Facilitation Fund.

Webinar Series: Executive Summary

This three-part webinar series on Asia's Progress toward Greater Sustainable Finance Market Efficiency and Integrity addresses three main themes: (i) the ongoing development of **green investment taxonomies** in Europe and Asia, (ii) the drivers of **environmental, social, and governance (ESG) centricity in portfolio investing**, and (iii) the growing adoption and importance of **climate-related risk corporate disclosures** for regulators and investors. Throughout the discussions, speakers representing various market roles from Asia and around the world provided insight on (i) efforts to align taxonomy standards across regions and give support to transition finance, (ii) how Asian investors are adopting and adapting ESG integration methods to reflect regional circumstances, (iii) corporate perspectives on the practical benefits of disclosure, and (iv) how investors are integrating this data in investment decision-making.

Webinar 1: Enhancing Financial Market Efficiency through the Development of a Coherent Regional Taxonomy

Green taxonomies. Corporate financial disclosure standards facilitate market efficiency and improve investment risk pricing through greater transparency. Green investment taxonomies are being implemented in the European Union (EU), the People's Republic of China, and the Association of Southeast Asian Nations (ASEAN) as standardized frameworks for sustainable finance measurement and disclosure. Regulators intend for these tools to provide markets with a "common metric system" to catalyze capital flows for evidence-based green investment through reporting and transparency—not to mandate what businesses can or cannot do. But there is growing recognition that regulators must balance the desire for comprehensive and ambitious taxonomies with the need for practical and efficient implementation.

Sustainability disclosures. Investors need comparable data on the sustainability performance of every asset they invest in. Global investors prefer standardization in the content and format of corporate disclosures. This can make investment research more efficient and enhance risk pricing, with potentially lower funding costs for companies. Efforts are underway to develop globally aligned sustainable finance disclosure standards and "common ground" green taxonomies that could simplify cross-border reporting requirements. But universal standards with statutory backing requires multinational political agreement. So investors are currently focused on voluntary market-standards for corporate sustainability disclosures, such as the International Sustainability Standards Board.

Transition finance. Transition finance is increasingly recognized as a necessary component for effectively addressing climate change, especially in emerging markets like Asia, where energy demand

is growing and power generation and industry is carbon-intensive. Yet, carbon transition finance is controversial because many climate-focused investors are reluctant to own these “brown” assets. Asia is working to bridge this gap with transition-ready taxonomies that incorporate expert-qualified pathways with metrics for tracking progress to carbon-neutrality in hard-to-abate sectors. This has led to innovative approaches to support transition finance like the ASEAN's three-tier “traffic light” taxonomy and the Asian Development Bank’s Energy Transition Mechanism. These efforts seek to uphold market functioning and financial stability while giving credible guidance and confidence to investors.

Webinar 2: Trend toward ESG Centricity of Portfolio Investments

ESG demand drivers. The pandemic highlighted the need for green, sustainable, and resilient investment. In response, global asset owners are putting ESG at the center of their investment decisions. This has a financial rationale, as Asian Development Bank research shows ESG investments can provide superior returns through resilience to market shocks and lower corporate funding costs by mitigating regulatory and sustainability risks. Public policy shifts to address climate change and promote climate-related risk disclosures is supporting customer demand for ESG-integrated financial products. Private commitments such as the USD130 trillion Glasgow Finance Alliance for Net Zero are raising market awareness and interest. The rise of index and passive investing is another driver of ESG adoption in the investment industry, which has embraced ESG as a forward-looking alpha factor for active managers to differentiate themselves in an environment of fee compression.

ESG in Asia. The adoption of ESG investing in Asia is not a passing fad. The narrative has shifted on the link between ESG and financial performance as material risks increasingly manifest in market outcomes. Asian investment managers are finding that ESG integration for performance and values-alignment is now a must-have for clients, who have shifted from asking: “Why are you integrating ESG?” to “Why are you not integrating ESG?” Reflecting this, the Asian green and social bond market has emerged as a mainstream asset class, with investors appreciating the market’s growing size and liquidity, attractive relative risk-return profile, and backdrop of policy support in the region.

ESG concerns and greenwashing. Asian investors also face challenges in developing ESG. Many question the effectiveness of investment exclusion and divestment policies that cause ESG investors to give up their influence with companies—they prefer engagement and stewardship instead. Investors point out that ESG data and ratings are costly, often contradictory, and a challenge to integrate objectively. Not surprisingly, they call for more standardized ESG metrics and sustainability disclosures. And as ESG has boomed, many in the market have grown wary of the hype around green and sustainable investment. Asian asset owners are more carefully differentiating between ESG marketing and ESG investment skill, while asset managers are refocusing ESG research processes to be robust to scrutiny and capable of delivering superior investment performance.

Webinar 3: Importance of Disclosing Climate-Related Risks for Listed Companies in Asia

Disclosure benefits and costs. Disclosure helps companies adopt sustainability into corporate strategy. Corporate leaders find that sustainable reporting requirements focus minds and accelerate organizational change through the development of internal sustainability performance measurement. The cross-functional collaboration required to obtain this data is itself a key success factor for integrating ESG into corporate strategy. Currently, Europe applies the strictest requirements for corporate reporting on climate and sustainability. This entails an enterprise-wide response for identifying, quantifying, monitoring, and managing climate risks at the firm level. However, firms face regulatory uncertainty as many EU reporting requirements remain undecided, and disparate regional reporting standards are raising compliance costs. As a result, many multinationals support efforts to harmonize global reporting standards for comparability and a more level playing field.

TCFD disclosure in Asia. The Task Force on Climate-related Financial Disclosures (TCFD) is a global framework for reporting and analysis of corporate climate-related impacts for financial markets. TCFD began as a voluntary set of recommendations but is now part of regulatory frameworks in the EU, the People's Republic of China, Japan, Singapore, and other jurisdictions. While disclosure is still largely voluntary in emerging Asia, interest is growing, and locally developed guidance and resources are available. For example, banks in Southeast Asia are turning TCFD carbon disclosure data into insights for decarbonization best practices for clients. These early adopters advise that proactive commitment and preparation is crucial for managing the growing requirements and mandates for disclosure in the region.

Investors and TCFD. Investors want data to assess climate-investment risk, regardless of regulatory mandate. The state of global climate reporting is uneven, but TCFD is a starting point for the comprehensive disclosure that investors need to assess corporate strategy and earnings outlooks. In this sense, TCFD disclosure quality is a differentiating factor for companies to attract new capital and investment. But disclosures must be material: Investors want forward-looking, decision-relevant data on the company's impacts—not long essays—for analyzing risks and opportunities. Investors use these data with other TCFD components like scenario analysis, target-setting, and board commitment to assess that transition strategies are credible and on-track, and as input for corporate engagement efforts. As investors expect the same level of assurance for climate-related disclosures as financial data, industry should proactively adopt disclosure standards rather than wait for regulators.

SECTION 1

Green as an Opportunity and Disclosure as a Competitive Advantage

In late 2021, the Asian Development Bank (ADB), in collaboration with State Street Global Advisors (SSGA), hosted a three-part webinar series, Asia's Progress toward Greater Sustainable Finance Market Efficiency and Integrity. In this series, market participants—including private investment managers and public sector asset owners, regulators, and policy makers—from across Asia and Europe discussed the development of sustainable finance taxonomies for better market efficiency; the trend of environmental, social, and governance (ESG) centricity in portfolio investments; and the importance of corporate climate and sustainability disclosure from the standpoint of firms and investors. Their discussions revealed actionable insights for corporates and investors in Asia seeking to better understand the drivers of ESG investment trends and transition finance, how green and Sustainable Development Goals (SDGs)-aligned business is creating opportunities and attracting capital, as well as practical approaches to implementing corporate disclosure and ESG investment practices.

Announced in 2015, the United Nations (UN) SDGs are an ambitious global blueprint designed largely for governments to "achieve a better and more sustainable future for all" by 2030.[1] However due to impact of the coronavirus disease (COVID-19) over the last several years, the estimated global funding gap for achieving the SDGs widened from an already enormous USD2.5 trillion to USD4.2 trillion. At the same time, global public debt rose to a record high of 99% of global output in 2020 as fiscal revenues evaporated and governments spent in response to the pandemic's economic dislocations, causing public sector fiscal deficits to widen.[2] Yet, even this upwardly revised USD4.2 trillion SDG gap estimate represents only 1.1% of the USD379 trillion of financial assets owned and managed by global financial institutions in 2020. While governments will struggle mightily to achieve the SDGs alone, working together with businesses and investors, the challenge becomes difficult but doable.

In the wake of the pandemic, banks, investment managers, and asset owners like pension funds and reserve managers, globally as well as in Asia, are increasingly recognizing that nonfinancial ESG risks can have a material impact on their risk-adjusted returns and thus the long-term value of their assets under management. According to the *Asian Development Outlook 2021*, a shift in stakeholders' preference toward SDGs and the need to mitigate and hedge sustainability risks, prepare for regulatory changes, and meet the demand for investments in resilience to face increasing uncertainty are organically driving the need for sustainable finance.[3] This confluence of factors implies that the importance of ESG and

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[1] UN. Take Action for the Sustainable Development Goals. https://www.un.org/sustainabledevelopment/sustainable-development-goals/.

[2] International Monetary Fund. 2021. *IMF Blog. "Global Debt Reaches a Record $226 Trillion."* https://blogs.imf.org/2021/12/15/global-debt-reaches-a-record-226-trillion/.

[3] ADB. 2021. *Asian Development Outlook 2021: Financing a Green and Inclusive Recovery*. https://dx.doi.org/10.22617/FLS210163-3.

SDGs is an irreversible trend—and the earlier that businesses and investors adjust, the better prepared they will be to realize the opportunities.

Still, the development of a sustainable finance market is constrained by an asymmetry of information, a lack of transparency and consistent standards for reporting, ESG data and rating methodologies that can be subjective and often contradictory, as well as the absence of common definitions and metrics for measuring the impact that businesses and investments have on society and the environment. So as business and investors seek to sustain and grow their value, having improved sustainability metrics and data for making better-informed investment decisions is gaining importance. This data gap can be addressed by more proactive and comprehensive disclosures of material nonfinancial risks and impacts by businesses, together with thoughtful regulation and clear taxonomies to define "green and sustainable" activities for better market efficiency and integrity.

The aforementioned webinar series address these issues from a practical perspective to

- identify best practices and innovative approaches to developing and implementing sustainable taxonomies based on European and Asian experiences;
- discuss the trend toward ESG centricity in investments by global and Asian asset owners and asset managers, and its implications for corporate issuers and borrowers; and
- share experiences of implementing climate-related financial and sustainability disclosures, and discuss how this process can transform corporate decision-making and attract investment capital.

The three-part webinar series revealed several interrelated trends and opportunities for Asian business and investment leaders today. First, "green as an opportunity" is not just a feel-good catchphrase but an enormous mega-trend that has set off a race between different regions, policy makers, companies, and investors to seize the initiative. And the development of green taxonomies is not a faraway European project but one that policy makers and regulators in Asia are also actively engaged in for the purpose of accelerating and financing climate change adaptation and transition in the region. Efforts are underway for aligning green taxonomies between the European Union (EU) and the People's Republic of China (PRC) to promote cross-border flows of sustainable goods, services, and financial products between jurisdictions. The efforts of policy makers to promote sustainable development and achieve the SDGs in their respective countries presents a significant business opportunity for both companies and investors: An estimated EUR270 billion and USD1.5 trillion in green, sustainable, and SDG-aligned investments are required each year in Europe and Asia, respectively.

Financing these opportunities will provide growing demand for sustainable investment financial products and markets, such as green and other impact bonds, which reached a total of nearly USD2.2 trillion outstanding at the end of 2021. Investors in developed economies and emerging Asia are joining to fund this green future with commitments like the USD130 trillion Glasgow Financial Alliance for Net Zero (GFANZ). Private and public sector asset managers and asset owners are embracing green finance, not only in recognition of the risks from climate change to their investments but also due to the investment opportunities from solutions that address it.

Second, shifts in market preferences for sustainability and corporate transparency are fundamentally changing customer, investor, and policy making to better reflect the growing centricity of ESG concerns. Investment managers from developed markets report that 36% of total invested assets under management in their regions—a USD35 trillion slice of that market in 2020—is now managed according to sustainable investment principles. In response to the socioeconomic and health crisis of the COVID-19 pandemic, public and private sector issuers raised USD151 billion and USD193 billion via social bond issuances in 2020 and 2021, respectively, a more than 10-fold increase from 2019. To paraphrase one of the speakers at the webinar: "Clients used to ask, 'Why are you doing ESG investing?' Now they ask, 'Why are you not doing ESG investing?'"

Naturally, the demand for sustainable products, services, and investments itself creates a need for consistency in measuring, labeling, and marketing by corporates and investors, which is addressable in part through efforts to standardize sustainability reporting and introduce taxonomies. This has led to investor calls for higher quality and more consistent corporate disclosure of climate-related impacts and sustainability risks and opportunities, which are now an integral part of their ESG investment processes. While still voluntary in many parts of the world and Asia, investor and lender disclosures and improved sustainability performance in alignment with the Task Force on Climate-related Financial Disclosures (TCFD) is increasingly a key factor in lending and asset allocation decisions.

Third, stakeholder accountability and business integrity is manifesting in better corporate disclosure practices by firms and the adoption of ESG investment considerations by asset owners. Even as markets are a fundamental force for good in the world, consumers, investors, and society at large are increasingly demanding action in response to the negative environmental and social externalities that firms can generate. Asset owners entrusted with public funds face their own calls for more transparency and responsibility as global asset owners. To avoid the backlash and realize the opportunities from addressing these real concerns, firms are increasingly standing up and accounting for their impacts, backed with organizational change and tangible action.

Many corporates are finding upside from improved nonfinancial disclosures, as the enhanced operational awareness and inter-group coordination required to track and report these sustainability metrics actually improves collaboration between different corporate functions. Investors are taking notice and rating companies not just by the quality of their financial performance and investment potential, but also by the operational quality, governance, and strategic ambition apparent from their disclosure practices. Leading firms now compete to "out-disclose" their competitors to gain a competitive edge, as this factor is an increasingly key driver of the capital allocation decisions of investors.

Not everything is perfect of course, and Asian investors face challenges to implementing their ESG investment ambitions. The lack of standards and problems with ESG data quality and reporting consistency and materiality pose significant concerns. This makes ESG securities analysis less efficient and has resulted in a proliferation of potentially unsubstantiated claims of sustainability that impede the market's ability to effectively channel investments. Here, policy makers and the private sector have responded by developing guidelines for disclosure such as TCFD, the International Sustainability Standards Board (ISSB), and "Stakeholder Capitalism Metrics" to promote standardization, although

global adoption remains a work in progress.[4] However, investors have limited resources for processing and analyzing ESG data, and asset owners especially face problems substantiating ESG claims given the serious issue of greenwashing.[5] Taxonomies may offer help, and their development in Europe and Asia is advancing. But reaching consensus for cross-border alignment is a slow process that must account for the variety of income and development levels, domestic circumstances, technological availability, and philosophical differences that exist between jurisdictions.

Transition financing presents its own set of challenges. Asian policy makers and regulators spoke of the need for financing to support a rapid yet orderly transition of highly emitting and hard-to-abate sectors of the economy to low- or net-zero-carbon operations, but described pushback from investors who are reluctant to finance these "brown" assets given their own Net Zero pledges. Asian policy innovation in this field aims to address this thorny issue with credible approaches such as the Energy Transition Mechanism (ETM), which involve third-parties like ADB, and building transition directly into taxonomy development. But as the fierce debate in Europe around the suitability of nuclear power and natural gas as transition fuels under its own green taxonomy shows, the solutions are far from agreed.

Lastly, as Asian investors gain experience in ESG, they come to realize there are tradeoffs and unintended consequences to some common ESG investment approaches. For public asset owners, negative screening and exclusion policies can impose unacceptable limitations on portfolio diversification and return potential, although private investors may find that tailored exclusion policies are an opportunity to better address the values of clients and beneficiaries. Some investors described difficulties in getting Asian companies to take disclosure and ESG compliance seriously, and pointed out that divestment may be "irresponsible investment" as investors give up their power to positively influence companies. Meanwhile, best-in-class ESG investing can paradoxically lead to worse ESG outcomes, as investors focus on companies where ESG performance is already good rather than those that actually need to improve. Investors overall agreed that stewardship and engagement are well suited for the needs of Asian investors. However, market participants must hold each other to account for maintaining integrity in sustainable finance markets.

[4] Stakeholder Capitalism Metrics and disclosures are a proposed set of guidelines for companies to align their reporting on performance against ESG indicators on a consistent basis. For detail see, https://www.weforum.org/reports/measuring-stakeholder-capitalism-towards-common-metrics-and-consistent-reporting-of-sustainable-value-creation.

[5] Greenwashing is a market integrity problem whereby companies, investors, or organizations attempt to mislead consumers and the public with superficial appeals to environmental sustainability for primarily marketing purposes.

SECTION 2

Progress toward Greater Sustainable Finance Market Efficiency and Integrity: Webinar Summaries and Key Takeaways

Webinar 1: Enhancing Financial Market Efficiency through the Development of a Coherent Regional Taxonomy

The first webinar's discussions covered the motivations, experience, and challenges faced by the EU in development of the EU Green Taxonomy. Viewpoints from Asia were solicited to understand how the region is developing its own sustainable finance market practices and finding innovative approaches to tackle the controversial issue of transition finance. Global investors provided their own outlook of the promise and potential for taxonomy and sustainability data disclosure standards to align across jurisdictions. Throughout the discussion, speakers from Asia and Europe revealed the points of alignment and differences between the two regions.

The discussion addressed the following questions:

1. Why was the EU Taxonomy created? How do regulators and investors view taxonomies? What are the challenges?
2. What implications does the EU Taxonomy have for Asian markets? How can taxonomies be aligned across jurisdictions?
3. What experience does Asia have in developing green taxonomies? How is Asia innovating in this field?
4. How can transition finance be addressed in taxonomy development? How can investor concerns be addressed?

Webinar 1: Key Takeaways from the Speakers

- ✓ Global investors want improved standards of corporate financial disclosure for better market efficiency and accurate pricing of future risks. A green taxonomy can help improve market efficiency and support the development of sustainable finance.
- ✓ The European Union (EU), People's Republic of China (PRC), Association of Southeast Asian Nations (ASEAN), and many other economies and regions have already implemented or plan to develop their own green taxonomies. Public authorities from 18 economies, as part of the International Platform on Sustainable Finance (IPSF), are developing a Global Common Taxonomy by comparing and aligning existing national and regional taxonomies, particularly those of the EU and the PRC.

- ✓ Although a universal standard taxonomy is generally considered desirable, many doubt that the EU Green Taxonomy can be used as a global standard. While the EU Green Taxonomy seeks to be ambitious and comprehensive, it is also considered too EU-centric and complex in its current form for emerging markets to fully adopt.
- ✓ The PRC has been developing its own Green Taxonomy since 2014, which will be the central supporting pillar for building the green financial system there. Recently, ASEAN launched Version 1.0 of its own Green Taxonomy to reflect the region's development needs and the importance of transition finance.
- ✓ Incorporating transition finance into taxonomies and the question of brown industries and assets remain contentious, especially as global investors are concerned with reputational risks. In Asia, however, transition finance is considered crucial and policy makers are developing ways to credibly address this issue, including the ADB's recently announced Energy Transition Mechanism.

