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Emerging Markets – Global

# Deepening ESG focus in emerging markets will spur growth in sustainable debt

## Summary

» **Overall sustainability strategies of emerging market (EM) issuers will come under the credit spotlight.** EM economies are particularly susceptible to environmental, social and governance (ESG) risks, such as physical climate hazards and income inequality, and face immense investment needs to finance sustainable development.[1] EM issuers in exposed sectors and regions will therefore encounter growing pressure to adapt their business models and undertake investments to reduce or mitigate underlying ESG exposures. Those that are constrained, or show a lack of preparedness, in addressing ESG risks may find it more difficult to raise or refinance debt.

» **Sustainable finance in EMs is coming of age.** The fallout from the coronavirus outbreak has dampened near-term issuance prospects for EM sustainable bonds following last year's all-time high of $56 billion. Nevertheless, an increased focus on issuers' ESG credentials points to a favourable issuance outlook for EM sustainable debt over the coming years. EM sustainable debt markets will also continue to mature, with key trends including geographic diversification beyond China, the broader mix of sectors pricing green bond deals and the gradual expansion of new labels and asset classes – notably transition bonds, sustainability bonds and sustainability-linked loans.

» **Top-down policy support will remain important in driving the growth and development of EM sustainable finance.** National policy leadership – for instance, the implementation of sustainable finance guidelines and regulation or issuance of sovereign green bonds – tends to have a multiplier effect in driving sustainable debt volumes. This is because such actions provide clarity to issuers on criteria such as project eligibility and reporting. Clear guidelines also increase transparency for investors. Additional EM guidelines are likely in the coming years, most of which will align with international standards.

» **The development of sustainable finance in lower-rated, illiquid EMs will rely on the support of multilateral development banks (MDBs).** Many EMs face significant fiscal constraints and underdeveloped capital markets. In this context, multilateral and supranational agencies will remain important sponsors of sustainable finance development in the form of anchor investments, technical guidance and issuer incentives. Sustainable debt structures that embed some form of credit enhancement will become common practice, as multilaterals seek to "crowd-in" sources of private institutional capital into lower-rated emerging and frontier markets.

## Overall sustainability strategies of emerging market (EM) issuers will come under the credit spotlight

The overall sustainability strategies of EM issuers will come under greater scrutiny in 2020 and beyond, given the material ESG risk exposures of EM economies and the huge funding needs required for low-carbon, climate-resilient investments.

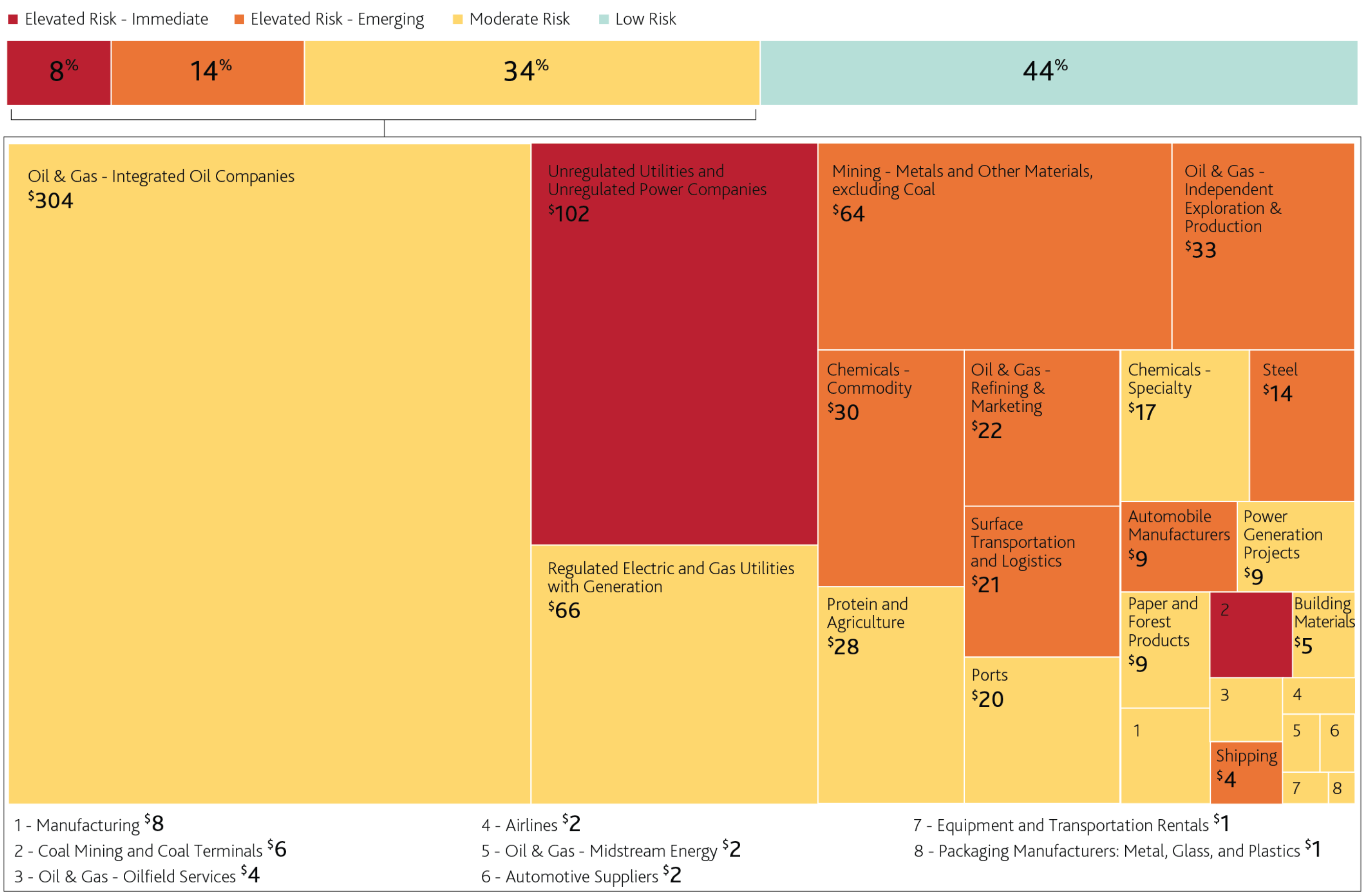
In general, EM economies are more susceptible than their developed market peers to environmental and social risks. Exposure to issues such as physical climate risks, income inequality and natural capital constraints are prevalent across all markets, but EMs typically have a greater economic dependency on natural resources, such as commodities or agriculture-based economic activity, exports and employment. They also tend to have lower overall income levels, weaker quality of infrastructure, and more limited economic, financial and institutional capacity to address sustainability challenges. Governance can also be more opaque.

