Financing for sustainability: Regional progress to harmonise ESG regulations may overcome the data gap

This is the third in a series of articles exploring the findings from ***Financing for sustainability: Asia Pacific's evolving ESG market***, an Economist Impact report sponsored by Westpac. The report draws on new research on the state of sustainable finance in the region gleaned from issuers in the US, Europe and Asia Pacific, and investors in Australia, Hong Kong, Japan, New Zealand and Singapore. It aims to understand today's sustainable finance market drivers and the potential for future growth, and provides comparisons to inaugural research conducted in 2019. This article provides deeper context to the survey results, with additional insights from major market participants.

Rapid growth in the sustainable finance market in Asia Pacific and a profound attitudinal shift among companies towards decarbonisation are key findings from *Financing for sustainability: Asia Pacific's evolving ESG market*, a research report from Economist Impact. As companies become aware of their immediate and future climate risks, their use of sustainable finance, and investor assets under management (AUM) allocated to sustainable investments, has grown in response.

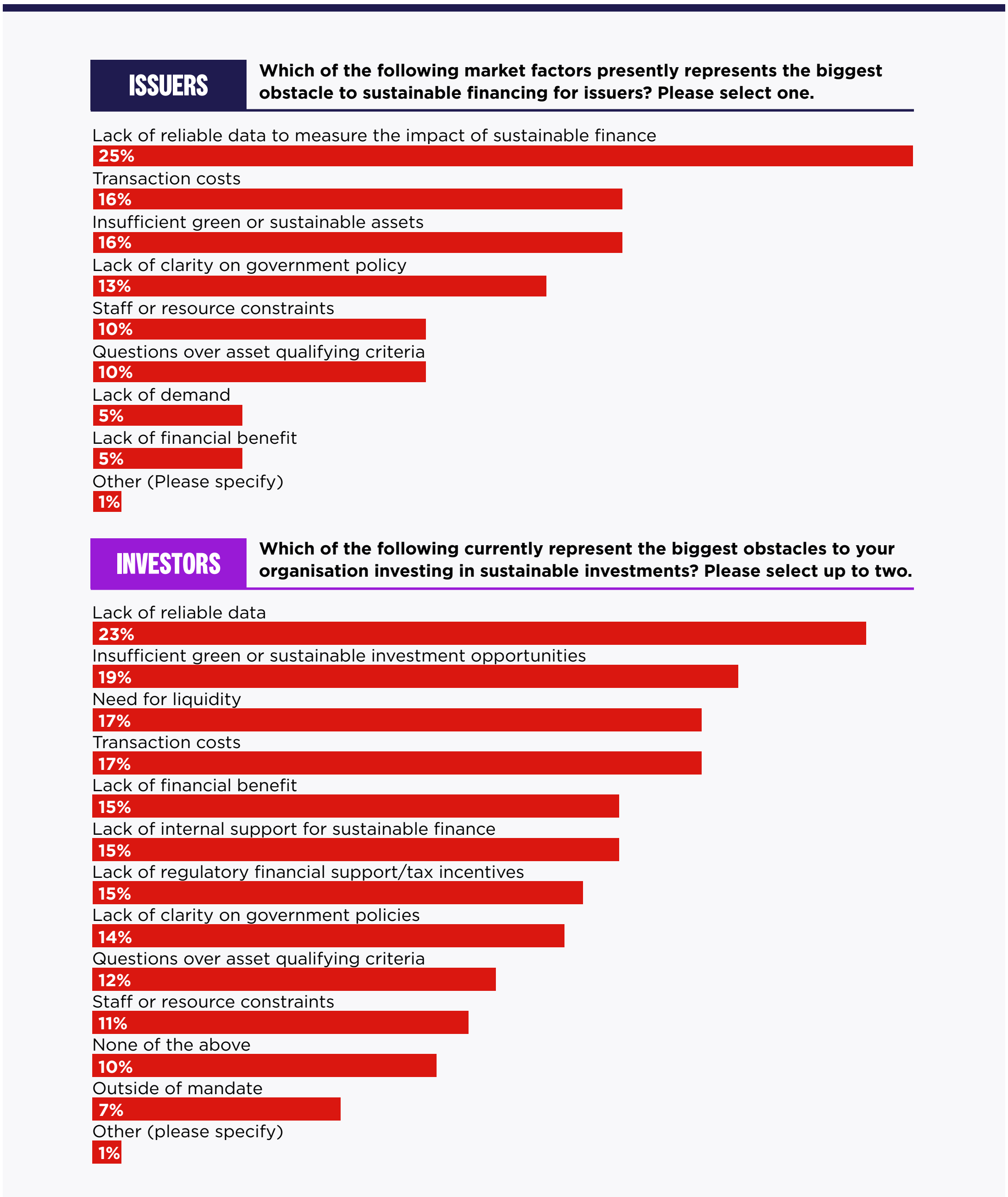
However, for the region's sustainable finance market to continue growing, several key market barriers will need to be overcome to enable issuers and investors to make full use of sustainable finance to achieve their decarbonisation targets. Chief among these is a lack of reliable data, with 25% of issuers and 23% of investors ranking it as the biggest obstacle to their use of sustainable finance and investing.

