

October 2023

A dynamic environment: Environment, social and governance lending

Debt & Capital Advisory (DCA)

Navigating a dynamic landscape

The Asia Pacific region is currently undergoing an Environment, Sustainability, and Governance transformation driven by decarbonisation commitments. As more borrowers set their own ESG targets and sustainable lending becomes commonplace, lenders are expanding their products while enforcing stricter Key Performance Indicators. The continuing Ukraine-Russia conflict has led most nations to reconsider their reliance on imported fossil fuels.

We see the below themes as driving changes in the Asia Pacific sustainable lending industry:

- 1 Larger borrowing base:** The uses for ESG financings have rapidly evolved. In the past, green loans used to dominate the market and applied mostly to finance recognised green projects, for example renewable energy. The rise of new borrowers into ESG-lending markets has led to the surge in popularity of sustainability-linked loans (SLLs).
- 2 Diversifying KPIs:** The flexibility of SLLs has allowed companies across the industry spectrum to access debt markets while still achieving ESG objectives. While KPIs like greenhouse gas emissions and energy saving remain the main assessment criteria, others such as water consumption, gender equality, and societal contributions illustrate opportunities for borrowers of all sectors to access the ESG lending universe.
- 3 Increased uniformity:** One concern during the rise of SLLs was the threat of greenwashing – the use of deceptive marketing to advertise organisations as being ESG-friendly. We have seen a drive among regulatory bodies and industry associations to continuously review sustainable lending principles and standards. Capital providers have also led the drive for stricter KPIs to better assess sustainability and measure it post-financing. Companies looking to conduct sustainability-based financings should be prepared for more thorough scrutiny throughout the life of the facility.
- 4 Transitioning from coal:** Many of the Asia Pacific governments are aiming to cut coal production and power generation significantly over the coming years. Nations like Indonesia, Vietnam, and the Philippines are no longer accepting new proposals for coal powerplants, and major players like China are no longer funding their construction overseas. ESG financing will play a critical role in supporting this transition.

Gaps to Close

How can we ensure the entire value chain is ESG-friendly?

How can capital providers drive greater commitment to energy transition?

How do we power Asia's growth while achieving net zero?

Markets are evolving

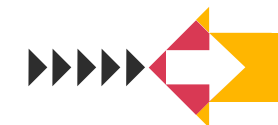
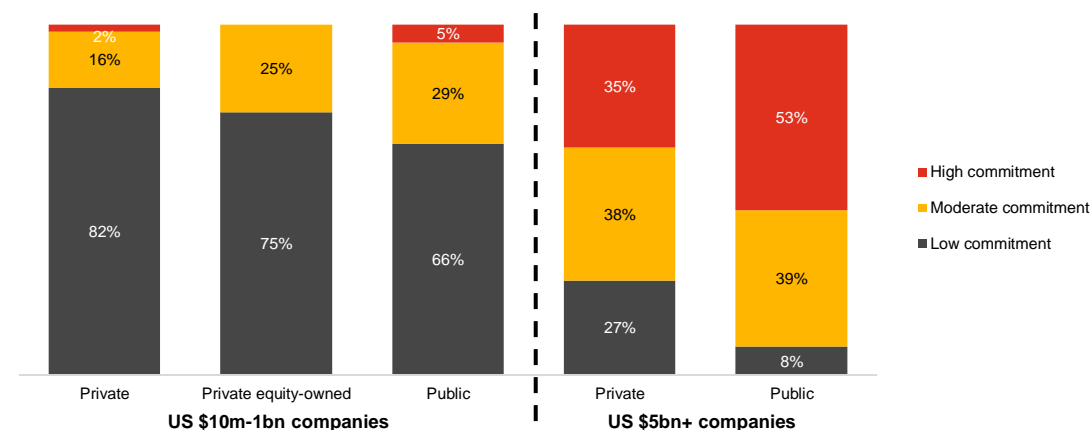