Our analysis highlights the material ESG exposure of EM issuers. Both at a national and subnational level, EM governments face greater risk exposures than developed markets in both our global environmental risk heat map and our global social risk heat map. For example, EM sovereigns in Asia, the Middle East and North Africa are most exposed to rising sea levels. EM corporate debt also carries significant environmental risk exposures. As Exhibit 1 illustrates, most of the outstanding debt within the universe of EM companies that we rate is concentrated in sectors that score as either elevated (22% of total) or moderate (34%) risk in our environmental risk heat map. The oil and gas sectors alone account for more than one-quarter of rated EM corporate debt outstanding.

Exhibit 1

**EM corporate debt carries significant environmental risk exposures**

**Environmental risk score of EM corporate sectors relative to value of rated debt, $ billions**




Based on the total face amount of debt publicly rated by Moody's for EM issuers in each sector as of May 2019.
*Source: Moody's Investors Service*

The scale of financing required to address ESG risk exposures is considerable. The funding gap needed to meet the UN Sustainable Development Goals (SDGs) in EM economies will be in the order of $2.5 trillion to $3.0 trillion per year through 2030.[2] Furthermore, the International Finance Corporation (IFC, Aaa stable) estimates cumulative climate investment of almost $30 trillion needed across six key sectors in EM cities by 2030, including waste and water management, renewable energy, public transportation, electric vehicles and green buildings.[3] Finally, according to the International Energy Agency, EMs will add roughly 4,000 GW of renewable energy capacity by 2040, equivalent to almost two-thirds of global capacity additions (with China and India alone accounting for 50%).[4] Public financing alone will be insufficient to meet such significant growth in renewables.

Against this backdrop, EM issuers in exposed sectors and regions are under growing pressure to adapt their business models and undertake investments to reduce or mitigate underlying ESG exposures. Those that are constrained, or show a lack of preparedness, in addressing material ESG risks may find it more difficult to raise or refinance debt in the capital markets. This is particularly relevant for issuers operating in sectors exposed to climate risks (both transition and physical) with limited available substitutes and significant funding needs. Indonesian coal miners, for example, will face large debt maturities in the next couple of years at a time when banks, investors and insurers are facing more stringent environmental and social lending requirements.[5]

In contrast, rated entities that outline clear financing plans to reduce their ESG and climate risk exposures stand to benefit from robust investor demand – and potentially more attractive funding costs, or access to a more diversified investor base. For example, strong investor appetite for the government of Chile's (A1 stable) debut 30-year green bond issued in June 2019 indicates that the sovereign has a ready pool of funding to support its commitment to combat climate change. The bond was more than 12 times oversubscribed with a historically low interest rate of 3.53%, with proceeds dedicated to climate shock mitigation and adaptation projects in six sectors across (1) clean transportation, (2) energy efficiency, (3) renewable energy, (4) living natural resources, land use and marine protected areas, (5) efficient and climate-resilient management of water resources, and (6) green buildings.