Background. The EU reached an important milestone when the EU Taxonomy, as outlined in the Climate Delegated Act, for aligning investments and the financial system toward sustainable projects and activities came into force on 1 January 2022. Covering six environmental objectives in a phased approach, the EU first published criteria for climate change mitigation and adoption that are now in force. This was followed by other objectives—including biodiversity, water resources, and the circular economy—which are planned to come into force in January 2023.[6] The underlying concept of this ambitious framework is to efficiently channel sustainable investment-seeking capital to economic activities that substantially contribute to these environmental objectives and are subject to the technical standards of "Do No Significant Harm" and minimum social safeguards. The opportunity for business and investment is evident: estimates from the European Investment Bank show an additional EUR270 billion per year is needed for Europe to reach its climate and energy goals by 2030 (Figure 1).

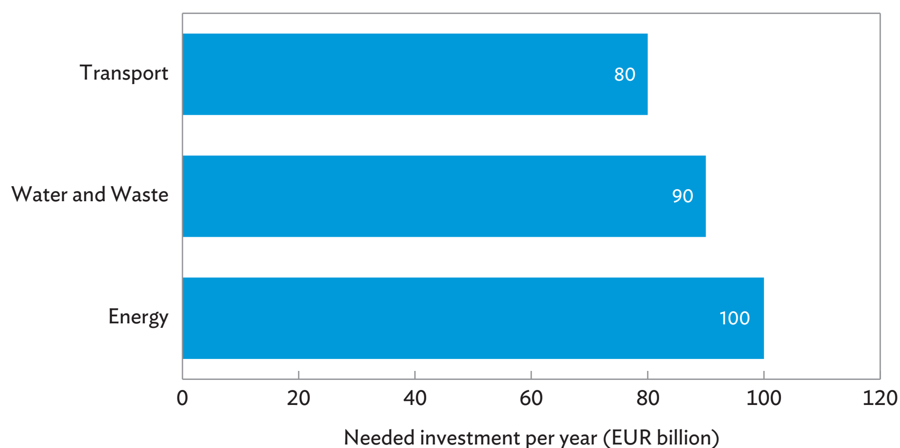
The PRC was an early adopter of green investment standards in Asia and the Pacific and most recently released its own *Green Bond Endorsed Projects Catalogue (2021 Edition)*. In July 2020, the EU and the PRC initiated a working group on comparing and aligning taxonomies for a common green taxonomy across the two markets.[7] The ASEAN Capital Markets Forum (ACMF) issued the ASEAN Green, Social, and Sustainability Bond Standards in 2017–2018, making progress toward implementing its Roadmap for the Development of Sustainable Capital Markets. It also recently launched "Version 1" of its own ASEAN Green Taxonomy in 2021. At the UN Climate Change Conference in 2021, more commonly known as COP26, ADB, together with Indonesia and the Philippines, announced an Energy Transfer Mechanism to accelerate Southeast Asia's clean energy transition through buyouts and the early retirement of coal-fired power plants.[8] Overall, the Asia and Pacific region is expected to need USD1.5 trillion in annual investments across the energy, health, transport, water, and technology sectors to achieve the SDGs by 2030 (Figure 2).

[6] EU. Taxonomy–Timeline. https://eu-taxonomy.info/info/eu-taxonomy-timeline.

[7] IPSF. 2021. *Common Ground Taxonomy—Climate Change Mitigation.* https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf.

[8] ADB. 2021. *News Release.* ADB, Indonesia, Philippines Launch Partnership To Set Up Energy Transition Mechanism. November.

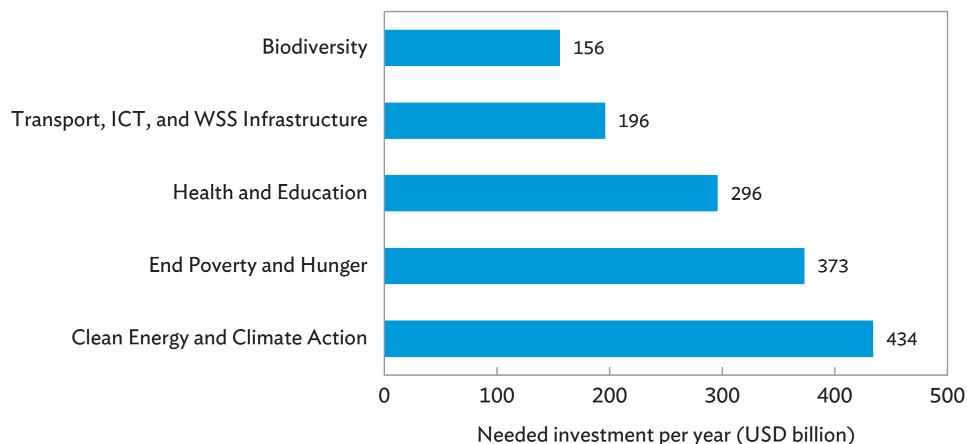
Figure 1: Annual Investment Needs for Sustainable Development in the European Union



EUR = euro.

Source: European Investment Bank. *EU Commission Action Plan Factsheet*. https://ec.europa.eu/info/sites/default/files/180308-action-plan-sustainable-growth-factsheet_en.pdf.

Figure 2: Annual Investment Required for Sustainable Development in Asia and the Pacific by 2030



ICT = information, communications, and technology; USD = United States dollar; WSS = water, sanitation, and safe water.

Source: ADB calculations based on UNESCAP data.

Speakers

- **Helena Viñes Fiestas**, Commissioner, Spanish Financial Markets Authority; Rapporteur of the EU Platform on Sustainable Finance
- **Nicholas Pfaff**, Member, Executive Committee; Head of Sustainable Finance, International Capital Market Association (ICMA); Member, EU Platform on Sustainable Finance
- **Jun Ma**, Chairman, Green Finance Committee of the China Society for Finance and Banking
- **Ephyro Luis B. Amatong**, Commissioner, Securities and Exchange Commission (SEC), Philippines
- **Rick Lacaille**, Executive Vice-President and Global Head, ESG, SSGA

Taxonomies and the Benefits of Disclosure

What are the benefits of having a taxonomy and what is it meant to achieve?

The European Regulatory Perspective
***Helena Viñes Fiestas**, Commissioner, Spanish Financial Markets Authority; Rapporteur of the EU Platform on Sustainable Finance*

"The Taxonomy has opened the eyes of investors, financiers, companies, and policy makers... the transition is not about incremental steps but transformative change."

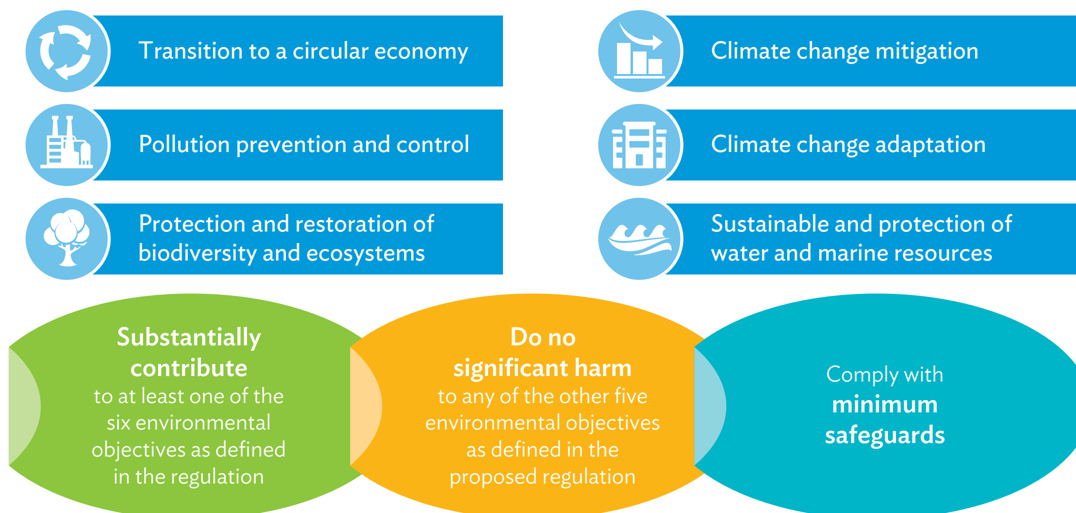
– Helena Viñes Fiestas,
Spanish Financial Markets Authority

The EU Taxonomy is a game changer for standards and clarity in sustainable finance. The EU Taxonomy is the first common measurement tool for sustainability. Although there are still issues to work out, the EU Taxonomy has already moved debate beyond the question of objectives to deciding on the details of implementation. EU regulators hope that the taxonomy will act as a dictionary that shows what economic activities are sustainable and under what circumstances. Before this, issuers and investors were defining for themselves what is green and how green they were, with greenwashing frequently mentioned as the number one concern for market stakeholders. The taxonomy addresses this through clarity and standards (Figure 3).

The EU Taxonomy is a common sustainability metric system for markets, not a ban on activities. The EU Taxonomy works through reporting—not by mandating what a business or investor can or cannot do. Going forward, companies will report their share of revenues and expenditures (capital expenditures and operating expenses) that are aligned to the taxonomy. This will allow institutional investors to efficiently calculate the percentage of investments in their funds that are aligned with the taxonomy and disclose this confidently and comparably. Through this market mechanism, the taxonomy can result in more efficient market pricing, better capital allocation toward sustainable business activities, and improved investor confidence and market integrity.

Investors need to know the sustainability performance of every asset they invest in. A public or private investor today must think about the economic life of every asset they invest in, and whether that asset is fit for purpose for that entire period—for example, is an investment appropriate for a carbon-neutral economy if its economic life exceeds the 28 years left needed to meet the global target of a reduction of 1.5°C? Otherwise, the investment may not be such a good one. They need to know the

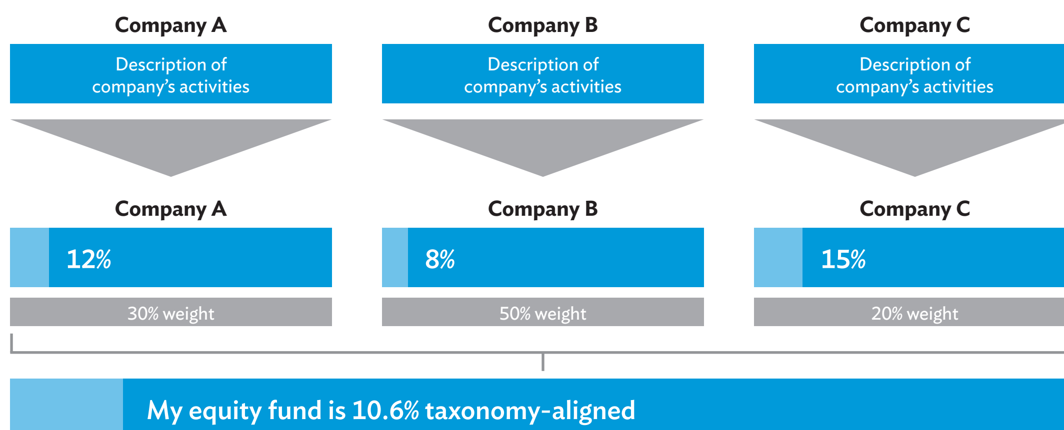
Figure 3: European Union Taxonomy—Conceptual Overview with Six Environmental Objectives and Performance Thresholds



Source: European Union Technical Expert Group on Sustainable Finance. 2020. *Taxonomy: Final Report of the Technical Expert Group on Sustainable Finance.* https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf.

sustainability performance of their assets and have a way to transform this complicated question into something that is simple—for example, what percentage of a business' activities or an investment fund's holdings is sustainable based on the taxonomy measure? With these standards in place, end-investors will be able to judge objectively and transparently how sustainable different investments are on a like-for-like basis (Figure 4).

Figure 4: Simplified Example of Applying the Taxonomy to a Portfolio of Investments
(based on revenue as a proxy for taxonomy-aligned activities)



Source: EU Technical Expert Group on Sustainable Finance. 2020. *Taxonomy: Final Report of the Technical Expert Group on Sustainable Finance.* https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/200309-sustainable-finance-teg-final-report-taxonomy_en.pdf.

The PRC Policy Maker's Perspective
***Jun Ma**, Chairman, Green Finance Committee of the China Society for Finance and Banking*

The PRC Taxonomy facilitates green policy development with evidence-based measurement. One of the taxonomy's important roles is moving policy forward based on consistent measurements of environmental performance and related indicators in the economy and financial system. For example, the Network for Greening the Financial System recently debated whether to apply differentiated risk weights for green and brown assets in the banking system. This requires data to analyze if green lending assets actually perform better than nongreen assets in terms of lower default probabilities. Over the past 6 years in the PRC, data show that green loans as defined by the PRC's Taxonomy had a 0.4% default rate versus an approximately 2.0% average for the entire banking system. Such evidence is important for convincing banks and regulators to consider implementing meaningful sustainable investment policies.

What role can taxonomies and disclosure play in developing efficient and sustainable markets?

The Global Private Sector Asset Manager Perspective
Rick Lacaille, Executive Vice-President and Global Head, ESG, SSGA

Investors are focused on improving corporate financial disclosure for global market efficiency. From the standpoint of investors, corporate disclosure is about looking forward and pricing future risks to investments. Investors are accustomed to dealing with the inefficiency that partial and inconsistent financial disclosure standards bring, as there is not always perfect agreement across jurisdictions. Ultimately, this is an additional cost to the analysis of the market's universe of securities. Through voluntary but universal standardized systems like those of the International Financial Reporting Standards (IFRS) Foundation, investors have been able to chip away at the issue of disparate reporting protocols and make progress toward achieving globally aligned standards of corporate financial disclosure and reporting.

> **"When we speak to regulators about the desirability of better data and disclosure, it's in the context of providing more complete information to investors about the potential future risk and opportunities of their investments."**
>
> – ***Rick Lacaille**, SSGA*

Universal taxonomies and disclosure standards can support market efficiency but face limits. The question of taxonomies and sustainability reporting regulatory standards presents investors with a new set of challenges. Regulation ultimately reflects national, political, and philosophical issues, especially with regards to sustainability. Regulators can be effective in collaborating regionally and even globally, but their mandates are economy-based, and there is a strong political dimension as well. Recent debates between EU member states in the development of the EU Green Taxonomy regarding the safety and desirability of nuclear power and gas as a transition fuel reflect fundamental national political differences. So while globally aligned disclosure standards with regulatory backing and statutory power may be preferable to some, there has to be clear recognition of the political challenges that exist.

Momentum is growing for corporate sustainability disclosures on a voluntary basis. At COP26 in November 2021, the IFRS Foundation announced the creation of a new standard settings board, the ISSB, for developing "a comprehensive global-baseline" of sustainability disclosures.[9] This new body will absorb and consolidate the existing Value Reporting Foundation and Climate Disclosure Standards Board.[10] It is an important step forward to providing comparability and effective global standards of disclosure in markets, albeit on a voluntary basis.

> **"At State Street we are very supportive of the efforts to provide better data disclosure, in the interests of financial market efficiency, which is what should drive all of our thinking."**
>
> *– **Rick Lacaille**, SSGA*

What are the lessons and potential pitfalls in designing and implementing taxonomies?

The Global Investor Alliance Perspective

***Nicholas Pfaff**, Member, Executive Committee; Head of Sustainable Finance, ICMA; Member, EU Platform on Sustainable Finance*

The EU Taxonomy development process shows what works and what does not. Countries and regions around the world are drawing lessons from the EU Taxonomy's development to create their own taxonomies. Based on the EU example, we now better understand what a taxonomy does and does not do. First, a taxonomy is well suited as a classification tool for businesses and investors to clearly know what is considered sustainable and what is not. Second, taxonomies function well as a disclosure tool for regulatory purposes, which incentivizes market stakeholders to adopt a taxonomy. Third, taxonomies can be used for setting policy and to facilitate the development of sustainable investment markets, specifically by enabling the increased issuance of green and other impact bonds.[11]

> **"Speaking frankly, the EU taxonomy is not globally scalable in its entirety... they have a fantastic example in Europe but it's not perfection, it's a work in progress, and there are pitfalls."**
>
> *– **Nicholas Pfaff**, ICMA*

While taxonomies can help, they have limitations and choices must be made. The EU Taxonomy was developed from an EU and OECD perspective and therefore is not truly internationally scalable. The EU Taxonomy contains many different aspects and criteria—Technical Screening, Substantial Contribution, Do No Significant Harm, and Minimum Social Safeguards—all designed from the EU and developed-market perspective. Adoption of the EU Taxonomy faces the risk of potentially being too comprehensive and ambitious, and of the development process becoming bogged down.

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9 IFRS Foundation. 2021. *News and Events.* "IFRS Foundation Announces International Sustainability Standards Board." 3 November. https://www.ifrs.org/news-and-events/news/2021/11/ifrs-foundation-announces-issb-consolidation-with-cdsb-vrf-publication-of-prototypes/.

10 The Value Reporting Foundation includes the Sustainability Accounting Standards Board and Global Reporting Initiative.

11 Impact bonds include green, social, sustainability bonds, among others. For more details, see ICMA. Sustainable Finance. https://www.icmagroup.org/sustainable-finance/.

The EU Taxonomy and Its Implications for Emerging Asian Markets

Can the EU Taxonomy become the global standard? What would make it work in emerging markets?

It is evident that the EU Taxonomy is coming from the standpoint of a very complex and developed economy. And the EU will soon add more objectives to the taxonomy. Is it more practical to have a taxonomy that is limited in scope and focused on being a workable global framework for a common issue like climate change, or is it better to aim for a comprehensive and complete taxonomy that acts as a global gold standard? What should be done to make the EU Taxonomy more adaptable for other countries?

European Regulator (Helena Viñes Fiestas): We have passed the time when we had the luxury to work on a global taxonomy first. We need to go ahead and build national and regional ones while working toward a global framework because we have less than 30 years left to fundamentally transform our economy. Investors need details on the sustainability of assets now. While there are changes to be made to the EU Taxonomy to make it internationally operational, it has set a robust methodological approach worth considering at the international level.

Global Financial Trade Association (Nicholas Pfaff): The EU Taxonomy is not globally scalable in its entirety. Europe's Taxonomy risks being too comprehensive and ambitious. While it is important to consider all aspects of sustainability including biodiversity, the global focus and priority must be on climate change.

PRC Policy Maker (Jun Ma): The process of implementing the EU Taxonomy is complex from an emerging market perspective, where implementation capacity is lower. To make the EU Taxonomy more relevant for emerging markets and improve the chance of global adoption, the EU could consider differentiated tiers of requirements and stringency. For example, the level of compliance could be strictest for large, listed firms in Europe, but less strict for small and medium-sized enterprises (SMEs). The European SME standard could then be applied to emerging market firms.