This is likely to be a long-term challenge for investors and issuers, as the rapid growth in sustainable finance will continue and expand into more complex ESG areas like social and impact finance and investing.

> **"Over one third (35%) of companies plan to issue or utilise sustainable financing for the first time in the next year and 47% of investors expect to have between 50% to 100% of their AUM allocated to sustainable investments in three years' time."**

While it is not something that can be rectified quickly, Kristy Graham, executive officer of the Australian Sustainable Finance Institute (ASFI), an industry-led organisation that is working globally to develop a better Australian taxonomy and regional regulatory harmonisation, says recent changes mean sustainable finance market players should soon have greater clarity on definitions and data.

Market barriers to sustainable finance in Asia Pacific



Source: Economist Impact

"Many countries in Asia Pacific are trying to bring additional credibility and rigour to their sustainable finance markets and guard against things like greenwashing, to ensure that sustainable finance and investments are achieving credible outcomes", Ms Graham explains. "That's where taxonomies, and standards more broadly, play a really important role."

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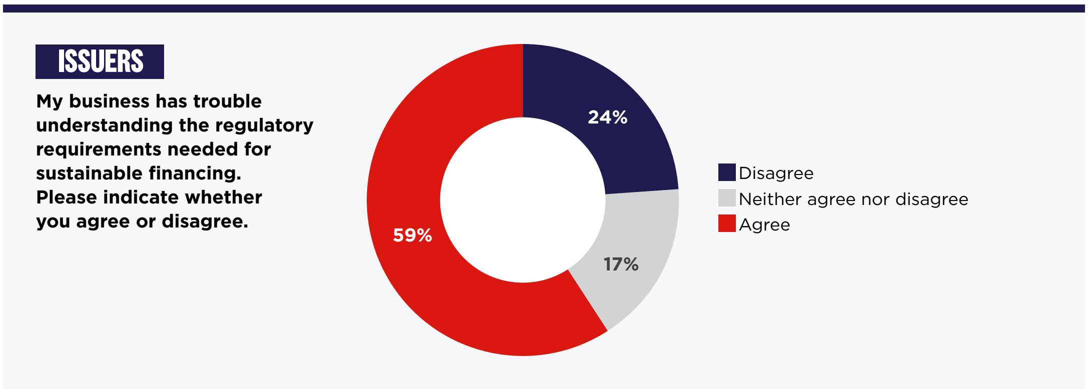
Data roadblocks

Reliable, comparable data has been an ongoing issue for the sustainable finance market in Asia Pacific. It is a necessity for the measurement and tracking of ESG targets and for portfolio analysis among investors and asset managers. A lack of reliable data is also a significant contributor to other barriers such as insufficient green or sustainable investment opportunities—companies cannot use sustainable finance if they cannot measure their progress on sustainability targets or have questions over asset qualifying criteria.

The problems in Asia Pacific are in large part due to the historically fragmented approach to sustainable finance among the region's regulators. There are fewer regulations governing ESG reporting in Asia Pacific at present when compared to Europe and the US, and each jurisdiction employs its own framework. For example, the definition of what constitutes an ESG investment differs substantially depending on the jurisdiction,[1] while regulations on the social side of ESG are missing entirely in some markets.

This means many companies do not have the guidance or impetus they need to report on ESG outcomes, and investors do not have the metrics they need for their analysis. It also impedes the development of new sustainable finance tools, like sustainability loans, sustainability-linked loans, and social bonds and loans, which are reliant upon solid data.

Issuer ESG reporting sentiment



Source: Economist Impact

1 Sustainable Finance in Asia Pacific: Regulatory State of Play, ASIFMSA, 3 March 2020. https://www.asifma.org/wp-content/uploads/2020/03/sustainable-finance-in-asia-pacific.pdf

As a result, well over half of issuer respondents to the survey agree that their business has trouble understanding the regulatory requirements needed for sustainable financing.

Over three quarters of issuer (79%) and investor (79%) respondents also agree that the growth of sustainable finance in Asia Pacific will be impeded without regional agreement on regulatory and reporting requirements for corporate climate risk.

