Learning About ESG

Progressing ESG adoption in Asia

Learning About ESG is an educational series that connects **environmental, social and governance** topics with investing.

Join us each issue to see how global developments can have implications for investors. The better we understand ESG, the bigger the role it can play in our everyday lives – and investment portfolios – contributing to a better world.

Key takeaways

- The scarcity of ESG investment products and fragmented data across the region have hindered widespread adoption of ESG principles in Asia.
- However, there's a positive shift taking place as the region moves towards implementing ESG disclosure and transparency requirements.
- This development should only make the region more appealing to global investors pursuing the opportunity of higher yields amidst stable and deepening credit markets.

Why has ESG adoption in Asia been sluggish?

While awareness and adoption are on the rise, up to now Asia hasn't displayed the same degree of regulatory emphasis on ESG integration as Europe, and to a lesser extent, the US.

The scarcity of available ESG investment products in the region acts as a deterrent to a broader audience of investors, limiting their ability to invest in line with sustainable principles. The fragmentation of ESG data and disclosure practices across Asia further compounds the challenges, with a clear distinction between developed and emerging markets in the region. In particular, financial hubs like Singapore and Hong Kong are making strides toward aligning with European regulatory and corporate disclosure standards.

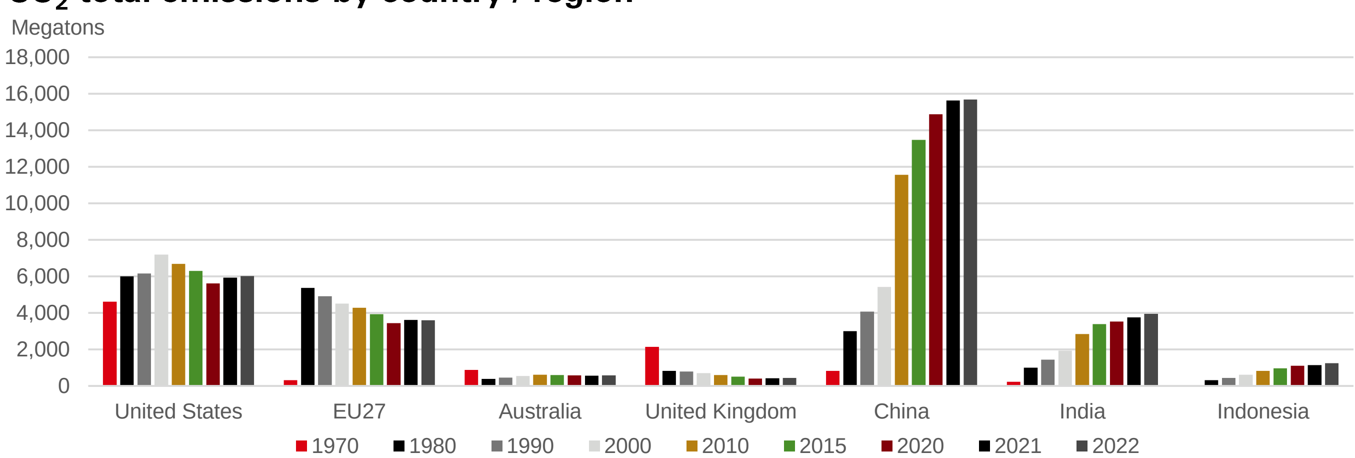
The absence of consistent company disclosures in emerging Asia poses a significant hurdle to ESG adoption. Due to a lack of standardised rules across countries, inconsistencies impede investors' ability to assess ESG factors. In this context, regulators in Asia have a crucial role to play in introducing consistent policies.

Asia faces diverse yet significant sustainability-related risks. For instance, the region is highly vulnerable to physical risks induced by climate change. However, much of developing Asia currently prioritises economic growth heavily reliant on natural resources and carbon-intensive industries, such as manufacturing – primarily due to outsourcing from developed markets. This results in a continually expanding carbon footprint that hinders their transition to a low-carbon economy, as shown in the chart below.

There's a clear need to drive sustainable economic development over the long term, supporting the expectation for greater adoption of ESG practices and disclosure in the coming years.

Despite the substantial challenges faced in Asia, there are two main reasons for optimism: a growing demand for responsible investment opportunities and increasing regulatory support. This is evidenced by a twofold increase in the number of ESG policies from 2016 to 2021.[1]

CO_2 total emissions by country / region



Source: Emissions Database for Global Atmospheric Research 2023

[1] Goldman Sachs Global Investment Research, February 2022.

Are there signs of a shift towards prioritising sustainability in Asia?

