ASEAN Socio-Cultural Community

POLICY BRIEF

ASCC Research and Development Platform | Policy Brief #1 | 2024

Strengthening the Climate Financing Ecosystem in ASEAN

Gopi Krishnan (C&G Analytica), Sonia Kumari (Universiti Malaya), VGR Chandran Govindaraju (Universiti Malaya) and J.S. Keshminder (Universiti Teknologi MARA)

EXECUTIVE SUMMARY

- Climate investment opportunities are emerging, but an integrated ecosystem is essential to ensure smooth financial flows for a climate-resilient economy.
- Regulation and surveillance of climate-related financial risks are critical to maintaining financial stability and ensuring large-scale, high-quality investments from the public and private sectors.
- Due to the lack of transparency and climate-related regulations, market participants remain constrained in ways that prevent the scaling up of investments needed for an effective and efficient climate transition.
- Solutions to improve the provision of climate finance in ASEAN include empowering relevant financial actors and reducing barriers related to the existing climate finance architecture.

POLICY RECOMMENDATIONS

- To strengthen the climate financing ecosystem in ASEAN, it is necessary to further develop an Environmental, Social, and Governance (ESG) Framework to enable effective integration of sustainable practices into investment decision-making processes.
- Reinforce the role of regulators and infrastructure providers by: (1) mainstreaming climate risks in financial sector assessments; (2) promoting transparency by focusing on climate reporting, data, and verification; and (3) harmonising regulation to promote capital mobility.
- Develop effective climate-related financial policies, climate disclosures, climate risk assessments, and responsible investment regulations within financial stability frameworks to encourage the financial sector in promoting transition financing, adopting innovative climate financing instruments and digitalisation of climate financing.
- Successful coordination and collaboration among civil society organisations, governments, academia, financial institutions, and businesses are needed to advocate sustainable consumption and production that incentivise investment and close financial-need gaps.

This policy brief was made possible with the support of:

The Government of Japan through the Japan-ASEAN Integration Fund (JAIF)

Japan-ASEAN Cooperation

1. Introduction

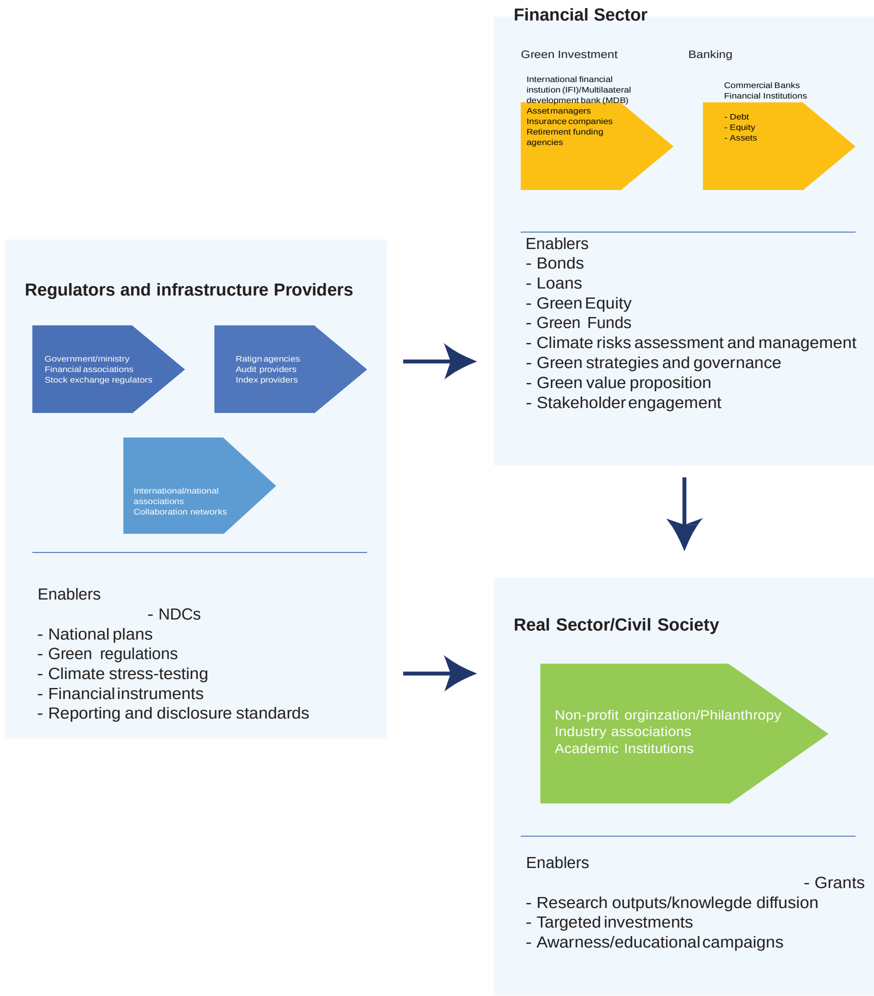
The existential threat of climate change will not only cause catastrophic impact on the environment, but will also exacerbate poverty, as well as health and social inequalities. Climate financing must be addressed as a core economic challenge, and the scale of action required cannot be underestimated. Tackling the environmental, economic, and social impact of climate change requires a fundamental transformation of all sectors. The transition to low-carbon economies will require coordinated efforts by governments, international organisations, private institutions, financial markets, and civil society. ASEAN is susceptible to climate risks, and as impacts of climate change worsen, scaling up investments will be critical for survival. Although the majority of ASEAN Member States have reaffirmed their commitment to addressing the climate emergency, climate finance is a relatively new area for most ASEAN Member States and needs further exploration.

