

## Summary version

# Current Situation and Challenges of Green Bonds in Japan from the view point of Promoting Repeat Issuance.

- Analysis on results of a questionnaire survey to issuers -

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There are a wide variety of funding sources for achieving the 2 degree or 1.5 degree goals set forth in the Paris Agreement and the 2030 Agenda for Sustainable Development with its sustainable development goals (SDGs). Green bonds are said to be one of the "best candidates" among financing products.<sup>1</sup> Global green bond issuance has more than quadrupled since 2014, reaching USD 182 billion in 2018.<sup>2</sup> However, this accounts for only about 2.5% of global bonds (including debt securities) based on the balance as of the third quarter of 2018.<sup>3</sup> This indicates that green bonds have the potential for further market expansion. There is still only a limited green bond market in Japan, where more than JPY 500 billion (about USD 4.2 billion) of green bonds were issued in 2018,<sup>4</sup> compared to about JPY 10 trillion of straight bonds at the same time. In order to encourage the expansion of the green bond market, there are two options: (1) multiple issuance by issuers that have already issued green bonds; and (2) issuance by companies or agencies which have no experience in issuing green bonds.

This working paper shows results of a questionnaire survey to analyse the following two questions: (1) What kind of challenges do companies need to overcome when using green bonds as a strategic means of funding green projects or activities under their business plan, so that they can issue green bond repeatedly? and (2) What policies and institutional measures by the government are necessary to encourage such companies to carry out repeated issuances? A total of 35 companies issued green bonds in Japan up to 31 January, 2019.<sup>5</sup> A questionnaire survey was conducted targeting 18 of those companies, which are the main actors engaged in the implementation of green projects. Financial institutions are not included in this survey, because they do not implement green projects themselves. Responses to the questionnaire were collected from 12 out of 18 companies. Interviews were also conducted at three companies out of those 12, to gain more detailed information.

Figures 1 to 3 are outlines of the questionnaire results. Figure 1 shows the motives for green bond issuance. The majority of responses stated that the advantage was "Raising profile as an environmentally-friendly

company" (10 companies, 33%). Specifically, some responses stated that companies intended to approach different investors from those to whom they issued straight bonds, and other responses stated that there would be a ripple effect of raising their profile among equity investors as an environmentally-friendly company. In addition, there were also responses that some reactions were beyond the expectation of the issuer, such as having actually gained publicity in the media or having received a green bond award. The second most common response was "High investor demand" (9 companies, 32%). Among these, some companies were convinced of high demand from investors, and others stated that they were not convinced but expected this before issuance.

Figure 2 shows the ratio of companies that have a plan for future green bond issuance. Of the 12 companies, four responded that they "Have a plan", and the remaining eight responded that they "Do not know." Of the eight companies that do not know if they will issue green bonds in the future, seven companies are hoping to issue bonds in the future. The most common reason why plans for issuing bonds are unknown is that it is difficult to identify green projects, despite showing a desire to issue green bonds. Five companies responded that they would like to issue green bonds if there are suitable green projects consistent with Green Bond Principle or if the use of proceeds can be specified.

Figure 3 shows how green bonds are positioned in financing plans. As a supplementary explanation by the company that answered "not included in the company's financial policy", the definition of green projects or use of proceeds is not well established, and no merit or necessity is recognized to issue green bond.