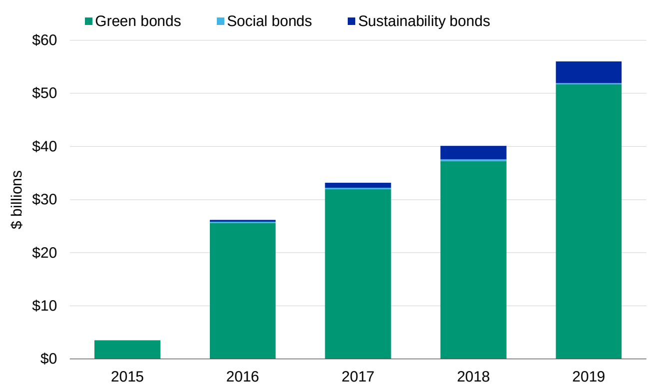
## Sustainable finance in EMs is coming of age

The fallout from the coronavirus outbreak has dampened the near-term growth prospects for green, social and sustainability bonds – collectively known as sustainable bonds – following last year's record issuance of $56 billion (Exhibit 2). Fear of contagion may provoke prolonged market disruption and weigh on investment sentiment, which in turn would dissuade issuers from coming to market over the next several months. Indeed, we recently revised lower our global growth projections, and now expect G-20 emerging market economies to expand by 3.8% in 2020, a deceleration from last year's 4.2% growth rate.

Exhibit 2

**The coronavirus outbreak may dampen growth after record issuance in 2019...**

**Global EM issuance of green, social and sustainability bonds, $ billions**

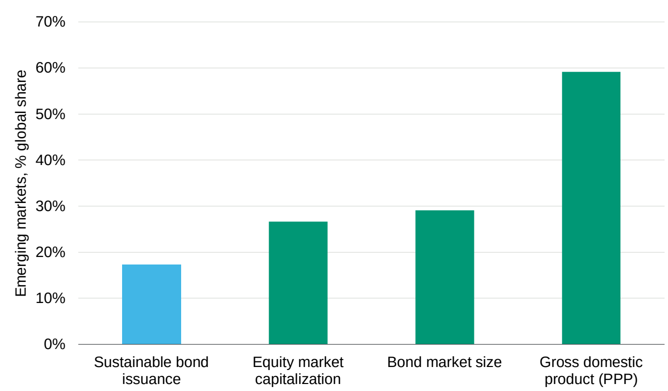



*Sources: Moody's Investors Service, Climate Bonds Initiative and Dealogic*

Exhibit 3

**... but the longer-term growth potential remains favourable**

**EM financial and economic data, % global share**




Sustainable bond issuance and equity market capitalization as of year-end 2019, bond market size as of end of H1 2019 and gross domestic product (PPP) as of 2018.

*Sources: Moody's Investors Service, Climate Bonds Initiative, Dealogic, World Federation of Exchanges, Haver and International Monetary Fund*

Nevertheless, the long-term issuance outlook remains favourable. Increased investor focus on issuers' ESG exposures and sustainability credentials will underpin strong growth across EMs. Sustainable bonds are effective instruments for issuers to demonstrate their ESG strategies, such as their commitment to climate targets and sustainable development goals, as well as their risk management practices and governance structures. Sustainable bonds also enhance transparency – often seen as a challenge within EM investing – because of commonly adopted practices around use-of-proceeds disclosure, proceeds management and ongoing reporting.

Sustainable bonds are also significantly underrepresented when compared to the relative financial and economic importance of EMs. As Exhibit 3 illustrates, EMs account for just 17% of total sustainable debt issuance, significantly lower than the 27% and 29% share of global equity and bond markets, respectively, as well as the 59% share of global gross domestic product (in purchasing power parity terms).

Beyond growth in issuance volumes, EM sustainable debt markets will continue to mature in a number of important ways.

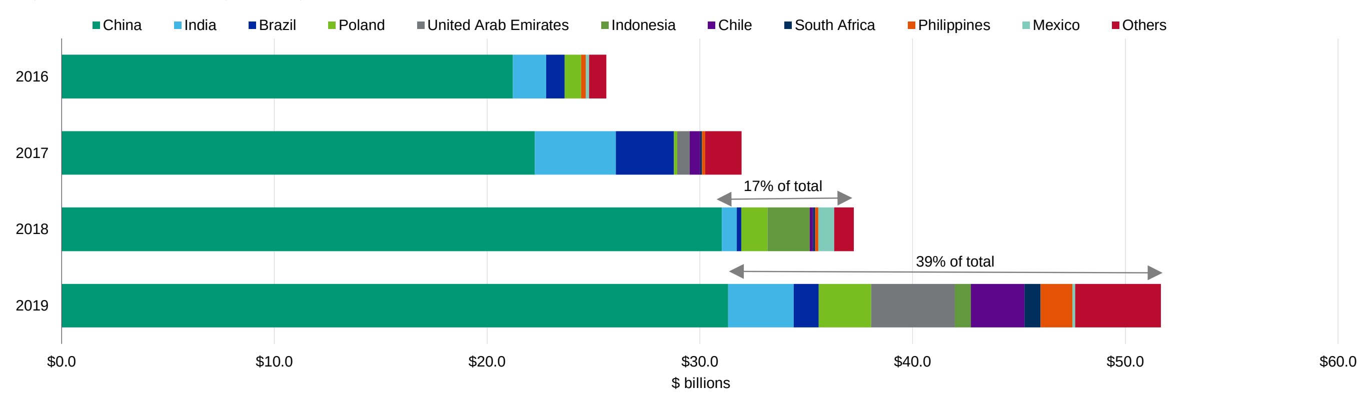
### Issuance is becoming more geographically diversified beyond China