Financial resources and sound investments are needed to reduce emissions, promote adaptation, and build resilience. Several ASEAN Member States rely heavily on public financing to meet their nationally determined contributions (NDC) commitments, and although private sector participation is gaining pace, it is uneven across the region. To facilitate the delivery of climate finance, there is a need to assess the strength and stability of the financial ecosystem. A strong financial ecosystem is necessary to increase the scale of finance flowing to mitigation and adaptation projects. This policy brief aims to address the financial gaps by identifying different approaches to strengthening climate finance in ASEAN and key stakeholders. Figure 1 categorises the key stakeholders within the financial ecosystem in ASEAN, and the potential roles they could play in mobilising funds for climate actions. Encouraging integration and coordination among all relevant stakeholders can promote greater transparency and accountability, as well as close the climate funding gap. Such integration and coordination support the Integrate-Involve-Motivate (IIM) approach in the ASEAN State of Climate Change Report (ASEAN Secretariat, 2021) which promotes not only the transformation of institutional and policy systems to strengthen and accelerate the distribution of financial resources across different sectors and industries, but also the transformation of society and the environment.

More and more financial institutions, companies, and investors among ASEAN Member States are increasing their efforts to achieve net-zero emissions by incorporating climate-related risks and opportunities into decision-making. However, market participants remain constrained in ways that prevent the scaling up of investments needed for an effective and efficient climate transition. This is underpinned by a lack of transparency and comparability of climate-related actions, as well as a lack of progress on globally coordinated climate action.

Strengthening the financing ecosystem requires addressing three key pillars: (1) reinforcing the role of regulators and infrastructure providers; (2) encouraging the financial sector to provide access to climate financing, and; (3) emancipating the role of civil society organisations.

Figure 1: Key Stakeholders with the Climate Finance Ecosystem



Source: Developed by authors

2. Reinforcing the Role of Regulators and Infrastructure Providers

Regulatory readiness is the first step in ensuring that the capital and financial markets are ready to offer climate finance instruments. As the financial risks of climate change begin to become relevant to the banking sector, more regulators are considering climate risk assessments as part of the mandate of central banks and financial supervisors.

2.1. Mainstreaming climate risks in financial sector assessments

To ensure the effectiveness of climate-related financial policies, climate risk assessments need to be systematically integrated into financial stability frameworks. Climate risk metrics are no longer just an ad hoc requirement but are increasingly becoming an integral part of assessing project financing decisions. It is critical that central banks and financial regulators support the mainstreaming of green finance and ensure that climate-related risks are adequately measured, verified, and reported. In 2017, the Central Banks and Financial Supervisors Network for Greening the Financial System (NGFS) was established. By February 2022, the NGFS had grown to 108 members and 17 observers, with the central banks of Cambodia, Indonesia, Malaysia, the Philippines, Singapore, and Thailand as ASEAN representatives. The NGFS (2019) recognises that climate change poses a serious threat to financial stability and has issued a 'Call to Action' that should be taken up by central banks and financial regulators to address both physical and transition risks (NGFS, 2019).