Based on the information obtained through the

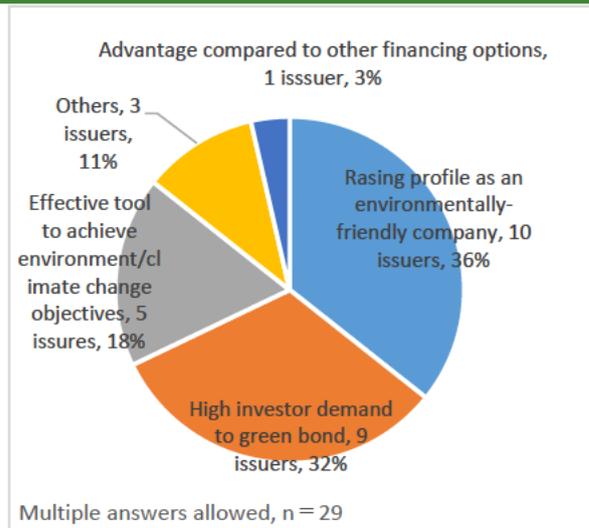


Figure 1: Motivation of green bond issuance

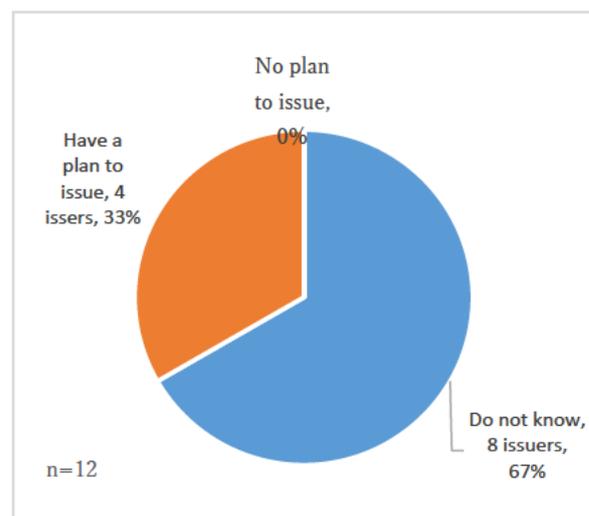


Figure 2: Issuance plan of green bond

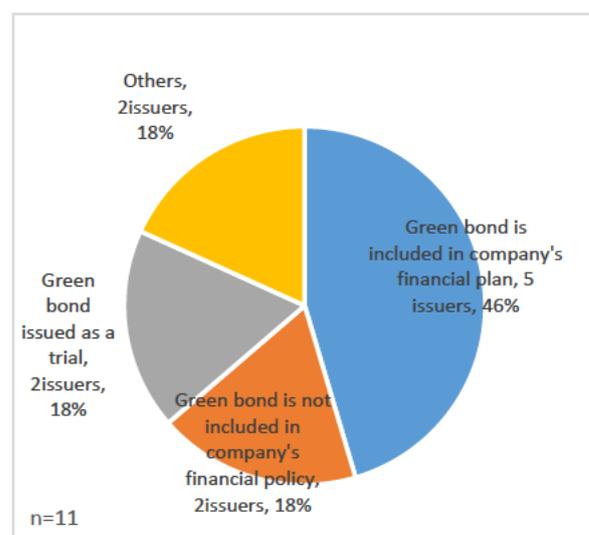


Figure 3: Positioning of green bond in finance plan



questionnaire and interviews, this paper discusses the following three points from the viewpoint of how to expand the green bond market in Japan:

(1) How to increase the benefits of green bond issuances

Benefits of green bond issuance are on the premise that there are a large number of investors who want to invest in green bonds and, as a matter of fact, this number is continuously increasing. From this point of view, ESG investment by investors needs to be expanded. As a policy option to expand ESG investment, an OECD report cites the following as ways to make it easier for investors to enter the green bond market: (1) Provide a mandate for public financial institutions to issue green bonds (e.g. German KfW)<sup>6</sup>; (2) Provide partial risk compensation by public financial institutions (guarantee, project bond rating improvement using subordinated loans etc.); and (3) Provide training on ESG compliance. The European Commission's Action Plan for Sustainable Financing, announced in March 2018, also indicates that institutional investors are required to take account of ESG factors as their fiducial duty. Of course, it is necessary to examine whether Japan can adopt such a policy. In any case, it takes a great deal of time to expand ESG investment, if it is left up to the market alone. At the very least, the government needs to send a clear signal to encourage increased ESG investment.