EMs excluding China, accounted for 39% of total green bond issuance in 2019, up from just 17% in the preceding year (see Exhibit 4). Most EM jurisdictions posted record issuance last year, with the UAE ($3.9 billion), India ($3.1 billion), Chile ($2.5 billion) and Poland ($2.5 billion) leading the pack.

Strong EM issuance worldwide more than made up for relatively flat growth in Chinese volumes. Cumulative Chinese green bond issuance came in at $31.3 billion in 2019, up just 1% from the previous year. However, we exclude an additional $25 billion worth of labelled Chinese green bonds from our sample because they are not considered "green" by international standards. Even with flat growth, Chinese issuers accounted for 16 of the 30 benchmark green transactions of over $500 million (across all currencies). China's large industrial banks remain regular issuers in the market in accordance with their mandate to support growth and development in green industries and to assist industries in managing asset risk associated with the energy transition and reorienting away from polluting industries.

Economic diversification, sustainable policy agendas and international investor appetite will remain important issuance drivers across EMs. For example, in the Middle East, we expect the continued promotion of economic diversification away from hydrocarbons-related activity, via capital spending on infrastructure and a near-zero tax environment – conditions that are conducive for sustained green bond issuance. One of the largest green instruments globally in 2019 was a seven-year, $2.69 billion green project finance loan provided to Noor Energy 1 JSC to finance solar power plants with an aggregate capacity of 950 MW. ACWA Power, an energy developer based in Saudi Arabia, Dubai Electricity and Water Authority (DEWA, Baa1 negative), and China's Silk Road Fund are developing the project, which once completed will include the largest concentrated solar power facility in the world.

Exhibit 4
**EM issuance is more than just a China story**
**EM green bond issuance by country, $ billion**




An additional $25 billion worth of labelled Chinese green bonds are excluded from sample because the Climate Bonds Initiative does not consider them "green".
*Sources: Moody's Investors Service and Climate Bonds Initiative*

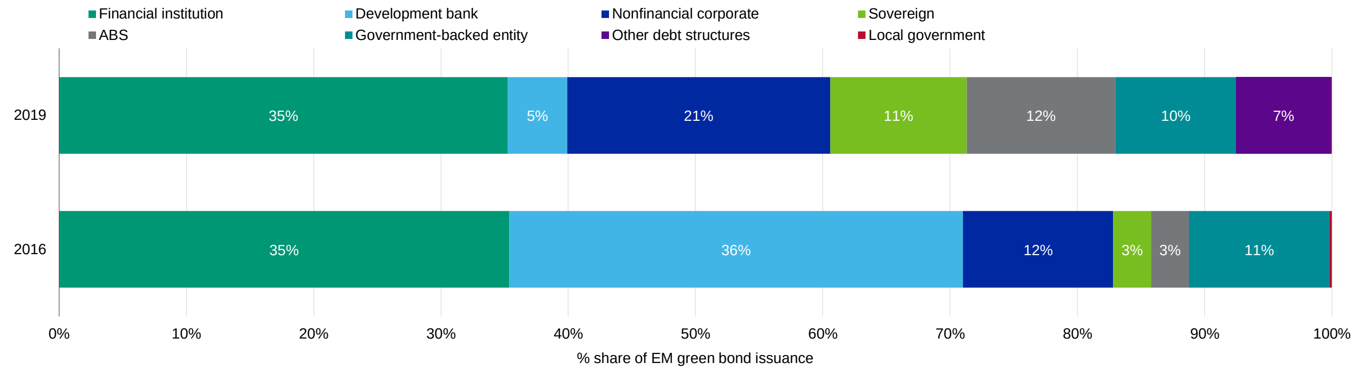
## A broader mix of sectors are pricing green bond deals, reflecting the multiple funding needs of EM economies

Exhibit 5 shows how the sectoral composition of green bonds has evolved since 2016. Non-financial companies (21%), sovereigns (11%) and asset-backed securities (12%) now represent a much more substantial share of total EM green bond issuance, alongside financial institutions (35%), compared with three years ago. Furthermore, the emergence of other debt structures (7%), including green sukuk (see box), reflects ongoing innovation.