ASEAN Financial Regulator (Ephyro Luis B. Amatong): For emerging markets, a multitiered taxonomy approach that takes into account levels of development, income, and investment would be more practical and inclusive for transitioning companies to low-carbon and Net Zero goals.

European Regulator (Helena Viñes Fiestas): The EU Commission has plans to research how to apply and adopt the taxonomy to SMEs to fit their realities. Discussions have begun on recommendations for how to adopt the taxonomy to emerging markets and developing economies. The EU is also considering ways to make the Do No Significant Harm criteria more applicable and easier to understand for non-European entities and European entities operating outside of Europe.

Global Asset Manager (Rick Lacaille, SSGA): It is important to view the perspective of both emerging markets and developed markets, especially the PRC and the EU, respectively, as two parts of the world focused on developing taxonomies and addressing the difficult technical challenges that arise. It is easy to be pessimistic about the idea for a global universal taxonomy standard. But a global standard would be extremely desirable and in the interests of everyone for developing sustainable, efficient markets.

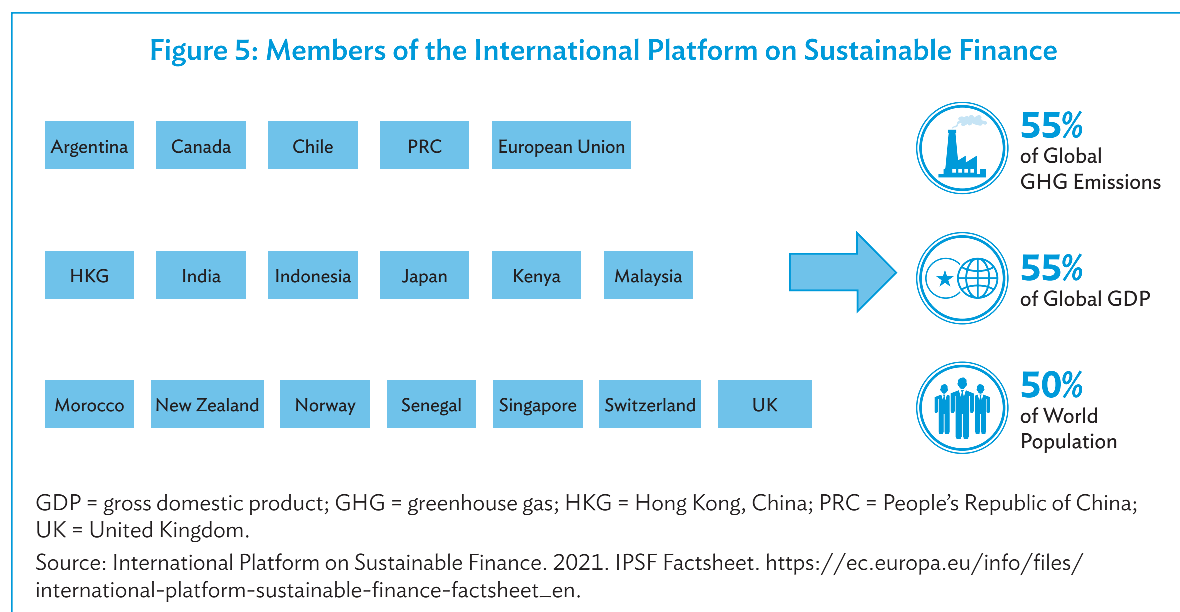
How are developed and emerging economies working to align taxonomies and disclosure standards?

The Global Financial Trade Association Perspective

Nicholas Pfaff*, Member, Executive Committee; Head of Sustainable Finance, ICMA; Member, EU Platform on Sustainable Finance*

The EU, PRC, United Kingdom, and others are assessing taxonomies with a view toward making them more comparable and interoperable. The IPSF is a consortium of public authorities from the EU, PRC, United Kingdom, and other economies that is developing an internationally aligned "Common Ground Taxonomy." The IPSF's main focus to date has been the comparison of the EU's Green Taxonomy and the PRC's Green Bond Catalog. Other jurisdictions interested in developing their own taxonomies can look to the EU Taxonomy and the IPSF's work on taxonomy comparison efforts as a guide (Figure 5).

Figure 5: Members of the International Platform on Sustainable Finance



GDP = gross domestic product; GHG = greenhouse gas; HKG = Hong Kong, China; PRC = People's Republic of China; UK = United Kingdom.

Source: International Platform on Sustainable Finance. 2021. IPSF Factsheet. https://ec.europa.eu/info/files/international-platform-sustainable-finance-factsheet_en.

The PRC Policy Maker's Perspective

***Jun Ma**, Chairman, Green Finance Committee of the China Society for Finance and Banking*

The IPSF Common Ground Taxonomy can be either a template or a starting point for others. The IPSF Common Ground Taxonomy, which was announced in November 2021, represents the overlapping sections of the EU Taxonomy Climate Mitigation Act and the PRC Green Bond Taxonomy. Currently, this overlapping portion includes 80 categories: 61 categories are already agreed, while 19 more difficult categories are waiting for expert agreement. The first version of the Common Ground Taxonomy will focus on climate, followed by sections for biodiversity and the circular economy. The IPSF's work provides a methodology for comparing taxonomies and finding commonalities. Other jurisdictions can choose to adopt this work as their own taxonomy, or use it as a starting point for expansion to reflect local priorities. The Common Ground Taxonomy is expected to provide practical benefits to market participants, such as companies marketing sustainable finance products in different market jurisdictions (Table 1).

> **"Chinese Green Bond issuers looking to issue products in Europe or vice versa can voluntarily use the Common Ground Taxonomy for smoother verification and cross-market compliance."**
>
> ***– Jun Ma,***
> *China Society for Finance and Banking*

Table 1: Common Ground Taxonomy—High-Level Mapping between the EU and PRC Taxonomies

EU Objectives	PRC Objectives
Climate change mitigation	Climate change response
Climate change adaptation	
The sustainable use and protection of water and marine resources	Environmental improvement (pollution control and ecological conservation)
The protection and restoration of biodiversity and ecosystems	
The transition to a circular economy	More efficient resource utilization (circular economy waste recycling and pollution prevention.
Pollution prevention and control	

EU = European Union, PRC = People's Republic of China.

Source: International Platform on Sustainable Finance. Common Ground Taxonomy—Climate Change Mitigation Instruction Report. https://ec.europa.eu/info/sites/default/files/business_economy_euro/ banking_and_finance/documents/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf.

Taxonomies in the PRC and ASEAN

How has the PRC used the development of a taxonomy to build its own green financial market?

The PRC Policy Maker's Perspective
Jun Ma*, Chairman, Green Finance Committee of the China Society for Finance and Banking*

A taxonomy has been central to catalyzing the green finance market in the PRC. The PRC first began work on a green finance system in 2014. It was based on four pillars: taxonomy, incentives, disclosure, and products to meet the needs of the green economy. Taxonomy, as the first and foremost pillar, supports all the other pillars by defining activities, enabling performance measurement, and preventing greenwashing. As an illustration, it is important to quantify green loan growth by banks, as banks provide almost 90% of all green financing in the PRC. Incentives encourage market development and growth. Examples of taxonomy-based incentive schemes include the People's Bank of China's decarbonization facility that rewards banks for providing loans that help reduce emissions. To establish incentives, however, it is necessary to first identify green assets and measure their performance—these boundaries are provided by the taxonomy. Disclosure entails reporting based on the consistent standards of the taxonomy—for example, banks reporting on their green assets and revenues. Lastly, we require products to support the needs of the economy such as green bonds, green asset-back securities, and green loans. These also require clear definitions with boundaries set by the taxonomy.

> **"We [the PRC] started with a very simple taxonomy for the banking system as early as 2013... That taxonomy was very simple: One pager, 12 lines... Now we have a science-based approach for defining what categories are green... in the process of 6 years our taxonomy grew from one page to 60 pages, from 12 categories to 211 categories."**
>
> ***– Jun Ma,***
> *China Society for Finance and Banking*

How are ASEAN policy makers approaching taxonomy development?

The ASEAN Regulatory Perspective
Ephyro Luis B. Amatong*, Commissioner, Securities and Exchange Commission (SEC), Philippines*

ASEAN is fast-growing, exposed to climate risks, and has big sustainable infrastructure needs. ASEAN is the fastest-growing region in the world, with combined output that would rank it as the world's fifth-largest economy. But it is also a region that is highly exposed to climate change risks such as sea level changes, so there is great demand for sustainable infrastructure. To attract the necessary sustainable investment flows, the ACMF launched the ASEAN Green Bond Standards (AGBS) in 2017

> **"The reality is that there are environmental and developmental differences between ASEAN and other regions. Having different levels of development means that different regions have different sets of options for their sustainability journey."**
>
> ***– Ephyro Luis B. Amatong****, SEC*

in cooperation with ICMA.[12] The AGBS has two purposes: (i) provide clear guidance to ASEAN issuers for accessing funds for sustainable development, and (ii) provide assurance to investors that AGBS-labeled green bonds adhere to high standards. But rather than use a "positive list" to define what can be done— such as with the PRC's Green Bond Catalog—the AGBS uses a "negative list" to exclude certain activities, including fossil fuels, as a power source. Since 2017, ASEAN issuers have issued green, social, and sustainability bonds meeting the AGBS worth an aggregate USD16.8 billion (Figure 6).[13]

Figure 6: Key Features of the ASEAN Green Bond Standards

Issuers or issuances must have a geographical or economic connection to the ASEAN region

Specific exclusion of certain projects:

- Fossil fuel power generation projects are exluded from ASEAN Green Bond Standards to mitigate green washing of projects
- Projects which involve activities that pose a negative social impact related to alcohol, gambling, tobacco, and weaponry are excluded from the ASEAN Social Bond Standards. Issuers are also encouraged to develop a list of additional ineligible projects for the issuance of their ASEAN Social Bonds, if applicable

Issuers are required to disclose information not only in the issuance documents but throughout the tenure of the bonds on a public website designated by the issuer

Issuers are encouraged to provide more frequent periodic reporting to increase transparency on the allocation of proceeds

The external reviewer must have the relevant expertise and experience in the area, which they are reviewing. The external reviewer's credentials and scope of review must also be publicly disclosed

ASEAN = Association of Southeast Asian Nations.

Source: Association of Southeast Asian Nations (ASEAN) Capital Markets Forum. 2021. Roadmap for ASEAN Sustainable Capital Markets. https://www.theacmf.org/initiatives/sustainable-finance/roadmap-for-asean-sustainable-capital-markets.

ASEAN launched its own taxonomy with an innovative "traffic-light system" for transition. ASEAN is new to the taxonomy development business, but the process has already begun. Version 1 of the ASEAN Taxonomy was launched in November 2021.[14] A key design principle of the ASEAN taxonomy is to respect the domestic sustainability priorities of ASEAN member states and provide a common language for mainstreaming climate change adaptation and sustainability. One unique feature of the ASEAN Taxonomy is the use of a "traffic-light system." "Red" means not aligned with the Paris Agreement, i.e., not aligned to the goal of 1.5°C. "Green" means clearly Paris Agreement-aligned. There is also an intermediate category, "amber," for transition. There is a major need, especially in emerging markets, to transition high-emitting industries and companies. However, this cannot be achieved

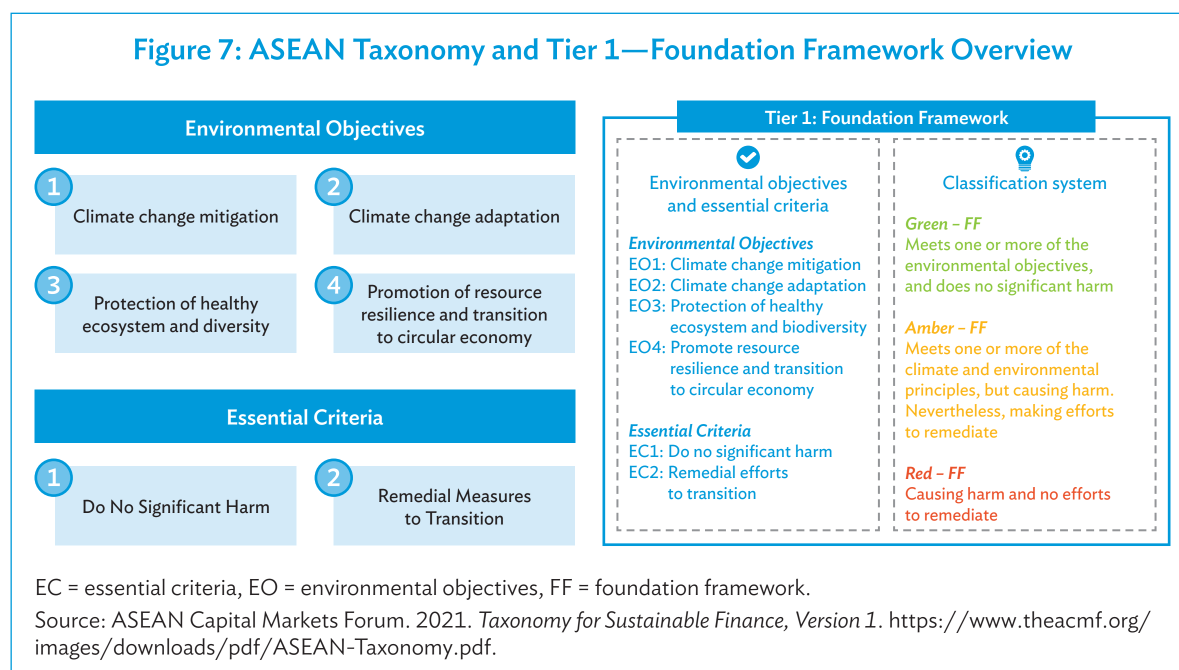
[12] The ACMF is a high-level grouping of capital market regulators from all 10 ASEAN jurisdictions that was established in 2014 under the jurisdiction of ASEAN finance ministers. The ACMF's primary responsibility is to develop a deep, liquid, and integrated regional capital market. For details, see https://www.theacmf.org/.

[13] The total climbs to approximately USD20 billion equivalent when including Indonesian self-labeled green *sukuk* (Islamic bonds) issuance.

[14] ASEAN. 2021. *News Statement.* "ASEAN Sectoral Bodies Release Taxonomy for Sustainable Finance." 10 November. https://asean.org/asean-sectoral-bodies-release-asean-taxonomy-for-sustainable-finance-version-1/

overnight, either because the necessary technology has not yet been developed or is not yet available in the region. So while ASEAN policy makers are considering the work of other jurisdictions and widely used taxonomies where relevant, ultimately the ASEAN taxonomy must be made practical and useable for all ASEAN members (Figures 7 and 8).

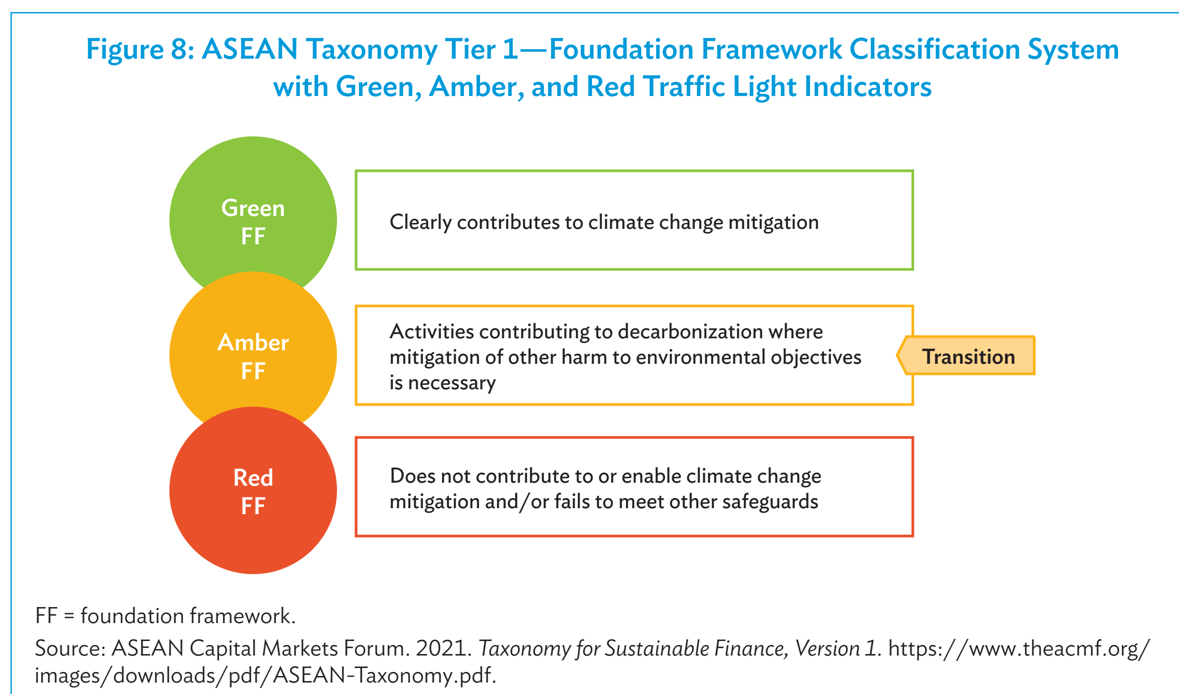
Figure 7: ASEAN Taxonomy and Tier 1—Foundation Framework Overview



EC = essential criteria, EO = environmental objectives, FF = foundation framework.

Source: ASEAN Capital Markets Forum. 2021. *Taxonomy for Sustainable Finance, Version 1*. https://www.theacmf.org/images/downloads/pdf/ASEAN-Taxonomy.pdf.

Figure 8: ASEAN Taxonomy Tier 1—Foundation Framework Classification System with Green, Amber, and Red Traffic Light Indicators



FF = foundation framework.

Source: ASEAN Capital Markets Forum. 2021. *Taxonomy for Sustainable Finance, Version 1.* https://www.theacmf.org/images/downloads/pdf/ASEAN-Taxonomy.pdf.

Transition Finance and Taxonomy Development

How can transition finance help decarbonize high-emitting and hard-to-abate economic sectors?

The PRC Policy Maker's Perspective

***Jun Ma**, Chairman, Green Finance Committee of the China Society for Finance and Banking*

> **"Transition finance is a complex issue that requires a framework with four elements."**
>
> ***– Jun Ma,***
> *China Society for Finance and Banking*

1. **Taxonomy.** Companies in high-carbon industries need a taxonomy with multiple pathways to transform themselves into low-carbon companies. For example, several pathways exist for coal-fired power generation companies to become renewable energy companies and for steel and cement companies to become carbon-neutral companies. Once a potential pathway is agreed on and recognized by experts as a qualified transition activity, then financial markets can support it with greater confidence.

2. **Disclosure.** The disclosure of a company's carbon reduction performance must be properly designed and reported as a process, not as a project-based static disclosure. Companies should disclose performance over a meaningful timeframe (e.g., their carbon-reduction trend over a 5-year period).

3. **Financial instruments.** The problem facing many transition companies is that they are already in financial difficulty, so suitable financial products are needed. Often, such companies cannot borrow easily because they are highly leveraged, so equity financing may be more appropriate than loans and bonds at the initial stages. For example, private equity, venture capital, and buyout funds can be combined with debt–equity swaps and, at a later stage, with transition bonds and transition loans as necessary.