Regulation and oversight of climate-related financial risks are critical to maintaining financial stability. When these risks are assessed as material and likely to threaten financial stability, regulators should be able to intervene early. Climate change has two main impacts (physical risks and transition risks) that directly affect the financial system, which makes it significant enough to be a core responsibility of financial regulators (Prudential Regulation Authority, 2018). Physical risks arise from climate and weather-related events and are associated with destructions that create imbalances in supply chains and trade flows, which can affect financial stability. Transition risks are consequences that can arise as societies move toward a low-carbon economy. Several central banks across ASEAN Member States are already active in pursuing green central banking policies and ensuring climate disclosure, risk assessment, and responsible investment among the financial sectors. Disclosures by financial institutions are increasingly being made mandatory. As a regional community, ASEAN should further engage and discuss continuously streamlining green central banking policies and increase the likelihood for members to achieve their mandates.

2.2. Promote transparency by focusing on climate reporting, data, and verification

The key objectives of securities regulators involve protecting investors and reducing systemic risk while maintaining fair, efficient, and transparent markets. As climate-related risks are increasingly recognised as a source of financial risk, promoting transparency in the markets is critical. Disclosure of climate-related information enables market participants to identify and assess climate-related risks and opportunities.

Rating agencies and audit providers play an equally important role in measuring and highlighting the extent of climate-related credit risks. Credit ratings issued by rating agencies serve as a guide for market participants to obtain hard data on companies' climate disclosure practices and forward-looking environmental conservation commitments. It is undeniable that the true extent of climate-related credit risks may still be significantly underestimated by rating agencies, especially given the uncertainty about future climate policy, which is exacerbated by evidence that climate risks are not very well priced into financial markets (Schnabel, 2021). Nonetheless, credit rating agencies and index providers remain relevant because they highlight the importance of the coverage, quality, and comparability of corporate disclosure of greenhouse gas emissions and emission reduction strategies.

ASEAN can play a key role in creating opportunities to enhance transparency of climate actions and ensuring that members have sufficient capacity to meet the reporting requirements of the Enhanced Transparency Framework (ETF) established under the Paris Agreement. Indeed, much progress is needed in the development of accounting methodologies, standard setting, and reporting requirements to uncover climate-related imbalances. Promoting such initiatives is essential.

2.3. Harmonising regulation and promote capital mobility

The ASEAN Capital Markets Forum (ACMF) presented the Roadmap for a Sustainable ASEAN Capital Market with four (4) priority areas. The first priority focuses on strengthening fundamentals by promoting common disclosure standards. This is critical to ensure that ASEAN Member States adhere to common global standards. Readiness to adopt and implement disclosure requirements would also improve market access to green finance.

Although several ASEAN Member States assert that more time is needed to adopt global standards, the shift in capital movements toward green finance is occurring rapidly, and ESG-related funds and thematic bonds are gaining traction globally. This growing trend will further limit access to countries that are unable to adapt to the changes and eventually lose their competitiveness to attract capital to finance climate action.

The ACMF also listed several recommendations to improve market access, product development, and incentive structures. The recommendation to strengthen the ASEAN Collective Investment Schemes (CIS) Framework and streamline the review framework for the ASEAN Joint Prospectus is a step in the right direction to facilitate cross-border capital flows. The ACMF also recommends the introduction of a "green lane" to accelerate the cross-border issuance of green, social and sustainable bonds and the distribution of sustainable funds without compromising regulatory standards.

The progress of CIS is encouraging given that the Philippines is the latest signatory to the collective scheme, but efforts need to be made to include other ASEAN Member States to achieve better scale and progress towards an integrated ASEAN capital market. This will allow ASEAN to have a strong, green and sustainable asset class that will attract more foreign capital to the region.

3. Encouraging the financial sector to provide access to climate financing

The financial sector has a central role to play in mobilising the financial resources needed to transition to net zero and in helping economies cope with adaptation and mitigation measures. Large-scale quantity and quality investments required not only public sector but also private sector contributions. Within the financial sector, banking and investment, in addition to an accommodative financial environment, can provide impetus for the path towards carbon reduction.