Exhibit 5

**A more varied sectoral mix**

**EM green bond issuance by sector, % share**



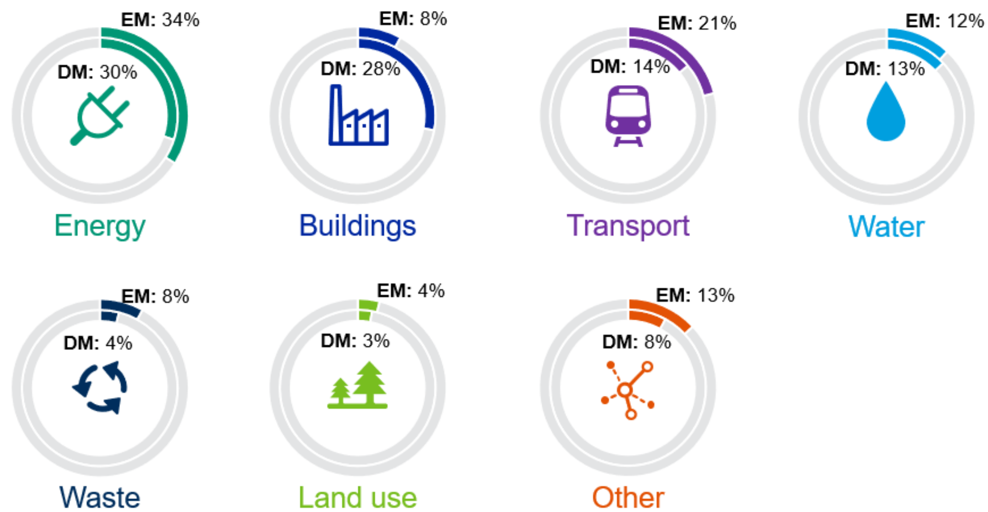

We use a proxy for development bank EM issuance by including all supranational green bonds issued in EM currencies.
*Sources: Moody's Investors Service and Climate Bonds Initiative*

Sector diversification will remain a key theme as the market matures, given the multiple funding needs of EM economies. While the build-out of renewable energy will dominate the use of green bond proceeds – particularly in China and India – we expect projects in the transport, water and waste sectors to remain much more significant contributors than in developed markets. This reflects the need to scale up infrastructure financing to balance growth and sustainability objectives across developing economies (see Exhibit 6).

Exhibit 6

**Multiple green funding needs across EM**

**Use of proceeds from green bonds: emerging vs developed markets, % share**

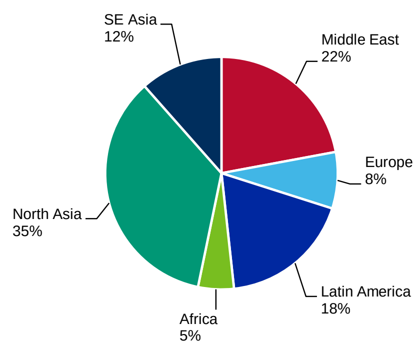



For each green bond, the $ equivalent amount is equally divided between eligible categories listed under issuer's framework, unless a specific allocation of proceeds is identified.
*Sources: Moody's Investors Service and Climate Bonds Initiative*

### New labels and assets, notably sustainability bonds and sustainability-linked loans, will show gradual expansion from a low base

Cumulative social and sustainability bond issuance grew by 51% in value terms to $4.3 billion last year, led by financial institutions. Meanwhile, there have been 24 sustainability-linked loans across a broad range of global EMs since June 2018 (see Exhibit 7), including a $1.4 billion credit facility for Dubai-based port operator and logistics company DP World PLC (Baa1, RUR DG) and a $2.3 billion loan for COFCO (Hong Kong) Limited (A3 stable), the subsidiary of Chinese commodities trader COFCO Corporation. Sustainability-linked loans fund general corporate purpose activities, with the interest margin typically linked to how the issuer performs on predetermined ESG metrics or criteria. While these numbers are only a small fraction of EM green bond issuance, they show how new financial instruments that reflect an issuer-centric focus on sustainability are gradually starting to develop.

Exhibit 7
**Sustainability-linked loans are blossoming across EMs**
**EM sustainability-linked loans by region, % share**