4. **Incentives.** A range of financial, regulatory, and policy incentives can encourage companies to transform into low-carbon businesses. For example, if a coal-fired power generation company wants to transition to biomass energy then it needs to secure a stable supply of biomass, which takes coordination with local communities. This is an area where the government can be involved to facilitate the process.

How can taxonomies and policies provide credible mechanisms to support transition finance?

The ASEAN Regulatory Perspective

***Ephyro Luis B. Amatong**, Commissoner, Securities and Exchange Commission (SEC), Philippines*

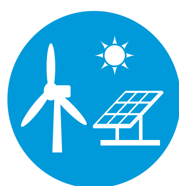
Energy Transition Mechanism (ETM): policy innovation to accelerate climate transition. One example of a policy for enabling a credible transition finance market is the ETM, a mechanism piloted by the governments of Indonesia and the Philippines and announced by ADB at COP26 in 2021. The motivation for this mechanism is not only to help the region achieve a just transition but also an

orderly transition, which is of particular importance for financial regulators. The concept of the ETM is to pool funds into a special purpose vehicle fund with ADB financing and technical assistance to accelerate the retirement of coal-fired power plants by taking these assets off the books of their current owners—i.e., buying them out—with a programmed and planned phase out of those assets. This allows the current assets owners and financiers to remain solvent and financially stable, while reinvesting the proceeds in more sustainable projects like renewable energy (Figure 9).

"We were looking at the idea of an energy transfer mechanism as early as 2019. We had feedback from our banks: They had successfully issued green bonds for financing sustainable assets… but this left carbon assets still on [their] books. 'Greening the book doesn't decarbonize the book' if I am a bank."

***– Ephyro Luis B. Amatong**, SEC*

Figure 9: Benefits of the Energy Transition Mechanism

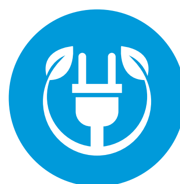


Accelerate climate action

Countries participating in ETM will be able to reach more ambitious emissions targets than under their current commitments.

Reduce energy costs

Speeding up the retirement of coal-fired electricity will increase the demand for clean energy 2–3 times, lowering overall energy costs in the long run.



Drive investment

ETM will help unlock or "crowd in" investment in cost-effective renewable generation and support and enable clean technologies, such as smart grids, hydrogen, and electric vehicles.

Provide a scalable model

ETM has the potential to be scaled up other parts of Asia and the Pacific, as well as Latin America and Africa, which could drive significant reductions in global emissions.

ETM = Energy Transition Mechanism.

Source: ADB. What We Do. Energy Transition Mechanism. https://www.adb.org/what-we-do/energy-transition-mechanism-etm.

Building the ASEAN Taxonomy to credibly address transition and support markets. Under the current AGBS, funding for the ETM would not be considered as a green use of proceeds. However, transition financing will be crucial for attaining the goals of the Paris Agreement. This is why the ASEAN Taxonomy has a separate and intermediate classification for transition with clearly defined metrics and milestones. These metrics can then be linked to a company- or industry–level transition, and potentially funded with sustainability-linked bond (SLB) issuance.[15]

[15] SLBs are intended for the issuer's general purpose financing needs, while incorporating forward-looking sustainability key performance indicators with targets that are linked to the financial and/or structural characteristics of the bonds (e.g., coupon step-up in case pre-set sustainability key performance indicators are not reached in time). Green and sustainability bonds on the other hand finance specific projects based on a use-of-proceeds approach. For details, see https://www.icmagroup.org/sustainable-finance/the-principles-guidelines-and-handbooks/sustainability-linked-bond-principles-slbp/.

How can investor concerns with transition financing be credibly addressed?

Global Asset Manager (Rick Lacaille, SSGA): The announcement of ADB's ETM along with South Africa's Just Energy Transition were some of the most exciting announcements from COP26.[16] This is because so much of total emissions come from power [generation], specifically coal power and particularly in emerging markets. The question is how to motivate investors to step into this difficult area where a sophisticated dialogue is required. Investors need to be committed to both their own Net Zero journey as asset owners and asset managers, while also being responsible for the brown, or difficult, assets throughout their carbon transition. The question remains how to start this dialogue with international investors to overcome their reluctance to be owners and financiers of such enterprises.

> **"Emerging markets are at a very energy intensive stage of development and obviously need to not turn the electricity off."**
>
> – ***Rick Lacaille**, SSGA*

ASEAN Financial Regulator (Ephyro Luis B. Amatong, SEC): The ASEAN Taxonomy is focused on defining transition as part of the overall taxonomy. This does not mean that transition itself is green or a permanent state: Companies have to transition to something else and continue improving. But transition is a necessary component for reaching the Paris Agreement goals. This requires defining transition with clear metrics and milestones, because investors have concerns that they will be attacked for owning brown assets. Multilateral development banks, acting as credible third parties to governments and companies, can provide assurance to market players by monitoring the transition mechanism in a transparent way.

> **"Some of these [coal] power plants in the Philippines are only 25 or 30 years into a 40- or 50-year lifespan. But we want to retire them, and their owners want to retire them, and the banks who finance them want to retire them, so we need to define a transition area so that the [investors] in this early retirement fund are not unduly criticized for greenwashing."**
>
> – ***Ephyro Luis B. Amatong**, SEC*

Webinar 2: Trend toward ESG Centricity of Portfolio Investments

In this webinar, global and regional Asian investors and regulators discussed the trend toward ESG centricity in portfolio investments. Global investors presented their views of the structural drivers of the ESG trend, the development of Asian sustainable investment markets, and the outlook and challenges for Asian green and social bond markets. Asian asset owners and asset managers described their own experiences as ESG investors, revealing best practices and an honest accounting of the challenges they face. Speakers' perspectives from a variety of roles shed light on how investors and policy makers are increasingly shaping markets where ESG plays a central role.

[16] UN Climate Change Conference. 2021. *Political Declaration on the Just Energy Transition in South Africa*. 2 November. https://ukcop26.org/political-declaration-on-the-just-energy-transition-in-south-africa/.

This discussion addressed topics such as the following:

1. What are the structural drivers of the trend for ESG centrality in investing?
2. How are sustainable investment markets developing in Asia?
3. How are Asian investors developing their own approaches to ESG investing? What lessons and best practices can they share?
4. What challenges do investors face when applying ESG analysis and integrating ESG data into their portfolio investment decisions?

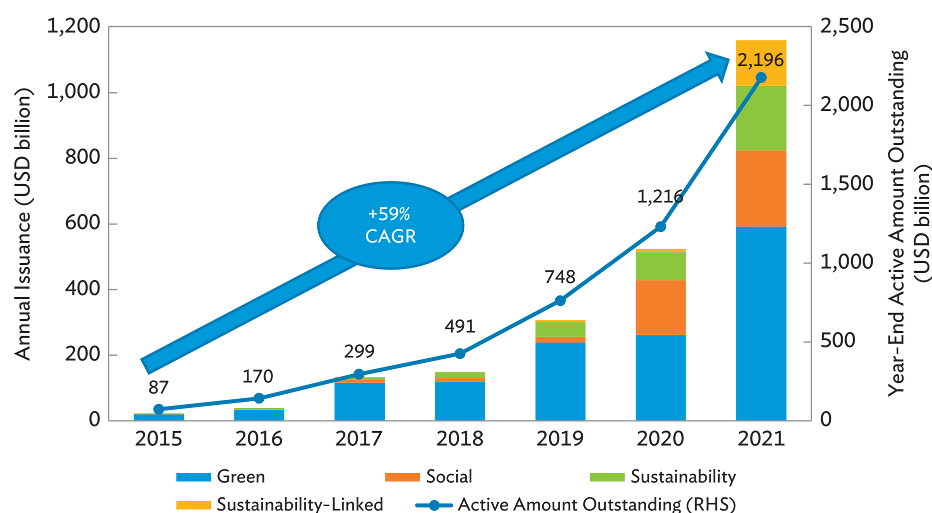
Webinar 2: Key Takeaways from the Speakers

- ✓ ESG is increasingly central to investor portfolios globally and in Asia. Global investor alliances such as GFANZ representing trillions of dollars in assets are committed to fighting climate change. Active asset managers are embracing ESG for standing out in terms of their process and performance. Leading Asian pension funds and regulators are likewise embracing ESG to actively steer the growth of local sustainable markets.
- ✓ ESG investments are growing more attractive in terms of liquidity, risk-adjusted returns, and resilience to market shocks and policy shifts. The global green bond market is now nearly USD1.5 trillion in size, and green bonds provide liquidity and investment potential that can satisfy even some of Asia's largest central bank reserves' managers. Investors are recognizing that changes in societal and client preferences are a lasting trend, and they are investing their portfolios accordingly.
- ✓ Despite getting a relatively late start to ESG investing, Asian investors are learning fast and developing their own approach and set of best practices by listening to and reflecting client values, developing a common organizational mindset, setting clear guidelines and objectives to address doubts, prioritizing stewardship and engagement, preparing for rapid change, and building a solid foundation of education.
- ✓ In the process of developing their own sustainable investment practices, Asian investors have encountered challenges and identified problems. Commonly applied methods like exclusion and divestment also have downsides and questionable effectiveness. ESG best-in-class selection may lead to less, not more, positive change in company behavior. And ESG data and ratings are costly, often contradictory, and a challenge to objectively integrate.
- ✓ The global green bond market is solidly mainstream. Green financial markets are developing in Asia, with policy maker support and increased social expectations for comprehensive action against climate change. The PRC is expected to need CNY3 trillion–CNY4 trillion in green investments by 2030, which will further increase demand. The social bond market has also grown rapidly since 2020, as investors are keen to contribute finance for attainment of the SDGs.

Background. The concept of ESG investing and sustainable development has grown into a mainstream pillar of finance over the past decade. The trend toward ESG centricity in investment decisions by asset managers and institutional investors—such as insurance companies, sovereign wealth funds, and pension funds—is accelerating in international financial markets, but there are differences between developments in Europe and in Asia and the Pacific. To direct financing resources toward a sustainable development trajectory, investors and intermediaries can take concrete actions to improve SDG alignment by enhancing transparency and accountability to reduce risks of misalignment and avoid negative externalities.

One fast-growing area of sustainable investment is the market for green, social, and sustainability bonds. These fixed-income instruments specify the use of proceeds for funding projects and assets with positive climate, environmental, and social impacts. From the first green bonds issued by the European Investment Bank and World Bank in 2007 and 2008, respectively, to the launch of the ICMA Green Bond Principles in January 2015, the global green bond market has now reached nearly USD1.5 trillion of active outstanding bonds—and nearly USD2.2 trillion when including the full line-up of impact bonds. Market participants and policy makers have been eager to participate in and grow local markets for these and other sustainable investments. However, investors in Asia often face tough questions about liquidity, attractiveness, and the risk of greenwashing that these investments entail (Figure 10).

Figure 10: Annual Issuance and Year-End Active Amounts Outstanding of Green, Social, Sustainability, and Sustainability-Linked Bonds



CAGR = compound annual growth rate, RHS = right-hand side, USD = United States dollar.

Notes: Bond notional and amounts outstanding have been converted to the United States dollar rate at time of issuance. "Active Amount Outstanding" refers to the cumulative outstanding notional amount of all types of publicly issued impact bonds at the end of each year, accounting for maturities and redemptions.

Source: Author's calculations based on Bloomberg LP data.

Speakers

- **Edris Boey**, Head, ESG Research, Maitri Asset Management
- **Kim Chong**, Head, Risk Management and Compliance, HKMA
- **Rick Lacaille**, Executive Vice-President and Global Head, ESG, SSGA
- **Srikanya Yathip**, Secretary General, Government Pension Fund Thailand

Structural Drivers of ESG Centrality in Investing

What is driving the trend toward ESG centricity in portfolio investments?

The Multilateral Development Bank Perspective
***Ingrid van Wees**, Vice-President for Finance and Risk Management, ADB*

The pandemic has highlighted the need for green, sustainable, and resilient investment. The COVID-19 pandemic has raised awareness of how ESG investment can address both environmental and social challenges. In response, investors globally and in Asia are increasingly putting ESG at the heart of portfolio investment decisions. A 2021 survey by the investor consultancy bfinance of investor attitudes showed that 95% of asset owners in Asia and the Pacific assigned either high or moderate importance to ESG investing, which exceeded the 91% and 70% response rates for European and US asset owners, respectively.[17]

> **"The COVID-19 pandemic and resulting severe socioeconomic challenges increased awareness that ESG investment can help address both environmental challenges like climate change and pollution, as well as social challenges like inequality and gender issues."**
>
> – ***Ingrid van Wees**, ADB*

ESG investments are supported by more resilient portfolio returns. ADB's *Asian Development Outlook 2021* detailed how the rapid expansion of global ESG investments is increasingly supported by sound financial rationale.[18] ESG investments demonstrate hedging performance due to their superior return resilience to shocks at the market and firm levels. This is because ESG investments create social capital in the market and increase trustworthiness among market participants, which pays off during times of crisis.

ESG investments mitigate regulatory and sustainability risks and lower funding costs. Governments and regulators are increasingly aligning their financial systems to assist in their commitments to the SDGs.[19] Amid rapid shifts in regulation, ESG-aligned investments can mitigate risks to investments related to the transition to Net Zero emissions. From a supply perspective, the changing preference globally toward responsible investment from both investors and stakeholders makes it easier for issuers of ESG-themed financial assets to attract stable funding from the market at competitive rates.

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[17] bfinance. 2021. "ESG Asset Owners Survey—How are Investors Changing?" *bfinance White Paper*. https://www.bfinance.com/insights/esg-asset-owner-survey-how-are-investors-changing/#.

[18] ADB. 2021. *Asian Development Outlook 2021*. https://www.adb.org/publications/asian-development-outlook-2021.

[19] UN. SDG. https://sdgs.un.org/goals.

What explains the investment industry's embrace of ESG investing?

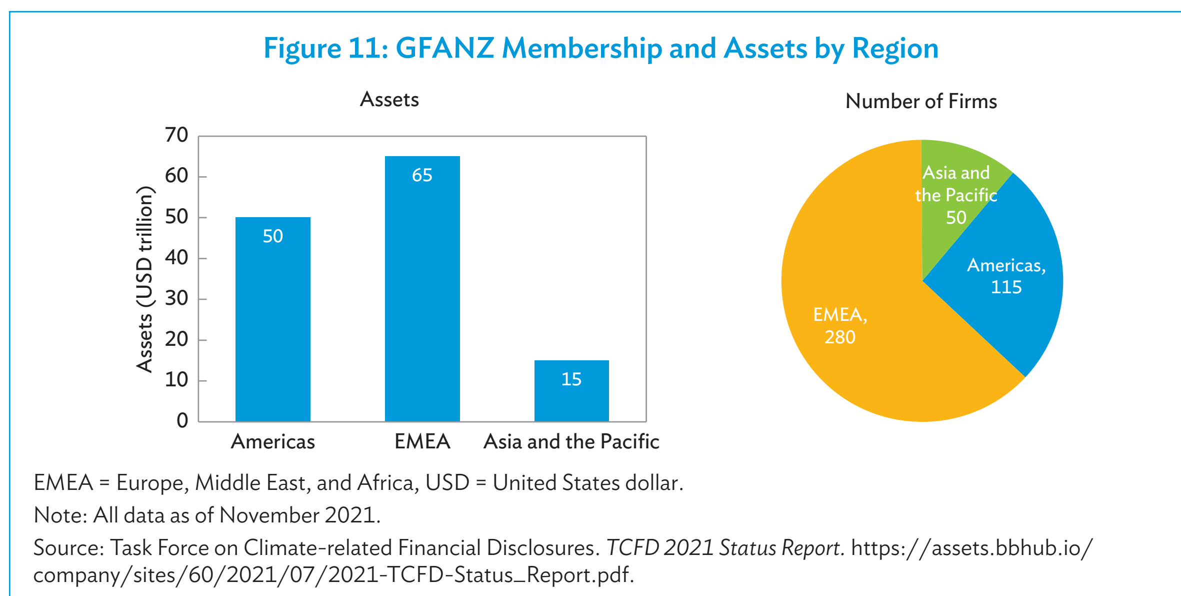
The Global Private Sector Asset Manager Perspective
Rick Lacaille*, Executive Vice-President and Global Head, ESG at SSGA*

> **"ESG investment is itself an investment opportunity."**
>
> – ***Rick Lacaille****, SSGA*

As index and passive investing has grown, ESG is a way for active managers to stand out. As investment capital has shifted from active to passive or index investing, the investment industry has come to see ESG as a unique and effective lever for active management. When assessing corporates or sovereigns, investors must apply a forward-looking lens. ESG data is very qualitative, often difficult to use, and inconsistent. These are precisely the areas where asset managers can differentiate themselves with their skill at generating investment alpha. So, while parts of finance have become more standardized and subject to factor-based and quantitative factors, ESG is the opposite—it is qualitative, a bit eclectic, and offers many opportunities for distinguishing an investor's process through superior returns.

Global customer demand for ESG is strong, and policy is further driving demand. Customer demand for ESG investment products is strong and growing, although each part of the world has a different flavor. Europe is an established leader in the field, and policy developments there are further driving ESG demand. GFANZ, a global coalition of financial institutions representing a USD130 trillion base of private capital committed to achieving Net Zero, is an example of how the private market is coalescing to mobilize mainstream finance for sustainability.[20] This and other initiatives demonstrate how market players increasingly recognize the need to account for negative externalities, consider the opportunities that climate change presents, and commit to changing how money is managed globally (Figure 11).

Figure 11: GFANZ Membership and Assets by Region



EMEA = Europe, Middle East, and Africa, USD = United States dollar.
Note: All data as of November 2021.
Source: Task Force on Climate-related Financial Disclosures. *TCFD 2021 Status Report*. https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.

[20] GFANZ. Net Zero. https://www.gfanzero.com/.

Growing Sustainable Investment Markets in Asia

How are Asian policy makers supporting the growth of sustainable investment markets?

The Asian Dual Regulator and Asset Manager Perspective
***Kim Chong**, Head, Risk Management and Compliance, HKMA*

Policy makers are promoting industry awareness of climate-related risks and disclosure. Market regulators including the HKMA are setting climate-related guidelines and expecting banks to assess their baseline risks. As part of the low-carbon trend, regulators are encouraging greater investment flows into activities consistent with lowering greenhouse gas emissions for the climate-resilient development of the market. For example, with the aim of aligning with the Common Ground Taxonomy, the Green and Sustainable Finance Cross-Agency Steering Group (Steering Group), which is cochaired by the HKMA and the Securities and Futures Committee, will explore developing a green classification framework for adoption in the local market to facilitate easy navigation between the Common Ground Taxonomy, PRC Taxonomy, and EU Taxonomy.[21] The Steering Group is also committed to aligning Hong Kong, China's finance industry with the TCFD by 2025 and continues to collaborate with stakeholders on evaluating and potentially adopting the sustainability standards of the IFRS Foundation.[22]

Increased commitments to Net Zero will raise public awareness. Market investors are increasingly driven by the belief that ESG investment offers better long-term risk-adjusted returns. Regulation will also play a role as a significant driver of sustainable markets. The EU is advanced in terms of setting regulations to tackle climate change, and more countries and companies in Asia are pledging Net Zero carbon commitments. This will have the effect of raising public expectations over time (Figure 12).