In ASEAN, collective efforts in facilitating strategies to enable ASEAN Member States to mobilise climate finance at scale and in a country-driven manner exist. For instance, the ASEAN Taxonomy for Sustainable Finance acts as a guide to help drive the region's sustainability agenda, catering to the different ASEAN economies, financial systems and transition paths. It serves as the region's common language for sustainable finance and provides a framework to encourage capital towards activities that promote sustainability initiatives. The taxonomy plays a crucial role in encouraging the financial sector to scale up sustainable finance efforts and, in turn, supporting the achievement of ESG targets. Likewise, the technical assessment of climate finance in Southeast Asia facilitates the development of an ASEAN Climate Finance Mobilization and Access Strategy to boost access and mobilisation of climate finance. The strategy is based on the climate finance needs identified by ASEAN Member States in accordance with their NDC goals. While these efforts exist, engagement with the financial sector can be further enhanced.

3.1. Financing stranded assets and promote transition financing

As the policy environment and regulatory focus shift to phasing out carbon-intensive energy production, the financial sector must realign its priorities to assessing the risks of carbon-intensive investments, efficiently mobilising capital for green sectors, and facilitating price discovery to ensure that green assets are priced efficiently. Currently, the financial sector is highly exposed to stranded asset risk due to insufficient attention to ESG risk factors and as policy and regulation move away from carbon-intensive industries. Inadequate climate action will exacerbate the situation as countries continue to invest in carbon-intensive infrastructure, leading to higher costs of dealing with stranded assets in the future. Therefore, to avoid uncertainties and shocks to the financial system, clear guidance is needed on stranded asset management and reducing exposure to carbon-intensive extractive industries. Transparency and clear regulatory information will make it easier for the financial sector to consider the write-off of obsolete assets gradually over time and to consider new low-carbon investment opportunities.

The financial market should explore innovative instruments to support the net-zero transition. ESG-related financial instruments such as sustainability-linked bonds (SLBs) and sustainability-linked loans (SLLs) are increasingly available to support this transition. Unlike green bonds or loans, SLL and SLB structures offer greater flexibility in how proceeds are used, and companies do not necessarily need to be labelled as a green industry. Under SLL and SLB fund structures, financing terms are tied to an agreed-upon sustainability performance target, allowing for adaptable financing terms that depend on the funders' and the company's ability to meet the sustainability targets. Companies that fail to meet the targets face penalties.

Given the growing global demand for SLL and SLB structures, ACMF has developed the ASEAN Sustainability-linked Bond Standards into the existing parameters for labelled instruments, i.e., Green Bond Standards (GBS), Social Bond Standards (SBS), and Sustainability Bond Standards (SUS). This will facilitate the alignment of SLB among ASEAN Member States and provide diversity and options for transitional financing in the region.

3.2. Adopting innovative instruments to support climate financing

Product and process innovation are greatly needed to facilitate the paradigm shift in climate finance, particularly in terms of improving access to finance. There is a need to promote innovation in climate finance to attract domestic and international investors to invest in climate change projects. Regulators need to facilitate market innovation to expand the breadth and depth of climate finance instruments in the financial market in ASEAN.

To address the problems associated with financing environmental projects, ASEAN Member States could consider introducing various forms of innovative financing mechanisms, such as front-loading finance and solidarity levies. The front-loading financing mechanism is an effective tool for making funds available much earlier to address time-sensitive issues such as public health emergencies and climate change risks. This early mitigation can avoid the social and economic costs of reconstruction and recovery in the future. For example, the International Finance Facility for Immunization (IFFIm) introduced the first front-loading funding in 2006. The financing secured binding commitments from donors for up to 20 years and offered predictable repayment through

ODA to investors who subscribed to the IFFIm vaccine bond. This accelerated the vaccination of the world's poorest children and prevented more than 15 million potential deaths (GAVI, 2022). Similarly, the International Facility for the Purchase of Medicines (UNITAID) has used funds from the international solidarity levy on airline tickets to support its investments in innovations to prevent, diagnose, and treat HIV/AIDS, tuberculosis, and malaria.

A similar structure can be used for climate change, particularly in climatically vulnerable areas, to mitigate the effects of climate disasters. ASEAN can impose a minimum levy on travel in the region that can be used as a climate change mitigation fund to support mitigation and adaptation efforts, particularly related to transboundary air pollution, to which airlines contribute directly. ASEAN Member States can work with MDBs and international donors to accelerate climate action by using future ODA or solidarity levies for repayment. This will also reduce the cost of borrowing for climate change initiatives in the region, especially for low-income member states.