*Sources: Moody's Investors Service and Dealogic*

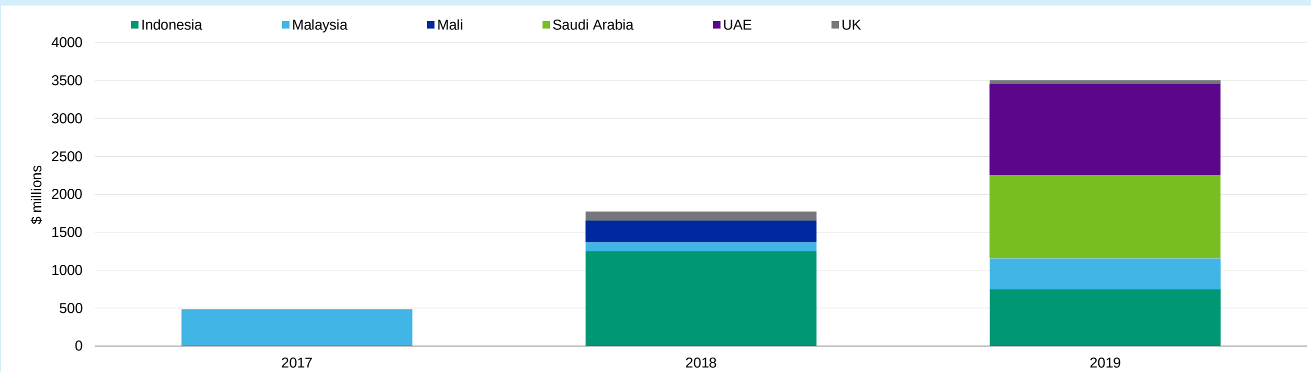
EM issuers may also a look to embrace the emergence of transition bonds globally. While proposed definitions vary, the common theme is that proceeds from transition bonds are used to help carbon-intensive issuers become more sustainable over time. In this regard, transition bonds will help channel investment toward a broader range of projects that are important to sustainable development beyond those that are viewed as pure “green”. This is particularly relevant in many EM economies, where Paris Agreement commitments today typically focus on a reduction in carbon intensity (such as in China and India), rather than a reduction in absolute carbon emissions. As a result, funding for more efficient modes of production will support EM economies in meeting their climate targets.

### Long-term potential in green and sustainable sukuk

Still very much in its infancy, the green, social and sustainability sukuk market holds attractive long-term potential. As a result, we expect a further pickup in transactions this year. Sustainable sukuk issuance came in at an estimated $3.5 billion in 2019, up from $1.8 billion the previous year, according to data from Dealogic. However, this accounted for just 1.1% of total sustainable bond issuance globally in 2019, reflecting the nascent state of the market.

Malaysia has led in terms of number of issuers of green sukuk, with small-scale utilities and power developers issuing ringgit-denominated Islamic bonds, while the entrance of the Indonesian sovereign to the market with a collective $2 billion of issuance in 2018 and 2019 has dominated in terms of value. However, green and social sukuk issuance is starting to broaden outside of Southeast Asia (Exhibit 8). In 2019, Dubai-based real estate developer Majid Al Futtaim issued the GCC's first green sukuk in May 2019 to finance and refinance green building and energy efficiency investments, following up with a second offering in October. Meanwhile, in November 2019, the Islamic Development Bank (Aaa stable) issued its debut green €1 billion sukuk to fund climate-change and green projects across its 57 member countries.

Exhibit 8
**New issuers enter sustainable sukuk market**
**Green and social sukuk issuance, $ millions**




*Sources: Moody's Investors Service and Dealogic*

Demand for green sukuk will benefit from robust growth in institutional investor demand for ESG products, given the natural crossover of sustainable investing and Islamic finance in integrating societal impacts. In common with investors in Shariah-compliant products, some sustainable investors use screening strategies to avoid certain activities and products to better align themselves with the values and goals of developing a sustainable society. For example, Islamic finance principles prohibit investments in certain industries that are forbidden (haram), such as tobacco, alcohol, gambling and weapons, as well as a range of other products and activities. Islamic finance products are selected to avoid such industries and ensure compliance with Shariah principles, similar to some practices used in sustainable investment.

Indeed, sukuk funding of environmentally sustainable projects, such as renewable energy assets, appeals to both traditional Islamic investors and conventional investors such as pension funds, asset managers and financial institutions. Global assets using some form of sustainable investment strategy totaled roughly $30.7 trillion in 2018, far surpassing the $2.2 trillion total size of the Islamic financial services industry. This illustrates the potential for a much larger pool of investors for green and sustainable Islamic bonds.[6] Although sukuk can be relatively complex compared with bonds, familiarity with and understanding of the instrument is increasing and there are no barriers to investors – both Islamic and conventional – from investing in them.

The market will need to overcome structural hurdles if it is to reach critical mass, however. For example, issuers face additional qualifying criteria, costs and reporting requirements to meet both green and Islamic markets standards. In this regard, the establishment of market standards, guidelines on project eligibility and local market initiatives will also help foster growth. For example, in September 2019, the Dubai Islamic Economy Development Centre signed a memorandum of understanding with the Dubai International Financial Centre, the Dubai Financial Market and the Climate Bonds Initiative to collaborate on growing the green sukuk sector in the UAE and globally. Meanwhile, Malaysia has introduced tax incentives for socially responsible and green sukuk, including a 6 million ringgit grant scheme to cover the cost of external reviews. Additionally, the creation of a high-level Islamic Finance and SDG task force run by the Islamic Finance Council UK will support the UK government in promoting and encouraging the adoption of the SDGs among Islamic financial institutions.