(2) How to strengthen the formation of green projects

According to the survey results, most companies do not have specific plans for repeat issuance, despite intending to continue to issue green bonds. One of the main reasons is that green projects suitable for green bonds in substantive amounts have not been identified or formulated yet. Even if companies set targets to scale up green projects or environmentally-friendly projects as one of their corporate goals, it takes time to specify priority projects and then prepare for their design and implementation. There is also the issue of whether the schedule for green project formation and implementation will align with green bond issuance. Therefore, it is necessary for companies to streamline their progress management system for the formation and implementation of green projects, in order to ensure repeated issuance of green bonds. Another reason why there is slow progress on green project formation is that the definition of green projects is not clear. Currently, for example, there are different opinions from the market about the eligibility of natural gas as a "transition in energy". There are no clear international standards for eligible green bond projects. Therefore, it is important for the issuer to explain to investors about their clear vision and concrete plans with a roadmap for a low-carbon pathway or contributions to environmental quality improvement. At present, there is a movement to define eligible green projects more clearly, in order to expand the global green bond market. For example, EU is developing a taxonomy on environmentally sustainable activities, and ISO is also engaged in green bond standardisation. Naturally, these international discussions and their outcomes could have an impact on Japan's green bond market. In addition, one of the challenges that was reflected in survey responses from issuers of green bonds, is the burden of additional costs such as obtaining external reviews. Currently, there is a subsidy programme in Japan to bear the cost of external reviews. However, the programme does not

cover the costs of green project formulation for issuance of green bonds. It will be important to improve the programme so that it can bear these costs. From a macro perspective, it is important for the government to clarify policies to expand green infrastructure development in Japan and to prepare a policy framework to support such development. This will encourage companies to develop more green projects. For example, France, Italy and Australia have already prepared national infrastructure development plans.

### (3) How to promote repeat green bond issuance by the same company

According to the Climate Bonds Initiative (CBI) report, out of all the green bonds issued in 2018 (334 institutions, USD 167.6 billion), over 130 institutions with USD 106 billion (63%) are issuing green bonds for the second time or more.<sup>7</sup> Repeat green bond issuance by one company has the merit of reducing issuance costs for related procedures. The following actions need to be implemented to promote multiple issuance of green bonds in Japan: (1) timely formation and implementation of a substantive number of green projects that attract interest from investors, and, (2) putting in place a mechanism that can simplify or omit the procedure for second and subsequent green bond issuances. For example, in CBI's green bond certification system, Programmatic Certification is applicable to promote multiple green bond issuance. Under the Programmatic Certification, no external review is required at the time of second and subsequent issuances. In general, public railways, renewable power generation projects, and water projects are likely to be recognised as green projects with huge investment. It can be said that a company or agency engaged in these sectors is in a good position to continuously procure necessary funds using green bonds. In order to promote multiple issuance of green bonds in Japan, where the green bond market is still under development, it is vital to put in place measures to encourage issuance by business areas and related organisations as described in the above sectors.

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<sup>1</sup> Gianfratea, Gianfranco and Perib Mattia (2019), The green advantage: Exploring the convenience of issuing green bonds. *Journal of Cleaner Production* No 219. pp127-135.

<sup>2</sup> ICMA, 2019, Quarterly newsletter from the Green & Social Bond Principles- May 2019

<sup>3</sup> Environmental Finance Home page, 2019年5月現在, Bond Data base

<https://www.bonddata.org/>

BIS, 2018 Q3, Summary of debt securities outstanding

<sup>4</sup> 環境省グリーンボンド発行促進プラットフォーム、2019年4月、市場普及状況(国内・海外); <http://greenbondplatform.env.go.jp/greenbond/current.html>

<sup>5</sup> 環境省グリーンボンド発行促進プラットフォーム (2019年)「国内企業等によるグリーンボンド等の発行実績」: <http://greenbondplatform.env.go.jp/greenbond/current.html>

<sup>6</sup> OECD, 2017, "Mobilising bond markets for low-carbon transition" P.56-68

<sup>7</sup> CBI, 2019, "Green Bonds: State of the Market 2018" p.11