3.3. Digitalisation of climate financing

Digitalisation plays a critical role in enabling inclusive financial sector participation. Internet banking has helped the banking sector reach rural society faster and more efficiently without the need for heavy investment in building physical infrastructure. Fintech and digital banking are expected to increase outreach and provide better access to banking services. Similarly, digitalisation offers the opportunity to develop inclusive financing for small projects, particularly community projects linked to climate change initiatives. As the market for ESG-based investing expands, financial technologies can help provide valuable data and tools to help individuals and institutions make optimal investment decisions. Utilising data-led fintech propositions such as Artificial Intelligence (AI) allows investors to make ESG-led investment decisions in confidence and with full transparency.

To address climate issues, low-cost community-level frugal technological innovations, such as biomass cookstoves, small-scale photovoltaic systems, micro-hydro plants, and pico-grids, can be financed through digitally based financial platforms such as P2P, digital banking, and crowdfunding. These platforms could provide broad and better access to finance, especially in areas where traditional banks and capital markets do not have a strong presence. With proper guidelines to reduce uncertainty risks and ensure accurate and reliable information flows, the adoption of digital finance will accelerate and help close financial gaps in addressing climate change.

4. Emancipating the Role of Civil Society Organisations

Collaboration among local communities, academic institutions, and industry associations in an inclusive and transparent manner would help uncover the complex social and economic impacts of climate change. Successful coordination among networks/stakeholders will lead to efficient distribution of resources to beneficiaries while ensuring that the concerns of those affected by climate disasters are heard by authorities and donors.

4.1. Advocate sustainable consumption and production

Awareness of sustainable use of natural resources is driving companies to develop new models that promote responsible consumption and production. Companies are increasingly adopting sustainable strategies in their production processes as responsible production becomes more necessary to raise funds, meet end-user demand, and satisfy buyer requirements along the supply chain.

Under Scope 3 emissions of the Greenhouse Gas (GHG) Protocol, carbon intensity disclosure is not limited to activities within the reporting organisation, but also includes organisations indirectly affected in the production value chain (World Resources Institute & World Business Council for Sustainable Development, 2021). The disclosure requirement has significant implications for industry competitiveness, particularly in global trade. The Border Carbon Adjustment Mechanism (CBAM) proposed by the European Union (EU) in July 2021 is a new mechanism that places carbon prices on imports of a certain range of products to prevent carbon leakage outside the EU. While the arguments on CBAM and its impact on global trade remain to be considered, ASEAN should evaluate the proposal and begin negotiations to avoid disruptions to trade between ASEAN Member States and the EU. In the meantime, clear guidance on CBAM requirements will be helpful for ASEAN to begin preparations for implementation.

Failure to comply with environmental standards and human rights obligations established by international laws not only leads to compliance issues related to legal requirements, but also to reputational risk for companies. The impact of reputational risk on companies can take many forms, including the ability to raise funds. Therefore, clear guidance and goals are essential to ensure a smooth transition of companies to sustainability.

Regional collaborative actions in aligning the financial sector to mobilise funds for sustainable consumption and production (SCP) implementation can yield concrete results to support a green and sustainable ASEAN community. For instance, the ASEAN SCP framework provides a guide for ASEAN Member States to mainstream SCP and circular economy principles into a regional action plan, while addressing cross-cutting environmental issues.

4.2. Empower the civil society, business and industry associations and academia

Civil society plays a critical role in addressing climate change and protecting the poorest and most vulnerable communities from its impacts. Non-governmental organisations, industry associations, philanthropists, and academics, among others, play a key role in forcing new laws, programs, and policies on climate change while holding governments accountable for their commitments. Capital raised by businesses, investors, and philanthropists can play a critical role in responding to climate change by targeting the regions, sectors, and solutions that need the most support.

Historically, philanthropies have generally been well-suited to address market failures in key areas. To increase impact, philanthropic activities through foundations, charitable firms, and individual donors can attract more funding from other sources by having a wide range of funding mechanisms (grants, mission investments, venture philanthropy, etc.). In addressing climate change, philanthropists have the expertise, resources, and techniques that can help accelerate decarbonisation and adaptation efforts. To support the large-scale implementation of climate solutions, they help foster collaboration and collaborative research, fund high-risk ventures, and advocate for policies. Globally, climate-related philanthropy grew by 14% between 2019 and 2020 (Impact Economist, 2022). As more donors begin to redirect funds to climate causes, several philanthropic foundations actively pledged funds at the COP26 summit, indicating serious potential to meet their commitments and make an impact.