Chart 1: Carbon maturity score by company type

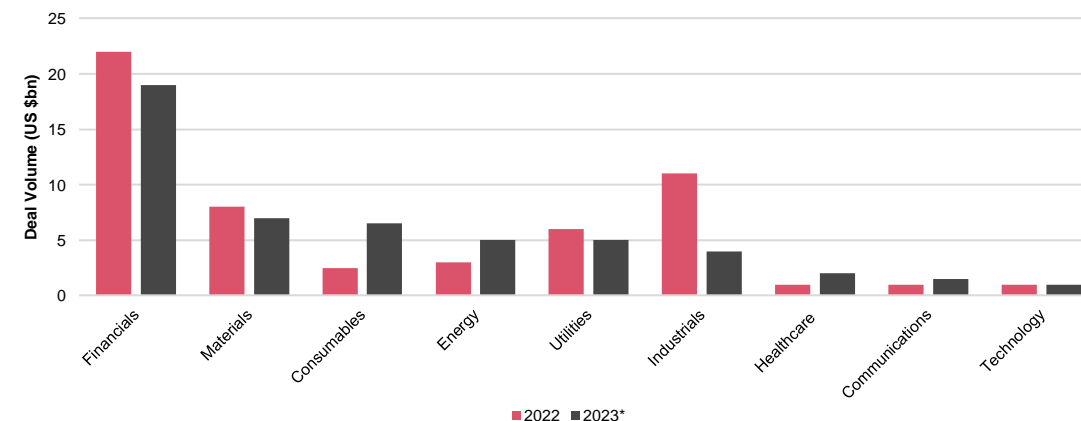


Source: Bain & Co, EcoVadis | "Carbon maturity" denotes an organization's commitment to managing its carbon output

With rising pressure from consumers, governments, and investors for socially-conscious business practices, more and more companies are striving to innovate their operations to benefit the environment and society.

Most high-volume sectors in 2022 have seen lower Year-over-year lending, **with industrials seeing the largest dollar-value drop in ESG lending**. This follows on poor performance from China's major industrial firms, which saw a 20.6% contraction from January to April 2023.

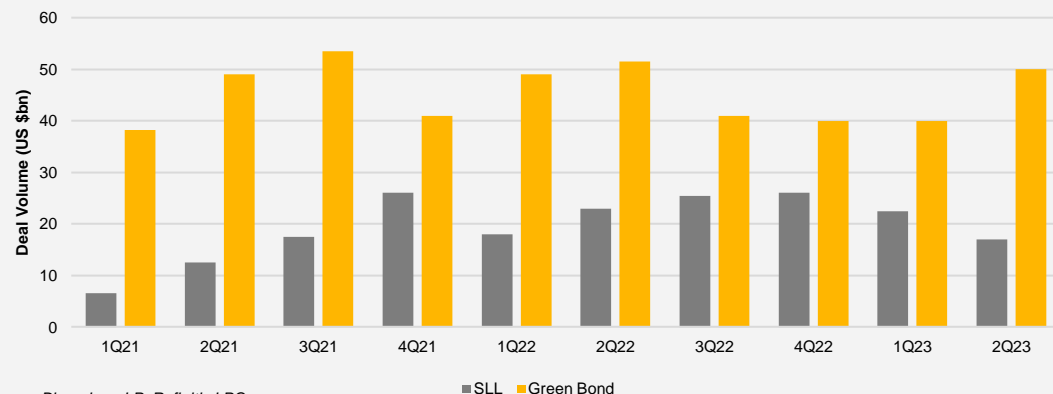
Chart 2: Breakdown by borrower industry



Source: Bloomberg LP | *1H2023 annualized to represent FY2023

A diverse lending space

Chart 3: SLL vs Green bond issuance

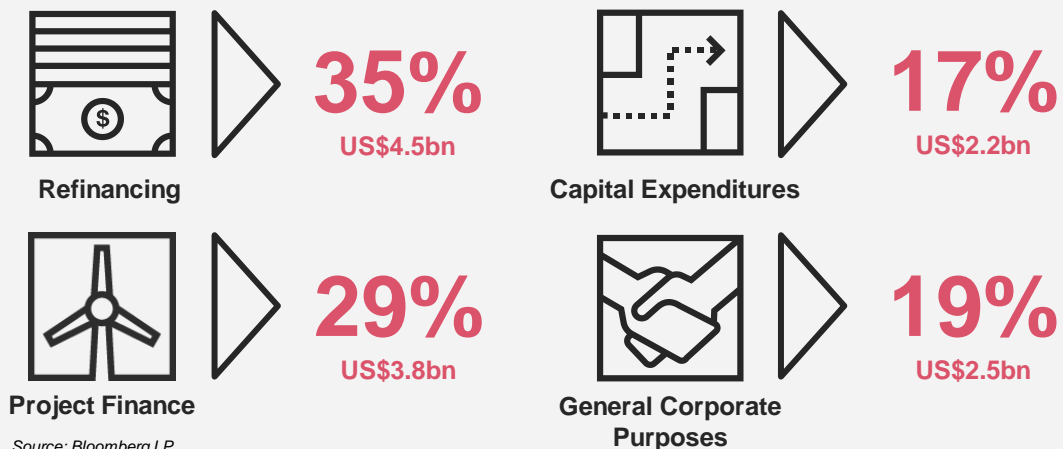


Source: Bloomberg LP, Refinitiv LPC

While green bonds remain a popular financing tool for corporates, SLLs have seen unparalleled growth in recent years due to more flexible requirements. However, this has spurred the development of green lending standards to combat deceptive practices. The **Asia Pacific Loan Market Association's ongoing review of SLL principles aims to minimise the occurrence of greenwashing**. Recently, APLMA has enhanced its SLL principles by introducing additional requirements that KPIs must be material to the borrower's core sustainability and business strategy. PwC's Asia Pacific Debt & Capital Advisory practise is a member of the APLMA.