Significant progress has been made. For instance, Asia crossed the USD1 trillion milestone in the impact bond market in Q2 2023, accounting for roughly a quarter of global cumulative issuance of green, social, and sustainability-linked bonds.[2]

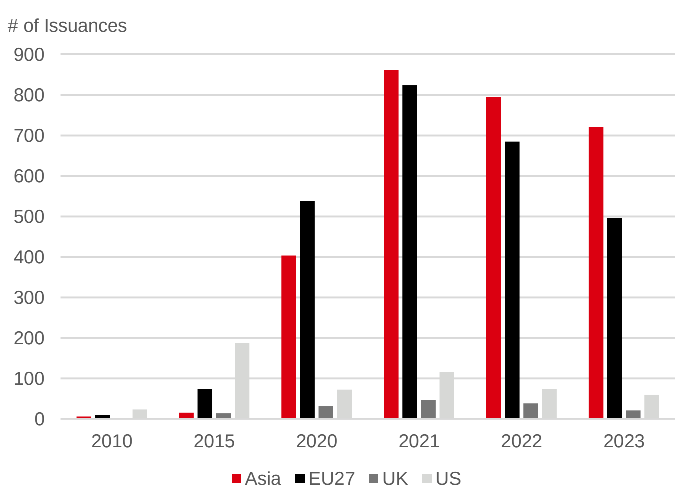
Importantly, bond markets offer more direct influence over the allocation of capital, compared to equity markets where investors are trading secondary securities. This, coupled with the massive need for funding of sustainable projects, has contributed to the remarkable growth of the sustainable bond market. Following a decline in issuance since the beginning of 2022, owing to rising interest rates and heightened market volatility, the market in Asia exhibited a robust recovery in the first half of this year.

While green bonds continue to dominate, comprising around 66% of bonds focused on ESG priorities, there has been a notable surge in social and sustainability bonds as well.[3] The scale of funding required for Asia's transition to a net zero economy, estimated at around USD30 trillion by 2050, supports expectations for significant growth ahead in sustainable bond issuance.

Beyond the expansion of sustainable bonds, the growth in ESG products in Asia is being catalysed by emerging ESG-fund labelling requirements. These requirements mandate that asset managers disclose how ESG factors are integrated into the investment process. Tighter regulations for corporate-level ESG disclosures and product-level transparency can greatly enhance corporate governance and market stability, while providing investors with better information to mitigate risks. In fact, companies in Asia that are aligned with the EU taxonomy have expanded their sector relative price premiums to 55% versus earnings, surpassing the global average of 37%.[4] Moreover, there has been increasing support in Asia for disclosures recommended by the Task Force on Climate Related Financial Disclosures, with almost half of 3,400 global supporters being Asian organisations.[5]

In fast-growing India, whose development is increasingly attracting international investors, the Securities and Exchange Board has mandated Business Responsibility and Sustainability Reporting (BRSR) for listed companies to disclose ESG risks. These steps are clear indications of the progress being made in ESG disclosure and transparency in the region.

Green bond issuances by Region



Source: Refinitiv, HSBC Asset Management. November 2023

[2] OECD, September 2023
[3] LSEG, August 2023
[4] Goldman Sachs Global Investment Research, February 2022
[5] PwC, September 2022

Why has India warranted investors' attention recently?

In 2023, India forayed into the sovereign green bond market, initiating two substantial USD1 billion local currency deals with plans for an additional USD2.2 billion equivalent issuance, aimed at mobilising resources for green infrastructure.

Proceeds of these sovereign green bonds are channelled towards investments in two critical areas: renewable energy and the electrification of transportation systems. These sectors are of immense significance, accounting for approximately 41% of India's greenhouse gas emissions in 2019 and projected to contribute two-thirds of emissions by 2050.[6] This signifies the rising importance of green bond issuances in India and elsewhere, and their direct impact on long-term sustainability.

Such notable developments are occurring alongside growing attention on India's extensive USD1 trillion government debt market, following its inclusion in J.P. Morgan's benchmark emerging markets government bond indices. This inclusion will deepen the sovereign bond market in India, with a substantial influx of foreign capital estimated at around USD25 billion, and setting the stage for a ramping up of bond issuance to fund future development.

[6] World Bank, June 2023.

On a broader scale, the deepening bond markets in Asia bode well for addressing long-term sustainability goals. Private capital will play a significant role in both economic development and the region's energy transition. Alignment with international standards, improved governance and enhanced disclosure practices will encourage capital flows that support sustainable development.

Given the benefits of ESG integration within Asia – notably, improved investment decisions as a result of better transparency and risk mitigation – ESG disclosure progress should only make the region more appealing to global investors pursuing the opportunity of higher yields amidst stable and deepening credit markets. Professional asset managers can assist through investment processes that integrate ESG considerations. This includes assessing ESG risks, carrying out enhanced due diligence of higher risk issuers and actively engaging with companies to address risks and achieve positive outcomes.

Glossary

ESG: A set of Environmental, Social and Governance criteria that investors can apply to analyse and identify material risks and growth opportunities in investments.

EU Taxonomy: Classification system that defines criteria for economic activities that are aligned with a net zero trajectory by 2050 and the bloc's broader environmental goals.

Sustainable Bonds: Used to finance or re-finance a combination of green and social projects or activities.

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