How has liquidity in the Asian green bond market developed?

The Asian Dual Regulator and Asset Manager Perspective
***Kim Chong**, Head, Risk Management and Compliance, HKMA*

Green bonds have shown similar levels of liquidity with nongreen bonds and an attractive performance. In Asia, green bond market liquidity and issue sizes have improved markedly. Benchmark issues of USD500 million or larger are now common, with an increasing variety of issuer types and industry sectors. Market liquidity will improve over time given the PRC's commitment to increase green issuance. By 2030, the PRC is expected to require CNY3 trillion–CNY4 trillion of green investments. The HKMA sees ESG bonds as

> **"We observed low volatility of green bonds in the initial market reaction to COVID-19 in 2020 and our own portfolio of ESG-themed mandates has produced good performance with alpha relative to the benchmark."**
>
> – ***Kim Chong**, HKMA*

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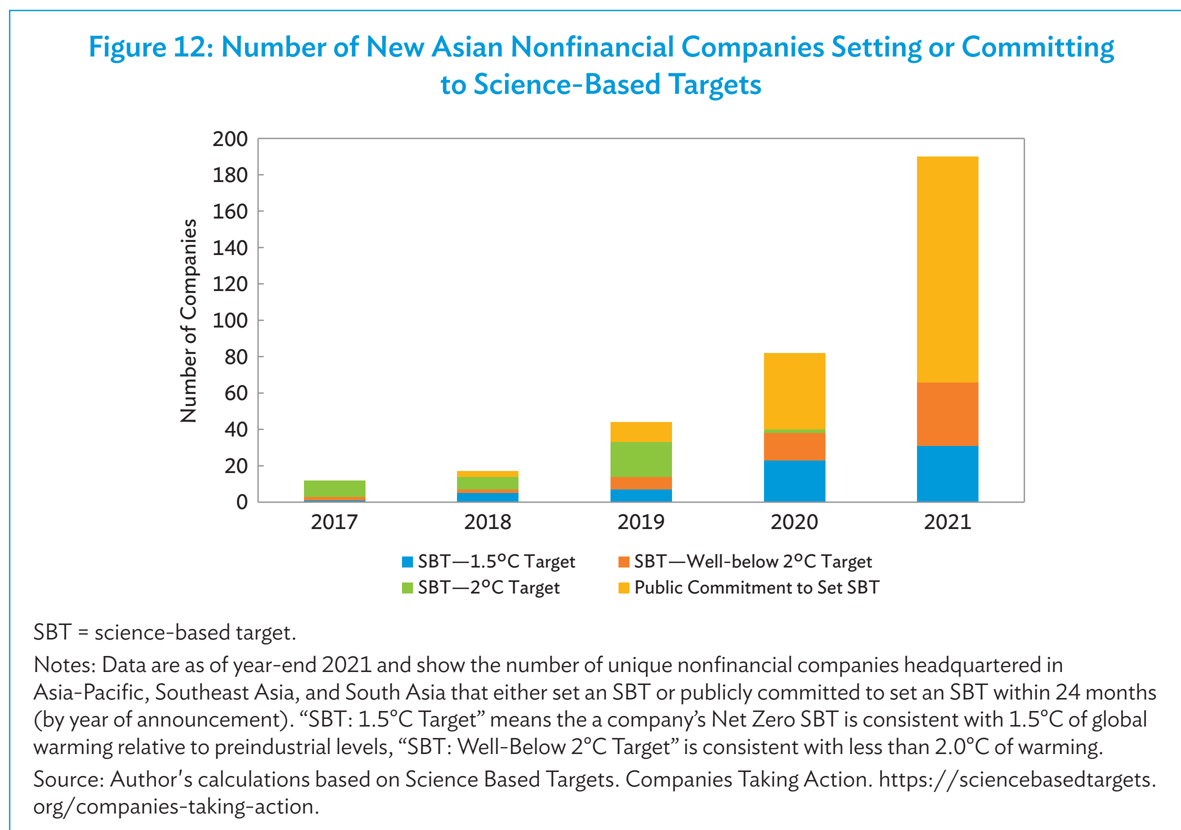
[21] IPSF. *Common Ground Taxonomy Instruction Report.* https://ec.europa.eu/info/business-economy-euro/banking-and-finance/sustainable-finance/international-platform-sustainable-finance_en.

[22] IFRS Foundation. Sustainability Standards. https://www.ifrs.org/.

Figure 12: Number of New Asian Nonfinancial Companies Setting or Committing to Science-Based Targets



SBT = science-based target.

Notes: Data are as of year-end 2021 and show the number of unique nonfinancial companies headquartered in Asia-Pacific, Southeast Asia, and South Asia that either set an SBT or publicly committed to set an SBT within 24 months (by year of announcement). "SBT: 1.5°C Target" means the a company's Net Zero SBT is consistent with 1.5°C of global warming relative to preindustrial levels, "SBT: Well-Below 2°C Target" is consistent with less than 2.0°C of warming.

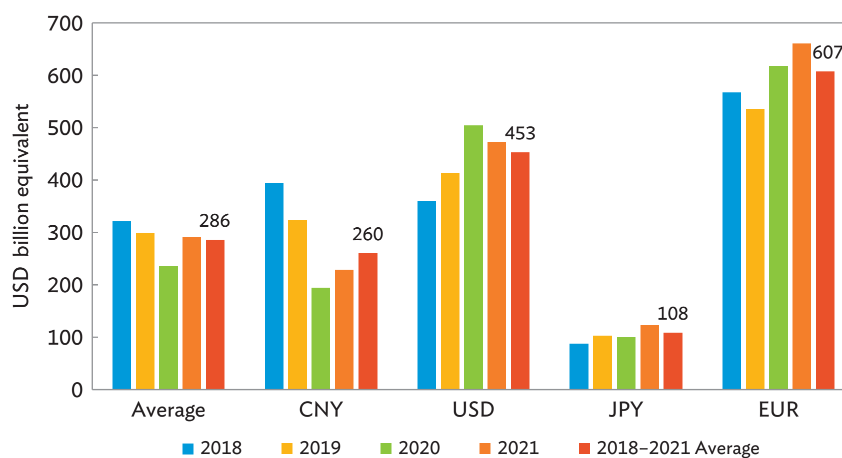
Source: Author's calculations based on Science Based Targets. Companies Taking Action. https://sciencebasedtargets.org/companies-taking-action.

exhibiting similar liquidity as other bonds from the same issuer, and the performance of green bonds has generally been in line with conventional counterparts across sectors and geographies. ESG bond investors are often buy-and-hold investors, which can lead to reduced secondary market trading for these instruments. Although this tendency can make it more difficult for investors to buy ESG bonds after they have been issued, it also means that ESG bonds are less subject to selling pressure in down markets (Figure 13).

As a market facilitator, the HKMA is growing a green financial market in Hong Kong, China. The HKMA has partnered with the International Finance Corporation in the Alliance for Green Financial Banks and has assisted the government in developing and launching a green bond program.[23] This issuance program has doubled in size to HKD200 billion, with recent issuances of USD-, EUR-, and CNY-denominated bonds in addition to bonds denominated in Hong Kong dollars. The HKMA expects to continue increasing green issuance in a mix of structures, tenors, and currencies to promote the market, and it sees these activities as consistent with its role as a reserve manager.

[23] International Finance Corporation. Alliance for Green Financial Banks. https://www.ifc.org/wps/wcm/connect/industry_ext_content/ifc_external_corporate_site/financial%20institutions/priorities/climate_finance_sa/alliance%20for%20green%20commercial%20banks.

Figure 13: Asian Green Bond Average Notional Sizes at Issuance by Currency and Year



CNY = Chinese yuan, EUR = euro, JPY = Japanese yen, USD = United States dollar.

Notes: Simple average of fixed-rate green bonds issued by corporates, sovereigns, and agencies domiciled in Asia and the Pacific.

Source: Author's calculations based on Bloomberg LP data.

How can the social bond market attract investor capital?

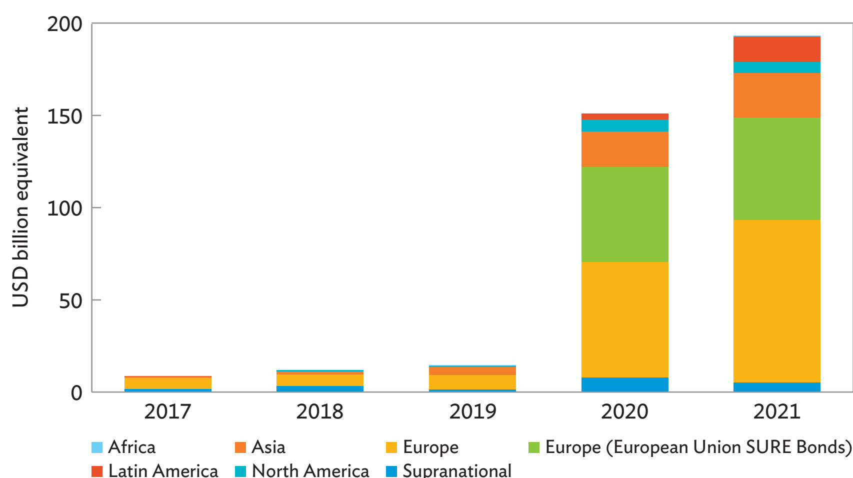
The Global Private Sector Asset Manager Perspective
***Rick Lacaille**, Executive Vice-President and Global Head, ESG at SSGA*

> **"Social issues received a lot of attention in 2020... investors looked at these companies and asked are they really 'living well' in terms of their communities and employees and customers."**
>
> – ***Rick Lacaille**, SSGA*

Along with liquidity, clear criteria and SDG links are required for growing the social bond market. While the social needs of Asia and the Pacific are great, markets need clear criteria for the social bond market to achieve sustainable growth. This is not an easy task, and one that the Green Bond Principles took a long time to get right. Markets also need both liquidity and size. While the green bond market is trillions of dollars in size with strong liquidity characteristics, the total market for social bonds outstanding at the end of 2021 was only USD440 billion. With individual social bonds, issue sizes are sometimes smaller, and liquidity can be an issue. Many social impact metrics are qualitative in nature, making them difficult for issuers to report on and for investors to analyze, while linkages to SDGs are crucial but not always made clear (Figure 14).

If investors have confidence in impact and liquidity, investment flows will follow. The most important issue for the market is ensuring that investment in ESG bonds is not just financing projects that would have happened anyway. There are many challenges in the world to finance but investors need to know they are making an impact. In emerging markets particularly, investors need the support of credible institutions such as ADB and others for translating these social needs into bond issues that investors

Figure 14: Social Bond Annual Issuance Trends, 2017–2021



ICMA = International Capital Market Association, USD = United States dollar.
Note: Annual issuance of ICMA Social Bond Principles-aligned social bonds..
Source: Author's calculations Bloomberg LP data.

can invest in. Beyond climate change adaptation, there is a strong appetite in Europe for investments linked to the SDGs, so bonds with compelling links to SDGs will attract capital from these investors.

Environmental investments can have a strong social aspect, especially in emerging markets. Social issues were at the forefront of markets in 2020 for both equity and fixed-income investors. Ultimately, the choice is not a matter of social or environmental, it is both. The amount of global capital needed for decarbonization is almost USD3 trillion per year. This investment can have a strong social dimension when considering the challenges faced by emerging market economies.

Asian Approaches to ESG Investing

Why are Asian investors adopting ESG investment practices?

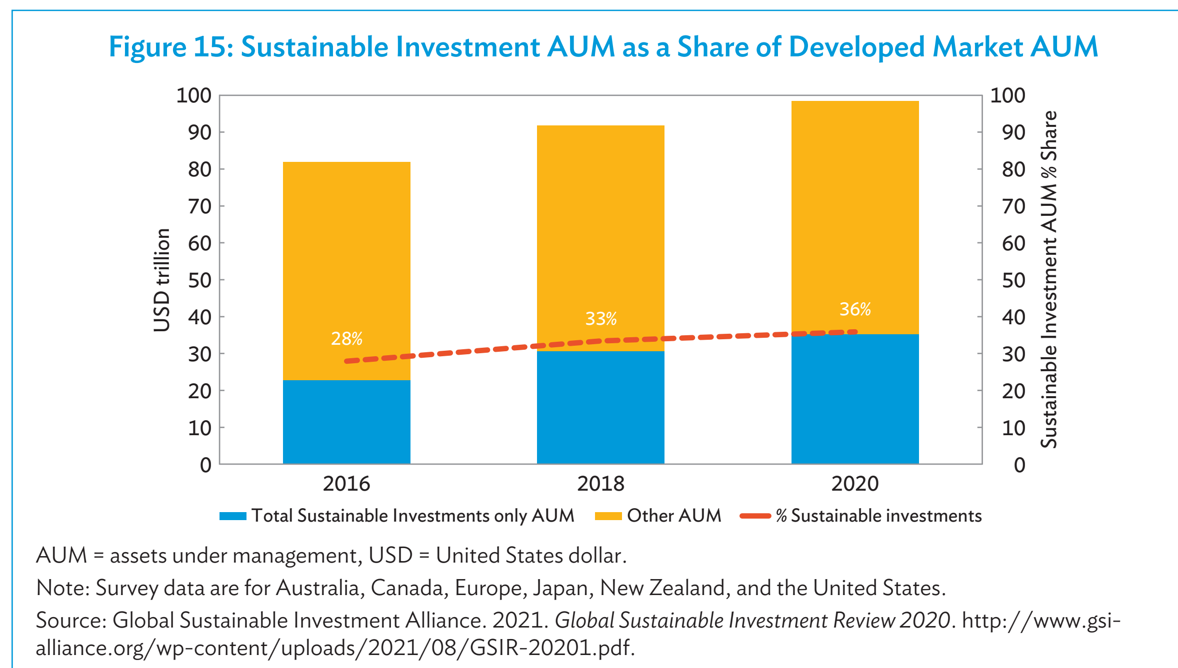
The Asian Family Office and Asset Management Perspective
***Edris Boey**, Head, ESG Research, Maitri Asset Management*

The narrative has shifted on the link between ESG and financial performance. Previously the question to investors was: "Why are you integrating ESG?"—because there was a need to prove financial performance. Now the question is: "Why are you not integrating ESG?"—because its importance speaks for itself. In many cases, the connection between ESG and investment performance is clear. For example, when investing in mining companies,

> **"In the pre-pandemic environment, we had to justify why Maitri was a responsible investment house. Today it is the opposite: Instead of being asked why you are doing ESG investing, the question is why one is not doing ESG investing."**
>
> – ***Edris Boey**, Maitri Asset Management*

climate risks are material because water shortages can directly affect the company's operations. When investing in tech companies, investors must consider the question of gender equality, as these companies often face litigation for gender discrimination. Investors' ESG integration sends a clear signal to companies that ESG risks can directly affect market prices and cause volatility. For Asian companies where disclosure is less common, this is an opportunity to encourage them to be more transparent because it compels them to take steps to become more accountable (Figure 15).

Figure 15: Sustainable Investment AUM as a Share of Developed Market AUM



AUM = assets under management, USD = United States dollar.

Note: Survey data are for Australia, Canada, Europe, Japan, New Zealand, and the United States.

Source: Global Sustainable Investment Alliance. 2021. *Global Sustainable Investment Review 2020*. http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.

The Thai Public Pension Fund Perspective
***Srikanya Yathip**, Secretary General, Government Pension Fund Thailand*

The adoption of ESG investing in Asia and the Pacific is a not a passing fad. ESG investing by universal owners is driven by their belief that global investing impacts all stakeholders—not just the entities they are directly invested in, but also the consumer, society, and the planet. This way of thinking is now an established trend among Asian asset owners. Thailand's Government Pension Fund (GPF) committed to ESG investment in 2018 with the determination to become a leader in ESG investing and initiatives. This has involved integrating ESG throughout the investment processes, while considering ESG as both a long-term risk and an opportunity.

How have Asian investors developed their own ESG investment approaches?

The Thai Public Pension Fund Perspective
***Srikanya Yathip**, Secretary General, GPF*

The Thai GPF focuses on four areas: human rights, climate, SDG 11, and SDG 12. Since 2021, the Thai GPF policy framework has focused on four specific areas. The first policy focus is human rights to protect and respect all those who are involved in the investment value chain. The second focus is climate

change as a global issue affecting all stakeholders. The third and fourth policy focus areas are SDG 11 (Sustainable Cities) and SDG 12 (Sustainable Consumption). All capital allocation decisions and assets at the Thai GPF are to be ESG-aligned and contribute to these focus areas, including investments in domestic stocks. When investing outside of Thailand, the GPF requires external managers to integrate ESG, engage with investee companies, and clearly explain the policies they apply when companies do not comply with ESG requirements.

The Asian Dual Regulator and Asset Manager Perspective
Kim Chong, *Head, Risk Management and Compliance, HKMA*

The HKMA has formalized guidelines to prioritize ESG where risk-adjusted returns are equal. As an asset owner, the HKMA has developed a guiding principle that priority is given to ESG investments if the risk-adjusted returns are comparable. While front office investment groups were at first concerned that ESG investment meant accepting concessionary returns, having this clear guiding policy helped change the mindset. In terms of liquidity, the HKMA maintains two separate portfolios: (i) the backing portfolio, which must be highly liquid; and (ii) the investment portfolio, which takes some liquidity risk such as private equity investments. The less liquid investment portfolio has invested in green energy projects and sustainable infrastructure, whereas investments with a higher priority on liquidity have included passive mandates with ESG benchmarks and active ESG mandates with carbon reduction overlays.

> **"ESG itself is not a significant constraint on investment once you make a clear distinction in the objectives."**
>
> *– **Kim Chong**, HKMA*

The HKMA practices investment stewardship over exclusion. The HKMA has opted for a stewardship approach based on voting and engagement, rather than exclusion or divestment, which can significantly restrict the investment universe. As the HKMA's equity holdings are managed externally, the reporting and voting records of external managers on controversial items is checked for consistency against their official policies. At the HKMA, stewardship as an asset owner means holding external asset managers to account.

What advice and best practices can Asian investors share from their experiences?

The Asian Family Office and Asset Management Perspective
Edris Boey, *Head, ESG Research, Maitri Asset Management*

ESG investment starts with understanding the client's values. Starting out as a family office whose single-largest beneficiary was the family's charitable foundation, it was important for Maitri's values to be aligned with the firm's beneficiaries.[24] At the start, this was straightforward. The firm could ask family

> **"I have observed the ESG investment space growing faster in the past 12 months than it has in the past 10 years combined."**
>
> *– **Edris Boey**, Maitri Asset Management*

[24] Ishk Tolaram Foundation. https://www.ishktolaram.com/.

members directly about their values, observe how the family business was run, and study the mission of the family's charitable foundation. For example, the mandate of the family foundation is to help youths create sustainable livelihoods in regions where the family business operates. Therefore, the family office chose to exclude investing in goods and services that cause loss of life, any detriment to health, or are associated with human trafficking.