The volatile lending environment has also led to an evolution in the use of proceeds – traditionally, the majority of sustainable lending would be allocated to financing green projects. However, current economic conditions have seen **refinancings making up the larger proportion of 2Q23 ESG loans**.

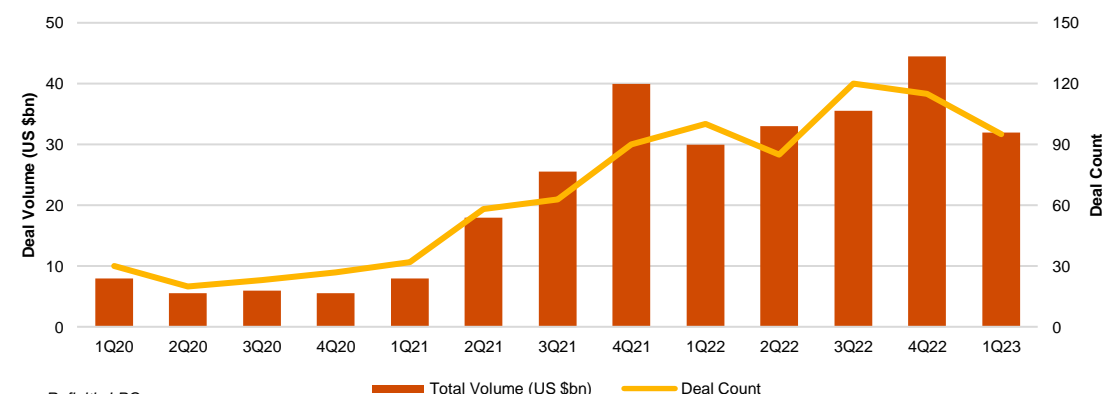
Chart 4: Use of proceeds by percentage & volume (2Q23)



Source: Bloomberg LP

Shifting market demands

Chart 5: Asia Pacific ESG loan volume & deal count

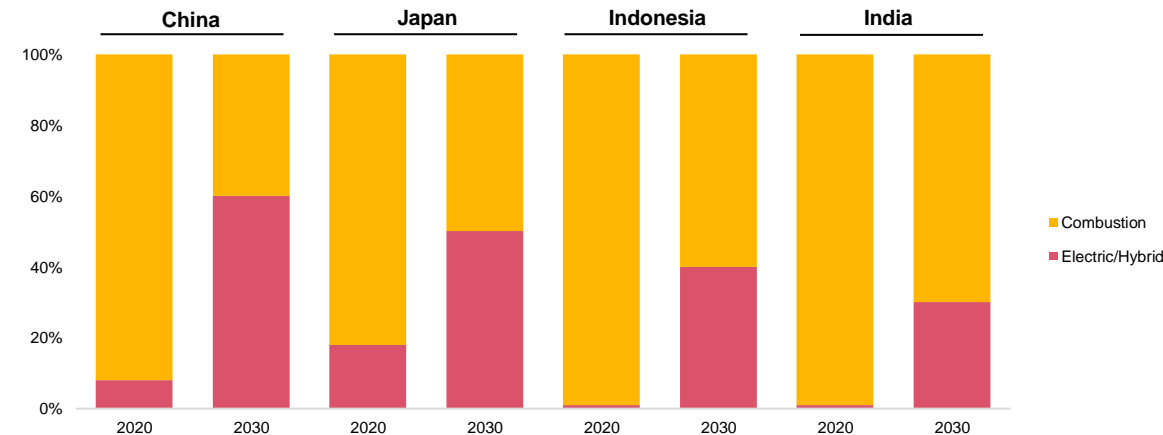


Source: Refinitiv LPC

2023 has seen steady performance for the green-SLL loan market. Rising interest rates and a slowdown in economic activity has caused many lenders to re-examine their ESG portfolios and KPI frameworks. We expect issuance to pick up when the Asia Pacific economy shows a more positive outlook and as more rigorous ESG reporting standards are adopted.

Net-zero goals have seen certain industries under pressure to adapt, with one major example being the Asia Pacific automobile industry as more governments push for lower emissions. Clear decarbonisation strategies for corporates are also increasingly important as large companies lead the ESG charge. These sweeping changes have seen PwC's Asia Pacific Debt & Capital Advisory team retained on numerous transition story engagements.

Chart 6: Asia vehicle sales by power type



Source: McKinsey

Contact us

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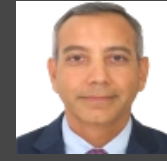
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