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Ms Graham says this is where taxonomies and standards play a significant role. "A taxonomy, by being a very clear, transparent, science- and evidence-based set of definitions based on performance criteria, gives you that level of rigour and, to a certain extent, common framework that applies across the whole finance sector," she says. This gives credibility to the resulting data and ensures all sides of a sustainable finance transaction can access the information they need in a format that is comparable between different sectors, assets, products and companies.

"It also comes back to how corporates or institutions are incentivised to invest in both data capability and to partner with others," Ms Graham adds. "So for example, governments hold a lot of different data sets that can be used and adapted for ESG reporting with some investment for a range of different purposes. And they are increasingly thinking about how they can make the data that they hold—for example, on biodiversity or natural capital—widely available and usable."

A skills gap is exacerbating the problem according to Giles Gunesekera, chief executive officer of Global Impact Initiative, an impact investment consultant. He says investors and companies that are trying to decarbonise and focus on ESG outcomes need clear, understandable metrics around their outcomes, which in turn requires someone with the financial understanding of investment markets, as well as a deep understanding of ESG, social impact and the measurement and reporting side of these factors. "And those people are really hard to find," he says.

"In five to ten years' time, you're going to close that skills gap because every second financial graduate coming out of a commerce degree will know what sustainable economics is," Mr Gunesekera continues. "But at the moment, companies are internalising that process... and they're building up their own skill base."

Harmonisation

As recognition of the need for change has grown, so too has impetus for action, and Ms Graham says there are hopeful signs of a potential resolution to the ongoing issues with ESG data, regulation and definitions in Asia Pacific.

On the regulatory side, the Association of Southeast Asian Nations (ASEAN) released the ASEAN Taxonomy for Sustainable Finance at COP26 in Glasgow in 2021[2] and is working to overcome some of the jurisdictional challenges in the region. The International Sustainability Standards Board (ISSB) was also founded in November 2021, and it aims to deliver a global set of sustainability-related disclosure standards about companies' risks and opportunities.

An initiative of the International Financial Reporting Standards, the ISSB has been welcomed by financial markets globally as a significant step forward, but it is still in its infancy and will take time to become established. Until that point, however, companies need to continue to improve their standards internally.

Mr Gunesekera says companies should focus on outcomes they are trying to achieve and not get trapped by the intricacies of data, especially in social and impact reporting. "Data is important, but it needs to be relevant for what you're trying to capture, what you're trying to measure and the outcome you desire" he says.

The best way for companies to achieve this is to embed ESG into business units, rather than treat it as a stand-alone issue, according to Mr Gunesekera. Using Unilever as an example, he says its corporate ESG function was disbanded and became a requirement of every business unit. This has made ESG customer-centric, according to him, which in turn has made the identification, sourcing and use of data easier. "Everyone should do ESG like this because that way it's embedded into your process. You're not coming up with a product and then working out at the end how to recycle it, or whether it can be recycled, you're doing it at the start," Mr Gunesekera explains.

Ms Graham says it is "incredibly exciting" to see the progress being made but adds that finding a "global norm around what a sustainable taxonomy will look like" may have its own challenges. In Australia, for example, she says the binary, green (activities that are already compliant with environmental objectives)/ brown (activities that are not judged compatible with environmental objectives) definition won't work due to the structure of the economy and the transition challenges the nation faces. "Singapore's approach has been to have green, which are activities that are already sustainable; orange, which are transition activities; and red, which are activities that are not sustainable, and will never be sustainable," she says. "That's just one approach to consider."

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A maturing market

As companies grow in their understanding and adoption of sustainable finance, the S in ESG is also starting to become more prominent, which will add further challenges to data ahead as organisations grapple with a new layer of reporting complexity. Almost half (48%) of investor respondents say they are now integrating impact and community investing into their existing investment decisions, and 55% are aiming to expand their investments in a combination of social and environmental asset themes.

2 ASEAN Taxonomy for Sustainable Finance, ASEAN, 2021.

Mark Konyn, group chief investment officer at AIA, says governance has always been a prime consideration in any investment the group has made, and that they are now happy that its environmental and sustainability approach has equally robust frameworks. AIA is now further strengthening its ESG investment criteria through a more direct focus on the social aspect of its investments and working to secure the data around that.

"What we do is continual, so we're not at the destination by any means," adds Mr Konyn. "Many of the things we need to invest in don't exist today. But I think we can significantly demonstrate in the next five to ten years that we're well on our way to meeting our objectives." As with AIA, the journey for all firms is likely to be long and uncertain, but the emergence of better metrics is making it easier to track progress and help firms meet their objectives.

Read the full report and details of research methodology on Westpac IQ.