Building a responsible investment practice requires a formalized approach. As Maitri grew and became a multifamily office, the firm formalized its responsible investment approach through four stages: introspection, education, development, and implementation. The first stage, introspection, involved understanding the client's perspective on responsible investment by asking the beneficiaries directly about their preferences and what values they wanted to express. The second stage, education, was important as the market has many terms—such as responsible investing, impact investing, and so on—for which there is no single agreed definition. This results in a wide spectrum of practices across the market, so Maitri referred to global trend setters and local initiatives to develop their own understanding. The third stage, development, involved testing the ideas gathered in earlier stages through trial-and-error. The fourth stage, implementation, involved integrating ESG research and ESG factors in the firm's investment process and decisions, supported by the availability of data from ESD data providers.

ESG is rapidly evolving and integration is a continuous learning process. The actual practice of integration is multifaceted and involves continuous learning. Investors should accept some degree of ambiguity—once an organization recognizes that there is no single definition of ESG or responsible investing, then it can move on to define and understand the concept for itself based on commonly agreed definitions. ESG investing is also a fast-moving space—a fundamental understanding is necessary upfront so that incremental knowledge will not be too hard to acquire. Just keeping up with the expanding range of initiatives, alliances, and task forces and their acronyms is itself demanding. When considering ESG materiality, investors should focus on understanding the market implications of policy and global movements like COP26 and be aware that collective engagement can be a powerful tool for smaller players (Table 2).

Table 2: Definitions of Common Terms in Sustainable Investment Strategies

ESG integration	The systematic and explicit inclusion by investment managers of environmental, social and governance factors into financial analysis.
Corporate engagement and shareholder action	Employing shareholder power to influence corporate behavior, including through direct corporate engagement (i.e., communication with senior management and/or boards of companies), filling or co-filling shareholder proposals, and proxy voting that is guided by comprehensive ESG guidelines.
Norms-based screening	Screening of an investment against minimum standards of business or issuer practice based on international norms such as those issued by the UN, ILO, OECD, and NGOs (e.g., Transparency International).
Negative or exclusionary screening	The exclusion from a fund or portfolio of certain sectors, companies, countries, or other issues based on activities considered not investable. Exclusion criteria, based on norms and values, can refer, for example, to product categories (e.g., weapons, tobacco), company practices (e.g., animal testing, violation of human rights, corruption) or controversies.

continued on next page

Table 2 *continued*

Best-in-class or positive screening	Investment in sectors, companies or projects selected for positive ESG performance relative to industry peers, and that achieve a rating above a defined threshold.
Sustainability theme or thematic investing	Investing in themes or assets specifically contributing to sustainable environmental or social solutions (e.g., sustainable agriculture, green buildings, lower-carbon tilted portfolio, gender equity, diversity).
Impact investing and community investment	**Impact investing** Investing to achieve positive, social, and environmental impacts—requires measuring and reporting against these impacts, demonstrating the intentionality of investor and underlying asset or investee, and demonstrating investor contribution. **Community investing** Where capital is specifically directed to traditionally underserved individuals or communities, as well as financing that is provided to business with a clear or environmental purpose; some community investing is impact investing, but community investing is broader and considers other forms of investing and targeted lending activities.

ESG = environmental, social, and governance; ILO = International Labour Organization; NGO = nongovernment organization; OECD = Organisation for Economic Co-operation and Development; UN = United Nations.

Note: There is no single accepted definition of "sustainable investment."

Source: Global Sustainable Investment Alliance. *Global Sustainable Investment Review 2020*. http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.

Acknowledging ESG Investment Challenges and Looking Forward

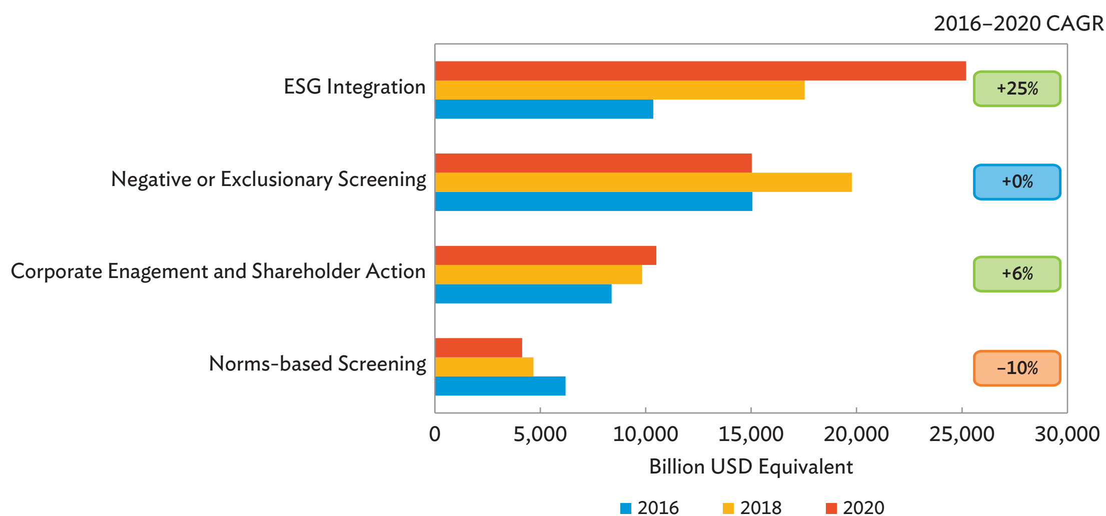
What challenges do investors face when integrating ESG into their portfolio investment decisions?

The Thai Public Pension Fund Perspective
Srikanya Yathip, *Secretary General, GPF*

The exclusion and divestment conundrum: What if another investor steps in when we step out?
ESG investors often face the following dilemma: What to do with an investee company that delivers good investment returns but does not have good ESG practices, especially if a suitable replacement for that investment cannot be found? ESG investors can engage to raise concerns, ask the company to comply with ESG considerations, and deliver an ultimatum; but in some cases companies cannot or will not respond with improvement. In that case it may be necessary to consider divesting from the company. However, this raises a new problem: If ESG investors exclude a particular industry or divest from a particular company, what happens if another investor with little or no consideration of ESG steps in as a replacement? Then, by not facing ESG investor pressure, the company may be even less motivated to address its ESG problems. This example illustrates that the reality of ESG and sustainable investing is not always straightforward. ESG investors have to consider the unintended consequences of commonly used approaches such as exclusion and divestment.

The downside to ESG best-in-class: Do investors make a difference when ESG is already good?
ESG investors are increasingly using the best-in-class approach as part of the growing adoption of ESG integration, while negative screening and norms-based screening are becoming relatively less

Figure 16: Reported Assets under Management per Sustainable Investment Strategy, 2016–2020



CAGR = compound annual growth rate; ESG = environmental, social, and governance; USD = United States dollar.

Note: Survey data from the Australia, Canada, the European Union, New Zealand, and the United States for selected sustainable investment strategies.

Source: Global Sustainable Investment Alliance. *Global Sustainable Investment Review 2020*. http://www.gsi-alliance.org/wp-content/uploads/2021/08/GSIR-20201.pdf.

common (Figure 16). Best-in-class or positive screening means selecting companies that do well by ESG factors. However, this approach also has a weakness. Investors may identify and invest in the companies that are doing well in ESG, but what does this approach imply for moderate or poorly performing ESG companies? In this case it can be argued that ESG investors are giving up their power to improve these companies since the best-in-class approach leads them to ignore companies that need ESG improvement the most. Conversely, should ESG investors continue to commit capital to an investment portfolio company that has a good ESG score but unattractive financial returns? These questions illustrate that ESG investing is not entirely straightforward in practice.

What challenges do ESG data pose for investors, and what can improve the situation?

The Thai Public Pension Fund Perspective
Srikanya Yathip, *Secretary General, GPF*

ESG information and ratings are often inconsistent and contradictory. To integrate ESG into investment policy, process, and decision-making, investors need material ESG data. Third-party data providers offer such ratings, but ratings from different providers is often inconsistent. This raises the question: Should ESG investors chose one

> **"ESG data is a nightmare to use… my recommendation is that we produce a 'centralized data source' [for ESG] together."**
>
> – ***Srikanya Yathip***, *Thai GPF*

data provider to use exclusively or consider multiple sources? And, in that case, how should investors compromise between contradictory signals? This lack of consistency and transparency is a barrier to ESG integration and investment. Skills and resourcing is another issue facing ESG investors, who do not always know what ESG factors are material and have limited resources, in terms of time and personnel, for carrying out ESG analysis.

Asian investors need more standardized and comprehensive ESG data and metrics. The lack of consistency and transparency in ESG data is a perennial issue facing ESG investors in Asia and globally. Collaborative cross-industry efforts to develop standardized analytical tools, metrics, data sets, and definitions are welcomed by investors. A "centralized source" for ESG may also help. Investors also need ESG data that cover large, medium-sized, and small companies, with consistent calculation methodologies, timely reporting, and regular update frequencies. The general lack of these qualities in ESG data today is an ongoing challenge for investors to turn their ESG investment ambitions into reality.

The Asian Family Office and Asset Management Perspective
***Edris Boey**, Head, ESG Research, Maitri Asset Management*

ESG investors face high lock-in costs from ESG data providers. It is important for investors to apply rigorous due diligence when onboarding data providers. Different providers use different methodologies and data platforms, so a deep understanding of the offerings of the data providers is a critical step before proceeding to integrating it into the investment process. This is because once investors go down the path of integrating a particular data provider's information, the investment approach to ESG assessment and scoring will inherently reflect this version of data and methodology. This can create friction for evolving one's ESG investment approach, as investors face high costs arising from the switching of their ESG data providers.

The Global Private Sector Asset Manager Perspective
***Rick Lacaille**, Executive Vice-President and Global Head, ESG at SSGA*

Momentum for a global baseline of sustainability disclosures is growing. The announcement of the ISSB at COP26 could lead to better quality sustainability data in the long run for asset managers globally to analyze ESG risks and opportunities more consistently and efficiently. Such initiatives, however, are not a panacea or a guarantee that all ESG investors will perform well. But it is an opportunity that many asset managers are grasping, and it is improving the asset management industry's overall prospects.

What can Asian asset owners, asset managers, and policy makers do to avoid greenwashing?

The Asian Family Office and Asset Management Perspective
***Edris Boey**, Head, ESG Research, Maitri Asset Management*

Responsible investment practices are needed to avoid greenwashing. Asset owners are concerned with greenwashing, and investors want to avoid this label. So it is incumbent on Asian financial institutions to have a firm understanding of and develop their own approach to responsible investing. Investment managers must seek to understand the values and motivations for asset owners and clients, and what these imply when implementing ESG investments on their behalf. Managers need

to communicate their own understanding and demonstrate that their ESG research process is robust and can withstand greenwashing scrutiny. In many jurisdictions in Europe, as well as in Asia and the US, regulators are taking steps to clarify ESG fund terminology in the market. In Hong Kong, China, for example, the Securities and Futures Commission published an updated circular in 2021 on what defines an ESG fund.[25]

The Asian Dual Regulator and Asset Manager Perspective
***Kim Chong**, Head, Risk Management and Compliance, HKMA*

As green markets boom, ESG investors are increasingly concerned with greenwashing. More than liquidity constraints, asset owners like the HKMA are concerned with greenwashing risks in ESG investment. Asset owners, in particular, are wary of the hype around green and ESG investments, seeing that many new players are entering this booming market. This means these investors need to compare managers' sustainable investment claims against their actual track record of voting and reporting. While a "high tide lifts all boats," asset owners must be increasingly discriminating between investment managers who are merely good at talking about ESG and those who are actually skilled in applying ESG for achieving investment performance.

What are the next steps for Asian ESG investors?

The Thai Public Pension Fund Perspective
***Srikanya Yathip**, Secretary General, GPF*

Next Steps: internal ESG factor valuations, portfolio impact assessment, and local initiatives. Investors are seeking to deepen their ESG integration and bring about real world impact. The Thai GPF is developing internal-use ESG factor valuations as an ESG lens for weighing and scoring the fund's securities holdings directly. The fund is also considering how to assess the impact of investments to better understand the ESG and SDG factors embedded in the total portfolio. The definitions and aims of impact investment can be difficult to understand for many Asian asset owners. These investors often express concerns that impact investing entails sacrificing returns, which contravenes a pension fund's fiduciary duties. As a result, the Thai GPF has begun to consider investment opportunities where both impact and attractive financial returns are possible. Additionally, the fund seeks to work with local regulators in Thailand to develop initiatives for the Thai market, including development of a "Human Rights Heat Map" to better understand the performance of Thai companies. The findings from this initiative may be useful for local market companies that are not yet following best practices.

> **"From 2022 onwards, we will begin looking at the impact assessment of our total portfolio. This is the next question after you have integrated ESG considerations: Do you understand the ESG and SDG factors embedded in your portfolio?"**
>
> *– **Srikanya Yathip**, Thai GPF*

[25] Securities and Futures Commission. 2021. "Circular to Management Companies of SFC-Authorized Unit Trusts and Mutual Funds–ESG Funds." https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=21EC27.

Webinar 3: Importance of Disclosing Climate-Related Risks for Listed Companies in Asia

In this webinar, sustainability experts from across the private sector discussed the value in and challenges of adopting new disclosure standards in Europe and Asia. Representatives from global financial and industrial corporations explained the practical steps their firms have taken to enable TCFD and sustainability disclosure reporting, and how this is transforming their business structure. An investment manager explained the growing link between high-quality corporate disclosure and capital allocation decisions, with insights into what global investors are looking for. The discussion explored how the growing centricity of ESG in investment is driving private sector collaboration and competition to deliver better disclosure.

This webinar provided actionable insights into the following:

1. What is the trend of TCFD and sustainability disclosure in Europe and other regions? How are corporates adapting to this challenge?
2. What is the status of TCFD and sustainability disclosure in Asia? How are Asian companies and policy makers responding?
3. How are asset managers integrating TCFD disclosures into investment decisions, and what are they looking for? Why is disclosure important for attracting investment capital?
4. What is the future of sustainability reporting? How are private market players pursuing standardization and raising the bar for disclosure quality?

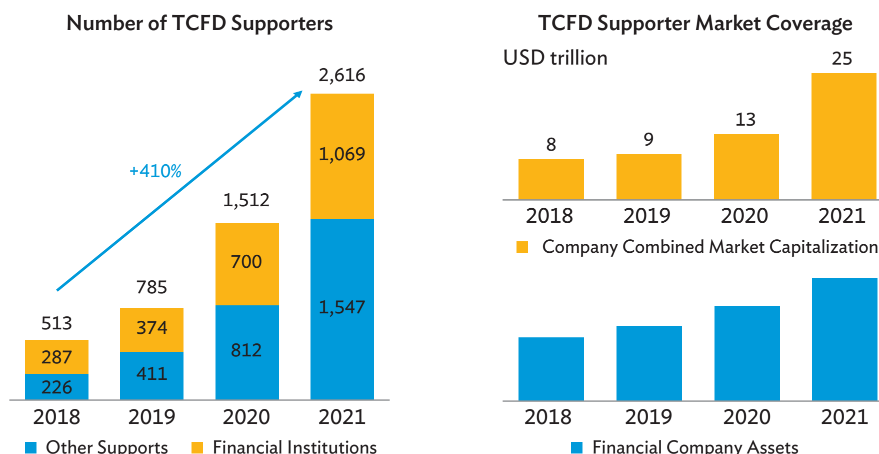
Webinar 3: Key Takeaways from the Speakers

- ✓ Disclosure helps companies accelerate their sustainability and climate transition strategies. The practical considerations for collecting, aggregating, and disclosing climate and ESG data across enterprises requires senior executive buy-in and cross-functional collaboration. This process reinforces and accelerates the organization's efforts to embed sustainability in strategy and decision-making.
- ✓ Financial market players use corporate TCFD disclosures as a core consideration in their analysis. Corporate analysts are integrating "Climate Risk Score Cards" in the investment process, and bank officers are assessing ESG risk in credit assessments for lending. Companies with leading disclosure practices will attract capital and lending at favorable rates and gain a competitive advantage. Those that do not disclose will find themselves increasingly left out of investor considerations.
- ✓ Investors want corporate TCFD reporting that is forward-looking and focused on material aspects of the business's operations. They need transparency to gauge the risks, opportunities, business strategy, sustainability performance, and ambition levels of the companies they invest in and lend to. Companies should consider both positive and negative aspects in disclosure, give credible and specific metrics that outside observers can compare, and leave out long-winded essays.

- ✓ TCFD disclosure is voluntary in most jurisdictions and Asian adoption of TCFD is low, especially for SMEs and unlisted companies. But success stories in the region do exist, as in Japan where public and private sector consortiums are effectively driving adoption. In Southeast Asia, local guidance and best practice guides are increasingly available for companies that want to begin their own disclosure and transition process.
- ✓ Finance and industry are not passively waiting for regulators to agree on global disclosure standards. Market-led initiatives such as the ISSB can accelerate the development of globally aligned sustainability disclosure standards and metrics. Multinational corporates expect to benefit from lower compliance costs and a more even playing field once reporting expectations across jurisdictions are harmonized

Background. The TCFD was created in 2015 by the Financial Stability Board (FSB), a Basel-based international body that monitors and makes recommendations for the global financial system. The TCFD focuses on the impact organizations have on the global climate and seeks to improve and increase disclosure of these climate-related impacts through a standardized reporting framework to financial markets. The purpose of the TCFD is to promote more high-quality, consistent, and comparable corporate climate-related disclosures so that investors can better assess the risks and opportunities from climate change and allocate capital more efficiently. At the same time, companies are encouraged to incorporate climate-related issues into their management, planning, and decision-making processes. While the TCFD started out as a voluntary set of recommendations, it has become part of the regulatory framework in the European Union; Hong Kong, China; Japan; Singapore; and other jurisdictions. As of October 2021, over 2,600 organizations—including financial institutions, nonfinancial corporates, government agencies, and regulators—had become TCFD supporters (Figure 17).

Figure 17: Overview of TCFD Supporters, Official Adoption, and Market Coverage



TCFD = Task Force on Climate-related Financial Disclosures, USD = United States dollar.
Source: Task Force on Climate-Related Financial Disclosures. 2021. *TCFD 2021 Status Report.* https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.

Speakers

- **Tanja Castor**, Senior Expert, Sustainability Strategy, BASF SE
- **Viki Farmaki**, Senior Global Financials Analyst, SSGA
- **Daniela Marilungo**, Managing Director–Head, Public Policy International, Bank of America
- **Masaaki Nagamura**, Fellow International Initiatives, Tokio Marine Holdings, Inc.; Member, FSB's TCFD
- **Jaclyn Yeo**, Sustainability Reporting Lead, DBS Bank Ltd.

Global TCFD and Sustainability Disclosure Trends

How are global firms responding to regulatory demands for disclosure in Europe?