## Top-down policy support will remain particularly important in many EMs in driving the growth and development of sustainable finance

There has been less "bottom-up" demand from investors across most EMs for sustainable finance instruments as compared with demand in developed economies. As a result, national policy leadership is of paramount importance for EM countries. Such initiatives include, for instance, the implementation of sustainable finance guidelines and/or regulation, or the issuance of sovereign green bonds. These actions tend to have a multiplier effect in driving sustainable debt volumes, because they provide clarity to issuers on criteria such as project eligibility and reporting. They also offer increased transparency to investors. Sustainable finance regulations and guidelines across EM countries have already expanded significantly (see Exhibit 9), and we expect further expansion in the coming years. Most of the rules and guidelines will likely align well with international standards.

Exhibit 9

**Growth in national and regional initiatives supports EM sustainable finance**

**Selected sustainable finance initiatives in EMs**

| Country/Region | Launch Date | Initiative |
|---|---|---|
| Africa | Nov-16 | Marrakech Pledge for Fostering Green Capital Markets in Africa |
| Argentina | Sep-18 | Argentina Securities and Exchange Commission - Guidelines for the Issuance of Social, Green, and Sustainable Bonds |
| ASEAN | Nov-17 | ASEAN Green Bond Standards |
| | Oct-18 | ASEAN Social Bond Standards |
| | Oct-18 | ASEAN Sustainability Bond Standards |
| Bangladesh | Jan-11 | Environmental Risk Management Guidelines for Banks and Financial Institutions |
| | Feb-11 | Policy Guidelines for Green Banking |
| Brazil | Sep-16 | Guidelines for Issuing Green Bonds in Brazil |
| | May-18 | Central Bank of Brazil resolution on pension funds incorporating ESG in investment policies |
| Chile | Apr-18 | Santiago Stock Exchange - Guidelines for Green and Social Bonds |
| China | Sep-15 | China Green Finance Committee - Green Bond Endorsed Project Catalogue (2015 edition) |
| | Dec-15 | People's Bank of China (PBoC) Announcement No. 39 on the issuance of green financial bonds |
| | Dec-15 | National Development and Reform Commission (NDRC) - Guidance on issuing green enterprise bonds |
| | Aug-16 | Guidelines for Establishing the Green Financial System |
| | Mar-17 | China Securities Regulatory Commission (CSRC) - Guidance for Supporting Green Bond Development |
| | Dec-17 | PBoC, CSRC - Guidelines on Green Bond Certification |
| | Mar-19 | NDRC, PBoC - Green Industry Guidance Catalogue (2019 edition) |
| India | May-17 | Securities and Exchange Board of India (SEBI) - Disclosure Requirements for Issuance and Listing of Green Debt Securities |
| Indonesia | Dec-14 | Roadmap for Sustainable Finance in Indonesia |
| | Dec-17 | Regulation on the Issuance and the Terms of Green Bond |
| Kenya | Feb-19 | Kenyan Capital Markets Authority frameworks for the issuance of listed and unlisted green bonds |
| Malaysia | Aug-14 | Sustainable and Responsible Investment (SRI) Sukuk Framework |
| | Nov-19 | Sustainable and Responsible Investment Roadmap for the Malaysian Capital Market |
| Mexico | Jan-18 | Climate Finance Advisory Group - Green Bonds Principles MX |
| Morocco | Jul-18 | Green, Social and Sustainability Bond Guidelines |
| Nigeria | Dec-18 | Securities and Exchange Commission Nigeria - Rules on Green Bonds |
| Peru | Mar-18 | Lima Stock Exchange - Green Bonds Guide |
| Philippines | Aug-18 | Guidelines on the Issuance of Green Bonds under the ASEAN Green Bond Standards |
| South Africa | Oct-17 | Johannesburg Stock Exchange Green Segment |
| Thailand | Dec-18 | Thailand Securities and Exchange Commission disclosure requirements for green bond issuances |
| UAE | Jan-20 | Guiding Principles on Sustainable Finance |
| Vietnam | Aug-18 | State Bank of Vietnam Decision No. 1640/QD-NHNN on a green bank development scheme |

