Expanding the green conversation

By Andrew Wong, Ezien Hoo, Wong Hong Wei and Wu Yao-Hua

REGULATORY support is needed in building Singapore as a green finance hub.

Singapore is primed to be the go-to hub in sustainable development with the government accelerating the move in a series of steps. Driving this change requires a common language about what it means to go green in terms of finance. The centrepiece of the government's initiatives is the Green Finance Industry Taskforce (GFIT), convened in January 2021 by the Monetary Authority of Singapore (MAS) to determine a taxonomy to identify activities that can be considered green or in the process of transitioning to green.

Having this common language is crucial to combat "greenwashing" where companies present inaccurate or exaggerated claims of being environmentally sound. GFIT continues to make inroads by launching a guide for climate-related disclosures and a framework for green trade finance in May this year.

Beyond actions which set out the regulatory landscape, MAS is focused on the development of Singapore as a green finance hub, with an inaugural sustainability report published in June 2021 which sets out the strategy on climate resiliency and environment sustainability. Earlier in the year as announced in the Budget 2021, the government has also pledged to issue green bonds for S$19 billion worth of infrastructure projects.

Beyond a good-to-have to smart-to-have

While SGX-listed companies, which includes Singapore-dollar corporate bond issuers, are subject to disclosure requirements, the increased focus on sustainability may lead to issuers going above and beyond mere disclosures. The speed at which issuers are expected to incorporate sustainability into their practices may depend on the industry sector, products and geographies.

Beyond ethics, climate resiliency is becoming a mainstream part of corporate strategy. Part of the reason is due to policy action and technological improvements.

For example, coal companies face asset obsolescence risk such as the plan to phase out coal power plants when sufficient capacity and commercial availability of lower carbon alternatives are achieved. Businesses can also be impacted directly by climate change. As an example, companies may incur physical asset damage from flooding or droughts which are exacerbated by climate change.

Such assets can be termed "stranded assets". Investors and lenders are likely to pay increased attention on stranded assets due to potential impairment or revaluation losses. Similarly, forward-looking financial markets may input a lower market value of equity for companies deemed to be at-risk as observed in the coal sector.

Several companies are addressing climate risks in concrete ways by diversifying away from fossil-fuel-reliant business models and putting sustainability in day-to-day business practices even if their businesses may not be directly impacted yet. Market leaders in the real estate sector who form a large part of the Singapore-dollar corporate bond market are stepping up their focus on higher standards of green buildings, be it in new property development or investment properties and this has extended beyond green office buildings into the industrial property sector.

While not primary emitters of carbon, financial institutions are instrumental in tackling climate change as they lend and facilitate investments to sectors and companies that may be at-risk. Already, many financial institutions have announced plans to limit or ban the amount of financing for carbon intensive industries, with a pullback in availability in financing and insurability often leading to higher cost of funding for such sectors. Overall, changes in financial markets, socio-political and legal regulatory environment may result in a change in the nature of asset base, income and cashflow stream of companies.

Coal companies face asset obsolescence risk such as the plan to phase out coal power plants when sufficient capacity and commercial availability of lower carbon alternatives are achieved. PHOTO: REUTERS

Transition finance to effect change

While much interest has been paid on the green finance market (funding for renewable power plants and green building being common examples), companies in "dirty" industries are still dominant and often major employers, especially in the region.

The cost to transform from brown to green can be impractical, especially for industries where there is a lack of economically or technically feasible options. Such harder-to-abate sectors include heavy industry (cement, steel, chemicals and aluminium) and heavy-duty transport (shipping, trucking and aviation). As eliminating such industries is impractical, it can be more impactful to fund transitions for sectors and companies to become greener.

We see sustainability linked bonds (SLB) as a subset of sustainability finance and are a key type of investment instrument for transition finance. Unlike green bonds which finance green projects as defined under green financing frameworks, proceeds of SLBs are not tied to specific uses but rather tied to sustainability targets at the issuing entity level. For example, an SLB may be structured with a goal of reducing carbon emissions by 25 per cent by a specific timeline and if unfulfilled, results in a higher interest cost.

This provides some flexibility to issuers and encourages sustainability to be a focus across entire business operations rather than solely through any specific investment.

For example, financing a cement maker to transition into green cement necessitate investments in research and development, and changes to manufacturing processes. A transition may require changes to human resources as new skills are needed and changes in the way products are sold and marketed.

Traditionally, certain green finance investors viewed SLBs with suspicion, given that some issue structures had lenient sustainability linked targets that were measured towards the maturity of the bonds.

In our view though, SLBs are a practical way to aid the transition and expect SLBs to evolve over time as acceptance increases and sustainability plans progress.

'Greenshoots' in the SGD corporate bond market

US$1.8 billion (around S$2.4 billion) will been deployed by MAS to five asset managers for climate-related investments, as part of building climate resiliency on its official foreign reserve's portfolio, seize investment opportunities and support the transition of portfolio companies.

These asset managers are also building out their regional sustainability hub in Singapore, which is likely to help spearhead developments in the public markets for sustainability investing.

The Singapore-dollar corporate bond market has been catching up in terms of sustainability finance, albeit from a low base.

As at July 23, 2021, there are a total of six green bonds and perpetuals outstanding, totalling S$1.9 billion and a sustainability bond totalling S$150 million.

While companies are undertaking increased green or sustainability-linked projects (for example, solar installations on rooftops), we expect new issuance of green bonds and/or SLBs to be driven more by substitution from conventional bonds in the context of the Singapore-dollar corporate bond market.

We view these bonds to be in greater demand as investors increasingly tilt portfolios into sustainable investments while issuers opt for green bonds and/or SLBs as part of building up their sustainability credentials amid developing sustainability-centred business models.

Away from the companies, the Singapore government is looking to fund certain infrastructure projects through green bonds such as the Tuas Nexus, an integrated water reclamation and waste management facility.

With S$19 billion of projects that need to be funded (at least in part by borrowings), public infrastructure is likely to become a new supply source for the bond market. This provides room for investors who wish to garner returns as well as do good.

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