The US Bank Perspective
***Daniela Marilungo**, Managing Director–Head, Public Policy International, Bank of America*

Different global reporting standards raise costs but also provide opportunities. How can companies navigate the global patchwork of disclosure requirements with a consistent approach? It starts by recognizing the importance of sustainable growth, having sustainable business goals, and an organizational structure designed to facilitate these goals with robust public reporting. There has been progress made toward consolidating various reporting frameworks, some compulsory and some voluntary. Currently, Bank of America (BOA) discloses its ESG strategy, policy, and practices in a single annual ESG report. The bank uses a variety of reporting frameworks, corresponding to a broad stakeholder and client base because of its many different lines of business. BOA now reports based on the Global Reporting Initiative.[26] The fact that reporting is not consolidated on a global basis is a cost for global businesses, but it is also an opportunity for them to share successes stories in a tailored format.

Europe applies strict requirements for corporate reporting on climate and sustainability. Europe is the most advanced and strictest jurisdiction in terms of climate reporting. Banks there must comply with nonfinancial reporting related to taxonomy regulations and corporate sustainability reporting directives. But collecting and disclosing these data is a practical challenge for corporates. For example, the EU Taxonomy in principle lays out clearly which economic activities are green and which are not green. The law entered force in July 2020 and the reporting obligations started from January 2022. The Corporate Sustainability Reporting Directive is another example of European legislation that applies to all companies, both listed and non-listed corporates and financials that have a legal entity in Europe.[27] The double materiality perspective in this law covers not just climate change and environmental standards but also supply chains and labor standards.[28] For a global bank, it is important to have an intuitive internal setup for how, when, and what data needs to be disclosed.

[26] Global Reporting Initiative. GRI Standards. https://www.globalreporting.org/.

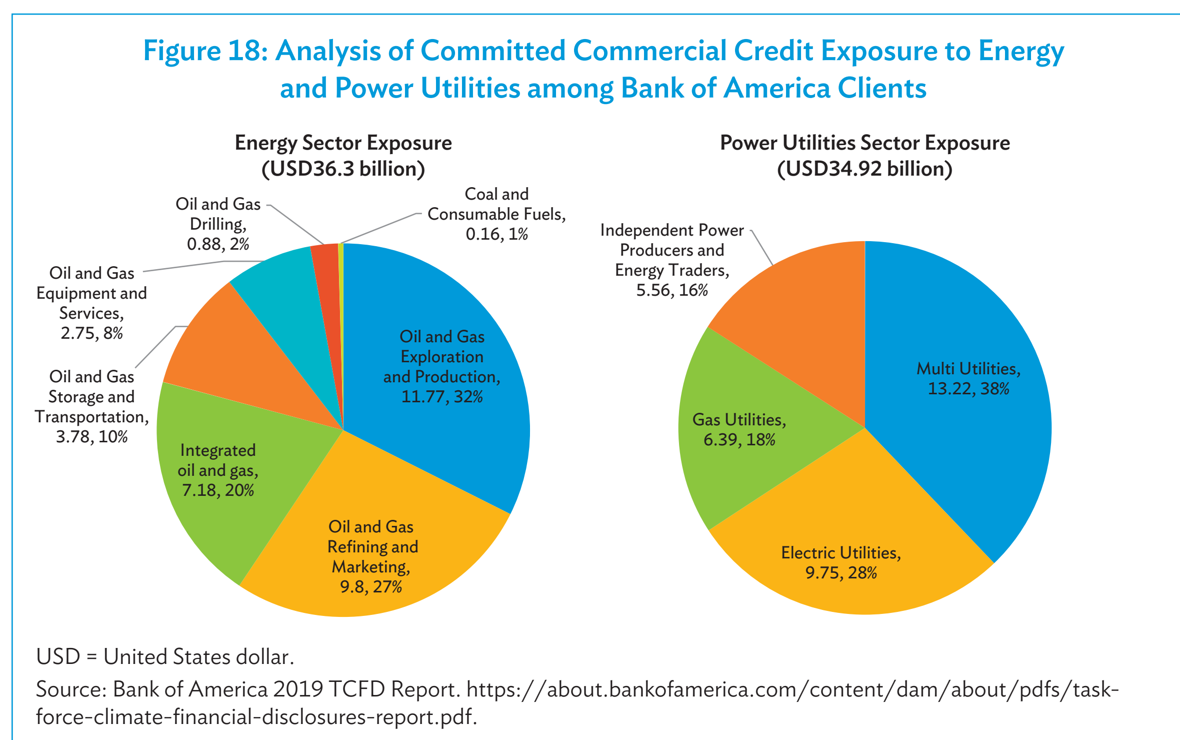
[27] European Commission. Corporate Sustainability Reporting Directive. https://ec.europa.eu/info/business-economy-euro/company-reporting-and-auditing/company-reporting/corporate-sustainability-reporting_en.

[28] GRI. Why Double-Materiality is Crucial for Reporting Organizational Impacts. https://www.globalreporting.org/about-gri/news-center/why-double-materiality-is-crucial-for-reporting-organizational-impacts/; *GRI: Double Materiality–Key Takeaways from the High-Level Policy Dialogue.* https://www.globalreporting.org/media/vtzblxss/double-materiality-publication.pdf.

The latest EU climate-related risk reporting directive requires an enterprise-wide response. BOA had already established a set of internal working groups that discussed climate change and environmental risks long before regulations came into effect. However, the latest set of disclosure legislation requires a fully-fledged, global-enterprise-wide function for identifying, quantifying, monitoring, and managing climate risks at the firm level. BOA has addressed this challenge with a task force to oversee the regulatory environment in all jurisdictions and interact with all business lines for mapping internally what needs to be done to collect the data. This involves gathering resources from the chief financial officer and chief risk officer; the compliance, legal, and public policy departments; and each business line.

The practical challenge to reporting is that EU laws have not been finalized in terms of what to report and when to report it. EU regulators are still deciding on the details and timeline of the laws' implementation. So in Europe, the Middle East, and Africa, BOA has set up a council chaired by the most senior executive in the international division to proactively track and respond to the bank's emerging disclosure requirements. Now, all frontline units are responsible for managing and disclosing climate risk in their business, and working groups chaired by senior executives meet once a week to review all the relevant changes across the region. Thus, BOA has responded to the challenge of disparate and rapidly evolving regulations (Figure 18).

Figure 18: Analysis of Committed Commercial Credit Exposure to Energy and Power Utilities among Bank of America Clients



USD = United States dollar.

Source: Bank of America 2019 TCFD Report. https://about.bankofamerica.com/content/dam/about/pdfs/task-force-climate-financial-disclosures-report.pdf.

How is TCFD disclosure transforming corporate sustainability strategy and governance?

The European Industrial Corporate Perspective
***Tanja Castor**, Senior Expert, Sustainability Strategy, BASF SE*

> **"As a large emitter of CO_2 emissions we felt it makes sense to integrate all material ESG topics into the management report... This is from our perspective one of the most important accelerating steps to push sustainability into the strategy and into the DNA of the company."**
>
> – ***Tanja Castor**, BASF*

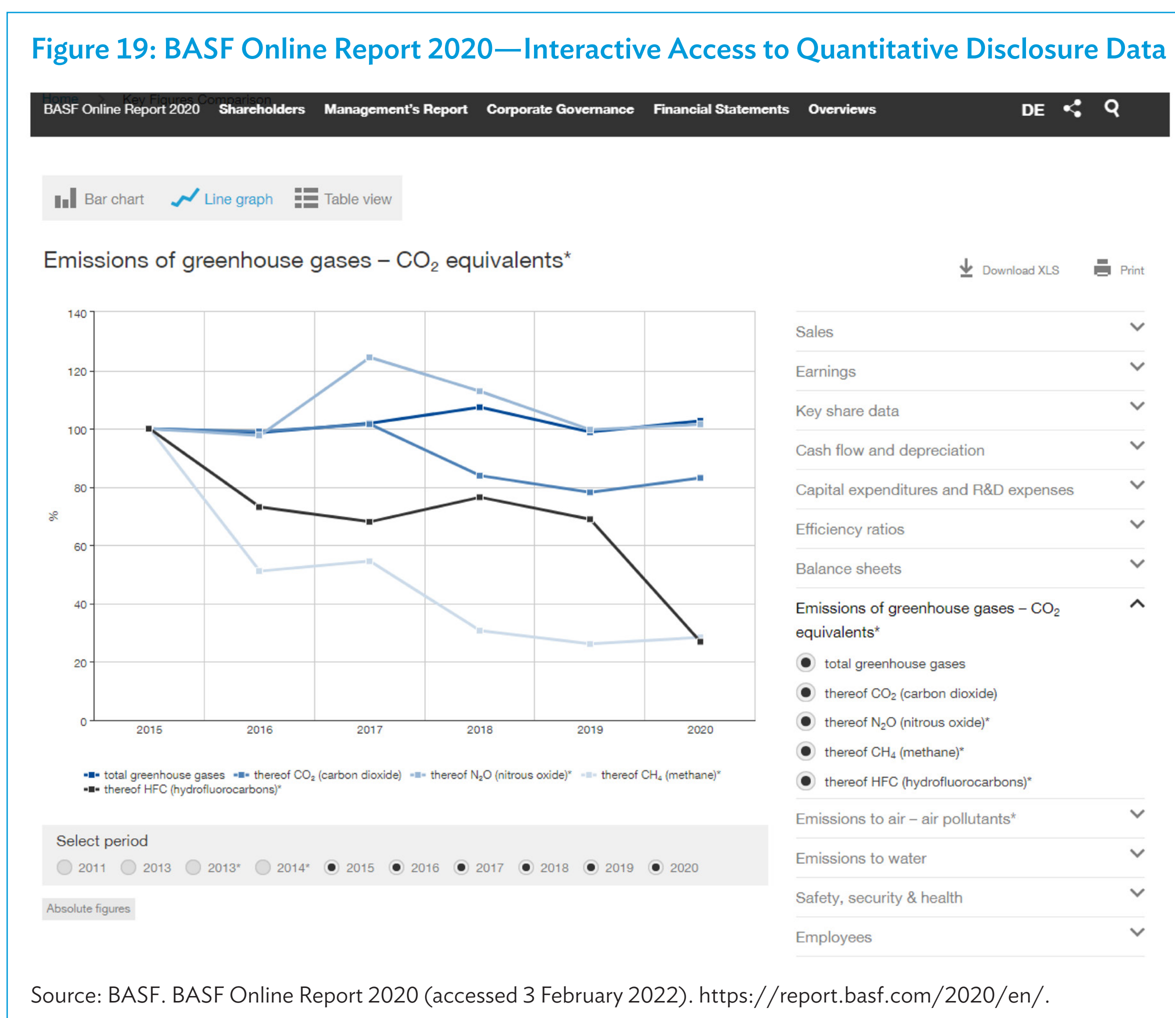
Disclosure helps companies to adopt sustainability into their corporate strategy. Carbon dioxide (CO_2) emissions and other sustainability topics are an intrinsic part of operations in the chemicals sector. And as a major global emitter of CO_2, it made sense from an early stage for BASF to report on the interdependencies between sustainability and financial performance. The company started comprehensive ESG disclosure as early as 2007 when it merged all material topics in its ESG reporting into a single integrated report. This approach has become standard in the EU, where companies are increasingly expected to integrate the most material ESG topics into their top-level management report. Doing so has played a critical role in embedding sustainability in BASF's corporate strategy.

Cross-functional collaboration is the key success factor for integrating ESG in corporate strategy. According to BASF, the most important practical step for integrating ESG disclosure in corporate strategy involves setting up cross-functional collaboration throughout the organization. BASF started with interactions between finance colleagues and the corporate strategy department, which led to new collaborations with investor relations and corporate finance, treasury, and accounting. These functions need to be onboard for integrating the company's ESG criteria in all investment decision-making, enterprise risk management, and research and development, as well as for shaping the company's merger-and-acquisition perspective.

Sustainable reporting requirements can focus minds and accelerate organizational change. Because of reporting requirements, BASF is now more cognizant of its operational sustainability performance and has prioritized metrics for CO_2 emissions reductions and the sales share of sustainable products to the highest level of its corporate steering. Since 2020, CO_2 emissions performance has been part of the board's target agreement and remuneration formula and incentive scheme, which focuses minds on this topic. The company recently announced the establishment of a Net Zero Accelerator Unit, with a president that reports directly to the CEO, charged with accelerating the transformation pathway for the entire organization. This unit is at the same level as the company's operating division (i.e., the highest level in the organization) to accelerate BASF's transformation pathway to achieve its Net Zero target (Figure 19).

Multinationals support efforts to harmonize global standards for a level playing field. BASF is engaged with the harmonization of global standards and welcomes the ISSB's new global initiative. The company is at the same time encouraging EU regulators to align European reporting standards with international initiatives. As one of these globally aligned standards, TCFD not only helps investors to test the future resilience of their investments in terms of the carbon transition, it also helps companies to integrate this important topic into their respective corporate strategies, governance, and steering mechanisms.

Figure 19: BASF Online Report 2020—Interactive Access to Quantitative Disclosure Data



Source: BASF. BASF Online Report 2020 (accessed 3 February 2022). https://report.basf.com/2020/en/.

TCFD Adoption in Asia

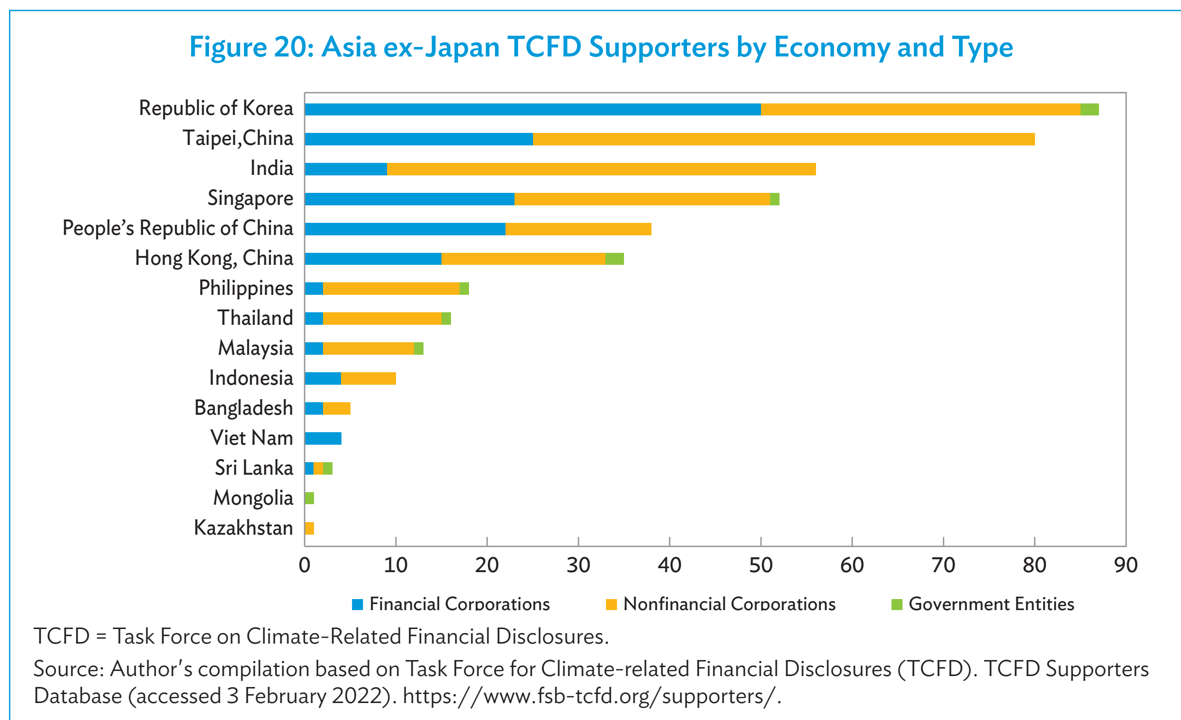
What is the state of TCFD adoption in Asia?

The Japanese Insurance Perspective

Masaaki Nagamura, Fellow International Initiatives, Tokio Marine Holdings, Inc.; Member, TCFD

TCFD disclosures by emerging Asian corporates are still low, though interest is growing. The number of TCFD supporters in Asia ex-Japan remains comparatively low (Figure 20). However, interest in the subject is growing, and early adopters in the region are starting to emerge. Some examples include the Philippines Climate Change Roundtable, where government officials and private sector industry and investment sector representatives promote the urgency for promoting TCFD disclosures. It will take time for the entire business community to follow suit, but others will likely join these early adopters.

Figure 20: Asia ex-Japan TCFD Supporters by Economy and Type



TCFD = Task Force on Climate-Related Financial Disclosures.

Source: Author's compilation based on Task Force for Climate-related Financial Disclosures (TCFD). TCFD Supporters Database (accessed 3 February 2022). https://www.fsb-tcfd.org/supporters/.

Japanese companies now make up over 20% of global TCFD supporters. Japan has achieved a rapid and widescale uptake of TCFD reporting since the recommendations were released in 2017, when only two Japanese firms publicly announced support. Now, over 530 firms in Japan support the TCFD recommendations, representing over 20% of total global supporters. The breakdown of this figure is also distinctive: Two-thirds of Japanese TCFD supporters are nonfinancial corporates, unlike in most economies where most supporters are financial institutions (Figure 21).

How are Asian firms implementing TCFD disclosures to improve corporate governance and promote sustainability?

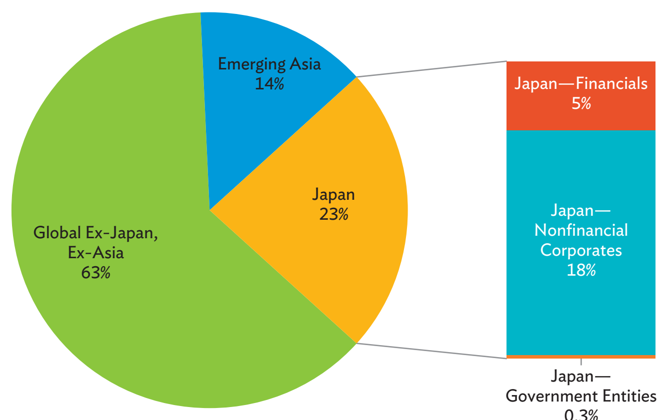
The Singaporean Bank Perspective

***Jaclyn Yeo**, Sustainability Reporting Lead, DBS Bank Ltd.*

While disclosure is still largely voluntary in Asia, it helps to commit early and prepare. DBS was one of the earliest supporters of TCFD disclosures, and was one of the first Asian banks to disclose based on measuring the carbon footprint of high carbon clients. This early preparation has helped as the bank now faces increasing regulations and mandates for disclosure in Asia. While the bank has reported for 3 years on the Scope 3 operational carbon emissions of its clients, climate-related disclosures in Southeast Asia remain limited.[29] Carbon emissions data disclosure is still uncommon among private companies and SMEs, and disclosure in Asia remains largely voluntary.

[29] US Environmental Protection Agency. Scope 3 Inventory Guidance. https://www.epa.gov/climateleadership/scope-3-inventory-guidance.

Figure 21: Global TCFD Supporters by Region



TCFD = Task Force on Climate-Related Financial Disclosures.