Similar to private financial institutions, businesses and industry associations also play a critical role in advancing climate change goals. Industry associations can promote investment activities in climate-friendly sectors and develop standards, certifications, and policies that benefit their members. In this aspect, ESG and sustainability reporting frameworks can be critical in driving investments related to climate change. The ESG framework serves as a guide for investors, financial institutions, and businesses to integrate climate risk assessments, carbon reduction strategies, and sustainable investment practices, thus fostering a more sustainable investment environment in ASEAN.

Recently, climate education has been growing rapidly as universities incorporate diverse climate topics into their curricula. Climate-related scholarship and climate research grants encourage innovation and networking among researchers focused on using science and problem-solving methods to combat environmental problems. Indeed, mobilising universities for change is necessary to develop decision-support tools to help policymakers assess climate risks. Evidence-based research findings that are related to climate financing can be incorporated into policy discussions and decision-making processes to help ASEAN understand and respond to the complexity of future climate change actions. Establishing platforms and opportunities for engagement among the private sector, civil society organisations (CSOs), academia, and the public to discuss and strengthen the climate financing ecosystem in the region should be encouraged. By enhancing dialogue and knowledge exchange, investments can be incentivised, and innovative solutions to reduce the financial resource gap and help achieve climate goals can be fostered.

5. Conclusions

The challenges faced by ASEAN Member States in accessing and distributing climate finance involve multiple sources and mechanisms. The ecosystem of climate financing is complex, given how intertwined the different segments of stakeholders are. In this context, ASEAN’s role is crucial. Solutions to improve the delivery of climate finance in the region, therefore, include not only empowering relevant financial actors but also leveraging ASEAN’s collective efforts to reduce barriers associated with the existing climate finance architecture. Regional policies can continuously support policymakers and other stakeholders responsible for financing climate action by integrating strategies and mobilising funds to support a green and resilient recovery. Progress needs to be made on multiple fronts to promote greater harmonisation of investment criteria, strategies, and frameworks for the entire ASEAN region.

References

ASEAN Secretariat. (2021). *ASEAN state of climate change report.* Jakarta: ASEAN Secretariat.

GAVI. (2022). *Our alliance - about*. https://www.gavi.org/our-alliance/about.

Impact Economist. (2022). *Data point: Is philanthropy failing the fight against climate change?.* https://impact.economist.com/sustainability/social-sustainability/is-philanthropy-failing-the-fight-against-climate-change.

NGFS. (2019). *A call for action: Climate change as a source of financial risk. Network for greening the financial system.* https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf.

Prudential Regulation Authority. (2018). *Transition in thinking: The impact of climate change on the UK banking sector.* London: Bank of England.

Schnabel, I. (2021). *Climate change and monetary policy.* Washington, DC: IMF.

World Resources Institute & World Business Council for Sustainable Development. (2021). *Corporate accounting and reporting standard. Greenhouse gas protocol.* https://ghgprotocol.org/corporate-standard

Editorial Committee

Advisor	:	**Dr. Kao Kim Hourn, Secretary-General of ASEAN**
Chairperson	:	**Ekkaphab Phanthavong, Deputy Secretary-General of ASEAN for ASEAN Socio-Cultural Community**
Members	:	**Rodora T. Babaran, Director of Human Development Directorate**
		Ky-Anh Nguyen, Director of Sustainable Development Directorate
		Roger Yap Chao Jr., Head of Education, Youth and Sports Division
		Ferdinal Fernando, Head of Health Division
		Mega Irena, Head of Labour and Civil Service Division
		Miguel Musngi, Head of Poverty Eradication and Gender Division
		Jonathan Tan, Head of Culture and Information Division
		Riyanti Djalante, Head of Disaster Management and Humanitarian
		Vong Sok, Head of Environment Division
Managing Editor	:	**Benjamin Loh, Head of ASCC Monitoring Division**
Production Editors	:	**ASCC Analysis and Monitoring Directorate**