Note: Emerging Asian TCFD supporters include Bangladesh; the People's Republic of China; Hong Kong, China; India; Indonesia; Kazakhstan; the Republic of Korea; Malaysia; Mongolia; the Philippines; Singapore; Sri Lanka; Taipei,China; Thailand; and Viet Nam.

Source: Author's calculations based on Task Force for Climate-related Financial Disclosures (TCFD). TCFD Supporters Database (accessed 3 February 2022). https://www.fsb-tcfd.org/supporters/.

Banks are turning carbon disclosure data into decarbonization insights for clients. The best approach to climate-related financial disclosures such as carbon emissions is to apply a consistent methodology for continuous tracking year-on-year. Based on this approach, DBS has achieved a steady decrease in its Scope 3 emissions. The know-how and data collected from disclosure has yielded information and insights for best practices in decarbonization across industry sectors. As a member of the Net-Zero Banking Alliance, DBS shares these data with clients, engaging with banking customers to identify sectoral decarbonization pathways and set realistic decarbonization milestones for better managing their carbon transition.[30]

Locally developed guidance and resources are increasingly available in Southeast Asia. Interest in climate disclosure in Southeast Asia is growing, not just among regulators and investors but also for companies themselves. Market players are especially focused on using TCFD as a tool to substantiate the analysis of risks and opportunities from climate change. On the regulation side, the Monetary Authority of Singapore released a set of Guidelines on Environmental Risk Management for all financial institutions based on Singapore.[31]

[30] UN Environment Programme Finance Initiative. Net-Zero Banking Alliance. https://www.unepfi.org/net-zero-banking/.

[31] Monetary Authority of Singapore. Guidelines on Environmental Risk Management. https://www.mas.gov.sg/regulation/guidelines/guidelines-on-environmental-risk-management.

Early adopters of climate-related disclosure in Asia can provide practical advice. Together with regulators and industry peers, DBS has co-developed a handbook for institutions getting started in making climate-related disclosures, covering practical topics like how to get buy-in from upper management and disclosure best practices They have also co-published a practical guide for climate disclosures that focuses not just on risk but also on opportunities for investors. These materials provide guidance for investors on what common ESG metrics are most useful from an Asian perspective.

How can TCFD adoption be promoted effectively in Asia?

Public and private sector consortiums have driven TCFD adoption in Japan. One factor driving Japan's rapid adoption of TCFD has been coordinated government and private sector support. The Government of Japan recognized TCFD as a central component of its growth strategy to align finance with the goals of the Paris Agreement, which is reflected in the Cabinet's long-term strategy. Three key offices were involved in the strategy's formulation and joint promotion of TCFD: Financial Services Agency; Ministry of the Environment; and Ministry of Economy, Trade and Industry. Parallel to the government's promotion efforts, a private-sector-led TCFD consortium was established in May 2019.

A key success factor for smooth adoption is to approach TCFD from a user-based perspective. A key factor for high TCFD disclosure rates in Japan is that emphasis is put on how users and preparers can apply the TCFD framework to channel finance more effectively, rather than treating it as just another burdensome disclosure requirement. The TCFD consortium set up a steering committee that meets on a bimonthly basis to keep the various members up to date on key developments related to TCFD and discuss how to align the work of the consortium accordingly. This experience has influenced the approach of other economies around the world: Mexico is about to launch its own version of the TCFD consortium based on the Japanese model (Table 3).

Table 3: In-Sample TCFD Disclosure by Top 50 Companies by Region

Region	Average % Disclosure in 2020
Europe	68
North America	42
Asia and the Pacific	36
Latin America	27
Middle East and Africa	27

TCFD = Task Force on Climate-Related Financial Disclosures.

Notes: Asia and the Pacific includes Australia, Japan, New Zealand, and emerging Asian economies. Data are for top 50 companies by revenue in 2020.

Source: Task Force on Climate-related Financial Disclosures (TCFD). *TCFD 2021 Status Report–Figure B8.* https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status Report.pdf.

Importance of TCFD Reporting from the Investor Perspective

Why are investors integrating TCFD disclosures into their investment process?

The Global Private Sector Asset Manager Perspective
***Viki Farmaki**, Senior Global Financials Analyst, SSGA*

Regardless of regulatory mandate, investors need data to assess climate-investment risk. Global investors are looking at climate risk as a corporate investment risk, and it has become an integral part of the investment process. Understanding the company's forward-looking strategy for climate change is a key piece of information for asset allocators to have confidence in the company that they invest in. Transparency and access to data are important for assessing transition risk and supporting companies in their transition. SSGA, for example, uses a forward-looking Climate Score Card that includes transition factors as part of the firm's research investment process for all companies. So it is crucial and in their own best interest for companies to provide these data along with comprehensive TCFD disclosures.

> **"SSGA recognizes the threat of climate change as an investment risk to our investments. Climate risk is an investment risk."**
>
> – ***Viki Farmaki**, SSGA*

Climate reporting is uneven but needed, and TCFD provides a standard for getting started. If investors cannot get consistent data from the companies in which they invest, then they cannot make good investment decisions. This disclosure needs to be proactive so that investors can see that companies are providing meaningful data and using it in their operations to improve earnings prospects and ultimately become a better investment opportunity. In other words, the information is important to both investors and companies themselves. TCFD provides the clarity and standardization that the market needs.

What are investors looking for from corporate TCFD disclosures?

The Global Private Sector Asset Manager Perspective
***Viki Farmaki**, Senior Global Financials Analyst, SSGA*

TCFD reporting-investors want material, forward-looking impact data, not long essays. Climate risk is an investment risk. Therefore, SSGA approaches TCFD disclosure from the perspective of assessing the risks and opportunities to its investments. Data availability and transparency are important for analysts to gain confidence in the company's progress and confirm that it has a credible transition plan. For investors, the key focus of TCFD disclosure is materiality. Long essays and fancy reports are not necessary. Instead,

> **"We want to see the targets companies have set are scientifically robust, cover both the short- and long-term perspective, and provide us with metrics so that as outside investors we can see how companies are executing on these targets and access the implementation of the plan."**
>
> – ***Viki Farmaki**, SSGA*

TCFD disclosure should focus on relevant information about the company's operations. In particular, analysts are looking for confirmation that managers are aware of climate risks, can measure these risks and provide a clear risk management process, and that this process is carried out across the entire organization. SSGA strongly supports the TCFD recommendation to use scenario analysis for providing material and specific information on a company's forward-looking impacts.

TCFD disclosure helps investors to assess a company's strategy and business outlook. Another factor investors consider is the company strategy. This is a key point of disclosure for analysts to understand where the company is heading, both from the perspective of risks and opportunities. Too much emphasis on the negative aspects of climate change in disclosure is a missed opportunity, according to SSGA. Investors also want to understand the positive aspects and opportunities that may arise to fully inform their investment strategy, for example, by assessing the potential for new revenue streams. And investors are looking for a strategy that is credible. This means focusing on the most impactful parts of the business, which may be limited to Scope 1 and 2 emissions, while for financials it typically includes Scope 3 emissions.[32] Although data limitations exist, as long as there is transparency and clarity then investors can use the information to do their jobs.

Other key TCFD components include scenario analysis, board commitment, and engagement. TCFD disclosures provide many key components for an investor's decision-making process. With scenario analysis, investors can check that the company's targets are scientifically robust and trackable with short- and long-term goals. Specific metrics provide investors the chance to independently verify and compare how successfully companies are executing these targets. Investors also look for evidence of commitment by the board. As part of its analysis, SSGA checks for top-down collective action, remuneration linked to commitments, and meaningful key performance indicators tied to climate-related risks. Related to TCFD, SSGA seeks to engage with companies around climate adaptation, including meeting with management teams to explain the investment process and specify how climate-related risk factors are being integrated.

How will TCFD disclosures affect an investor's asset allocation decisions?

TCFD disclosure is a key factor for attracting new capital and investment. Corporate TCFD disclosure is an increasing factor for investor capital allocation. The market will differentiate between companies that provide transparency and show a commitment to disclosure with evidence that they are executing on the strategy, and those that do not. For corporates, this will mean not only a lower cost of capital but also a competitive advantage through better access to capital.

> **"Inevitably, the companies that can better provide the information, show they have identified the risks, assessed the impact, and have a strategy to mitigate and are executing on that strategy—they are going to be the ones that investors and markets are going to be more willing to invest capital in."**
>
> – ***Viki Farmaki***, *SSGA*

[32] US Environmental Protection Agency. Scope 1 and 2 Inventory Guidance. https://www.epa.gov/climateleadership/scope-1-and-scope-2-inventory-guidance; US Environmental Protection Agency. Scope 3 Inventory Guidance. https://www.epa.gov/climateleadership/scope-3-inventory-guidance.

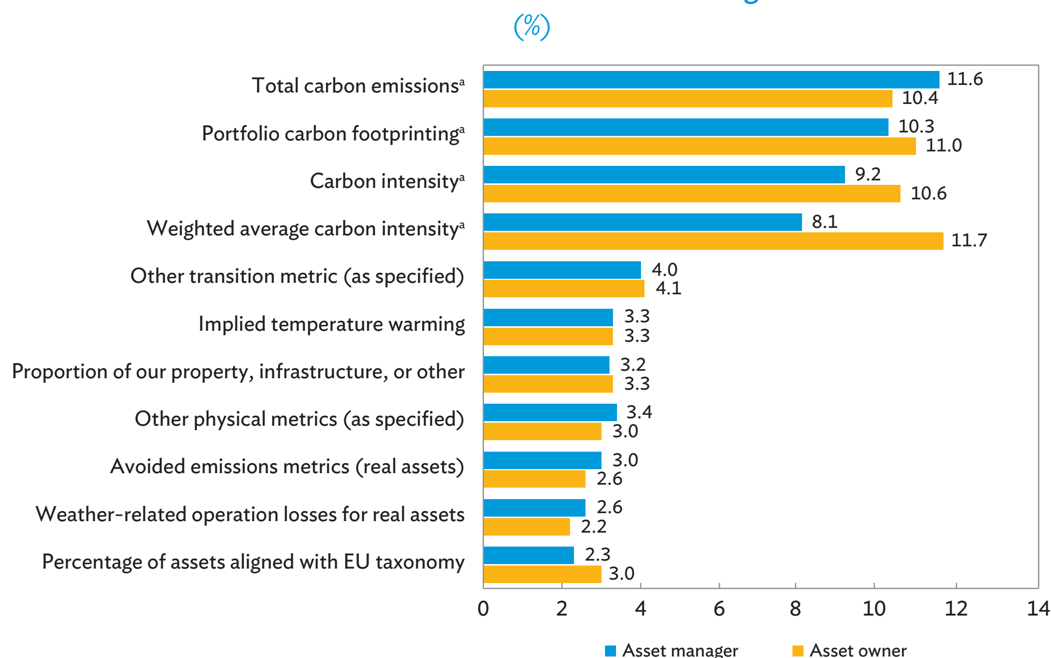
Dialogue: How can investors and financiers leverage TCFD disclosure to improve corporate sustainability performance?

Singaporean Bank (Jaclyn Yeo, DBS): From a bank's perspective, it is possible to shape customer practices though lending. For example, as part of DBS's Responsible Financing Standards, we assess the lender's ESG risks at every stage of the credit application process and engage with customers to help them understand what factors could affect them from a credit perspective. This can result in changes to the cost of lending or lending terms that we can provide. It is important to engage with customers based on their success in decarbonizing and ESG risk management.

Global Asset Manager (Viki Farmaki, SSGA): As active investors, engagement is key to moving forward. We have dialogue with the management of the companies that we invest in and make it clear that our investment process has evolved, with a very rigorous assessment of corporate climate risks. If companies want to be assessed in line with our investment process, then they need to provide the data. Ultimately this is positive for them, as they can have a better cost of capital and gain a competitive advantage versus competitors who are not disclosing. The key to improving sustainability practices and disclosure is to show how we are using these data in our own investment practices to make the right decisions (Figure 22).

Figure 22: Share of Asset Managers and Owners Reporting Use of Climate-Related Metrics to Manage Risk

(%)



EU = European Union.

Note: Base size: 2,182 asset managers, 538 asset owners.

[a] Carbon footprinting metrics.

Source: Task Force on Climate-related Financial Disclosures (TCFD). *TCFD 2021 Status Report—Figure B25*. https://assets.bbhub.io/company/sites/60/2021/07/2021-TCFD-Status_Report.pdf.

The Future of Sustainability Reporting

How can the private sector shape the development of global standards for sustainability disclosure?

The US Bank Perspective

Daniela Marilungo*, Managing Director–Head, Public Policy International, BOA*

Rather than wait for regulators, industry should proactively adopt a broad global standard. Private sector players should take a proactive approach to developing global disclosure standards because regulators will take too long to agree. Specifically, industry should push for a global framework of standards, metrics, and disclosures that goes beyond just the issue of climate change. At the World Economic Forum, BOA and the International Business Council introduced the ESG Stakeholder Capitalist Metrics, which 100 global corporates have already agreed to implement.[33] BOA believes that these metrics provide a consistent way of measuring companies' long-term value across industries and will help investors better direct capital based on consistent and globally accepted industry metrics.

> **"Using a single standard will help companies focus on the transition opportunities rather than navigate the alphabet soup of initiatives and reporting frameworks."**
>
> ***– Daniela Marilungo****, BOA*

How are global corporations raising the bar for high-quality, enterprise-level sustainability reporting?

The European Industrial Corporate Perspective

Tanja Castor*, Senior Expert, Sustainability Strategy, BASF SE*

Investors expect the same level of assurance for climate-related disclosures as financial data. As a multinational with Asian operations, BASF incorporates a global data management system with reporting requirements to clearly describe what is expected from all its subsidiaries. The company provides training on what needs to be done to prepare reliable and robust reporting data, not only for CO_2 emissions but also for other ESG topics, with internal audits to confirm that these requirements are met. The company also works with external audit firms to provide a level of assurance for its most material climate-related disclosures that is as high as that of its financial data.

> **"For the most material ESG topics at least, we must move on to provide the same level of external assurance as we guarantee for our financial figures. This is what we hear from our investors and partners in the capital markets: that they expect us to provide these figures with a certain level of assurance."**
>
> ***– Tanja Castor****, BASF*

[33] World Economic Forum. 2022. *Stakeholder Capitalism: Over 70 Companies Implement the ESG Reporting Metrics.* https://www.weforum.org/our-impact/stakeholder-capitalism-50-companies-adopt-esg-reporting-metrics/.

SECTION 3

Conclusion: Next Steps

Disclosure as the New Competitive Edge

Market participants around the world and in Asia now consider that corporate disclosure is not just "nice to have" but rather a critical factor for global capital market efficiency. ESG investing requires data, so disclosure of ESG risks and opportunities, and increasingly impact reporting as well, is key for corporates seeking to tap into this rapidly growing pool of capital. While the proper balance between market- and principles-based approaches and regulatory oversight is being debated, the underlying concept—that markets are more efficient with better corporate disclosure—is straightforward and likely to grow as an important consideration for investors and point of diversification for issuers.

Recognizing this, corporations should approach higher disclosure standards as a new competitive edge, where outperformance relative to peers can produce tangible benefits not only from potentially better pricing and access to investment capital, but also through better situational awareness of their own business operations and possibly reduced reputational and regulatory risks. In fact, the competition for disclosure leadership is already underway, with many leading global companies approaching this challenge as a core competency and unique differentiator. Asian corporates can thus improve their ability to attract and retain sustainable capital by taking proactive steps to elevate disclosure at the strategic level and embedding sustainability data and impact reporting in their operations.

Addressing the Pain Points of ESG Analysis in Asia with Centralized Impact and Sustainability Databases

Investors now demand robust corporate ESG disclosures as a crucial component of their investment process. And impact and sustainability data quality is increasingly subject to regulatory requirements in many major markets. These trends have resulted in exponentially increasing amounts of ESG and impact data production by issuers. However, given the practical challenges in developing global standards for sustainability disclosure requirements, much of these new data are unstructured and non-standardized, making it difficult and costly for market participants to access and analyze systematically. For example, researching and compiling impact data for the rapidly growing market in green, social, and sustainability bonds for securities analysis and reporting is particularly inefficient, as such impact data are often retrieved through manual research and archived in bespoke internal databases. For sustainable investment markets to develop with efficiency and integrity, there is an apparent unmet need to organize and make data more accessible to all investors.

Various regional initiatives for addressing the pain points for impact data and analysis have been launched recently in Europe, North America, and Latin America by multinational development banks, regulators, and securities exchanges.[34] Such databases typically aggregate impact bond documents such as secondary opinions and impact reports in a central searchable database, but at the time of writing no free-access Asian version existed. This is an area where ADB, as a credible third party with established regional infrastructure, may be well placed to facilitate market development. For example, ADB could leverage the existing *AsiaBondsOnline* platform as a portal for investors that facilitates access to documents and quantitative impact data for Asian bonds in one place, while also encouraging better disclosure and reporting standards.

The COVID-19 pandemic and associated economic turmoil has put immense pressure on society. Certain industries and business models have flourished in the upheaval, while others have been pushed to the brink and beyond. Inequality and resentment has increased as enormous gains accrued to some, while others lost livelihoods and had their savings wiped out. The hit to public finances and strains in society make the challenge of responding to climate change and achieving the SDGs by 2030 even more difficult. Ultimately, business prosperity cannot be isolated from the challenges of the society and environment in which it operates—the risk is "unhedgeable."

The development and growth of sustainable finance markets is giving businesses and investors the chance to systematically contribute solutions to these challenges with responsibility and integrity. The SDGs may have been designed for policy makers, but private firms are increasingly using the goals as their own blueprint for uncovering opportunities in the areas of climate change, biodiversity, health, and resiliency, as well as for addressing divergent economic opportunities. Taxonomies and improved disclosure are a way for firms to signal how they are reorienting and aligning themselves to contribute to these globally recognized goals. The companies that do this best will succeed at gaining and retaining customers, motivating employees, and attracting investors, while also ensuring long-term prosperity.

[34] For development banks, see https://www.iadb.org/en/news/idb-and-idb-invest-launch-green-bond-transparency-platform; for regulators, see https://www.environmental-finance.com/content/news/european-commission-plans-to-create-sustainability-database.html.

Asia’s Progress toward Greater Sustainable Finance Market Efficiency and Integrity

This report summarizes insights on transparency and integrity in sustainable finance markets shared by regulators and business leaders at a series of webinars co-hosted by the Asian Development Bank and State Street Global Advisors in November 2021. It provides an overview of policy and market practice to enhance transparency and integrity in sustainable finance and to foster the market’s development. The report covers three topics: (i) efforts to align taxonomies and standards across regions and to support transition finance, (ii) efforts of Asian investors to adopt and adapt to environmental, social, and governance (ESG) information disclosure and integrity requirements, and (iii) corporate perspectives on the practical benefits of enhancing ESG information disclosure and integrity.

About the Asian Development Bank

ADB is committed to achieving a prosperous, inclusive, resilient, and sustainable Asia and the Pacific, while sustaining its efforts to eradicate extreme poverty. Established in 1966, it is owned by 68 members —49 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.

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