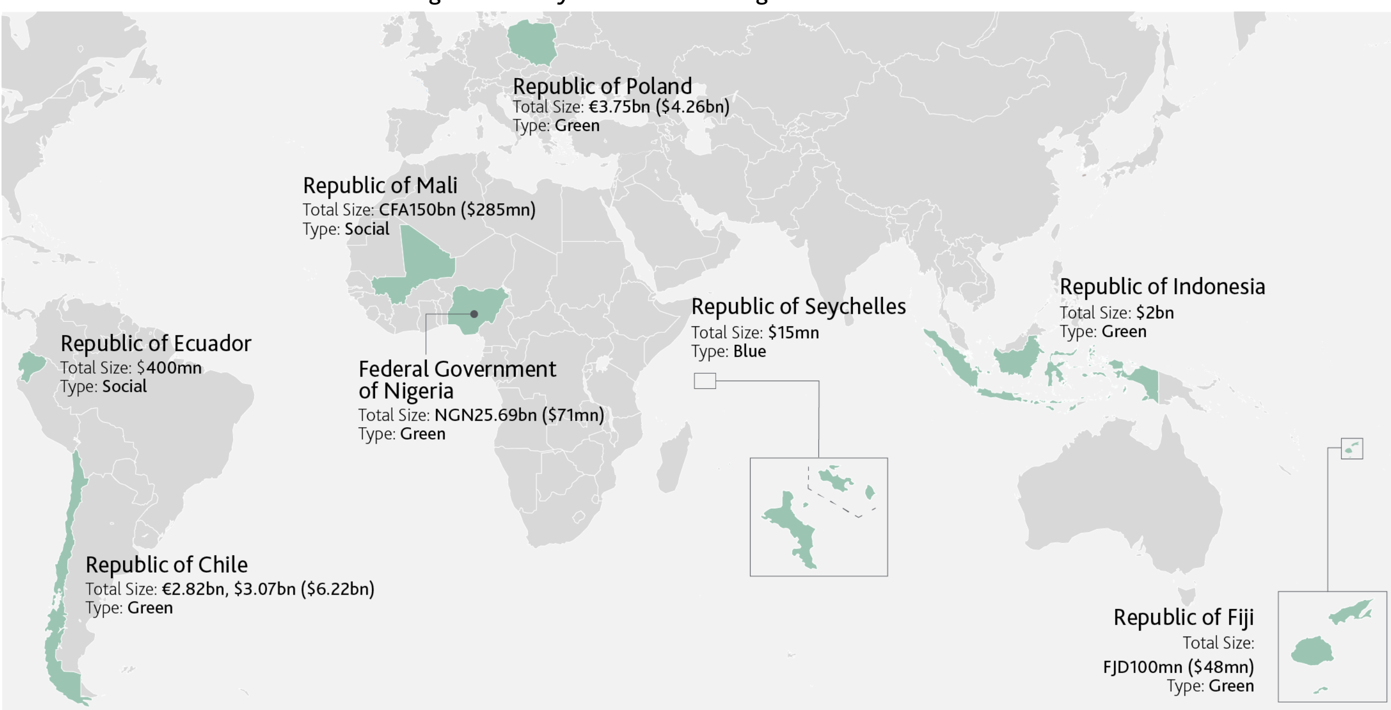
*Sources: Moody's Investors Service, International Capital Market Association and International Organization of Securities Commissions*

The introduction of sustainable finance regulations and guidelines in EMs often stimulates growth in sustainable bond issuance. In China, for example, growth in green bond issuance surged following the introduction of guidelines from the People's Bank of China and the National Development and Reform Commission at the end of 2015. Following issuance of just \$0.2 billion and \$1.3 billion in 2014 and 2015, respectively, Chinese green bond volumes jumped to \$21.2 billion in 2016. India and Brazil observed similar trends, where the introduction of green bond guidelines led to markedly higher issuance in the year following their release. And in Indonesia, the sovereign's debut $1.25 billion green sukuk in March 2018 closely followed the publication of green bond regulations at the end of 2017.

Sovereign sustainable bond issuance can also precede or coincide with policy developments, thereby serving as a catalyst for similar transactions from both public and private-sector issuers in the country. For example, the debut sovereign green bond from the Government of Nigeria (B2 negative, GB1) in December 2017 preceded both the publication of green bond regulations from Nigeria's Securities and Exchange Commission the following year, as well as additional green bonds from the North South Power Company in February 2019 and Access Bank (B2 negative) in March 2019. Indonesia (Baa2 stable) and Poland (A2 stable) have experienced similar follow-on issuance after the launch of sovereign green bonds.

Fourteen sovereigns globally have now issued sovereign sustainable bonds (see Exhibit 10), with EM countries accounting for 19% of the total through the end of 2019. We expect the number of EM sovereign sustainable bonds to grow further, with reports of prospective issuance from countries such as Egypt (B2 stable), Mexico (A3 negative) and Kenya (B2 stable), among others.[7] Such transactions will help spur the development of the broader sustainable finance landscape by providing high-quality benchmarks, enhancing market liquidity and providing technical expertise.

Exhibit 10
**Sustainable bond issuance from EM sovereigns can catalyse broader market growth**




EM sovereign bond issuance only. “Total Size” denotes total volume in issuing currencies, and dollar-equivalent amounts in parentheses. We have included the government of Mali's Islamic bond, which used a lease-based structure linked to the development of social housing projects.
*Sources: Moody's Investors Service, Climate Bonds Initiative and Dealogic*

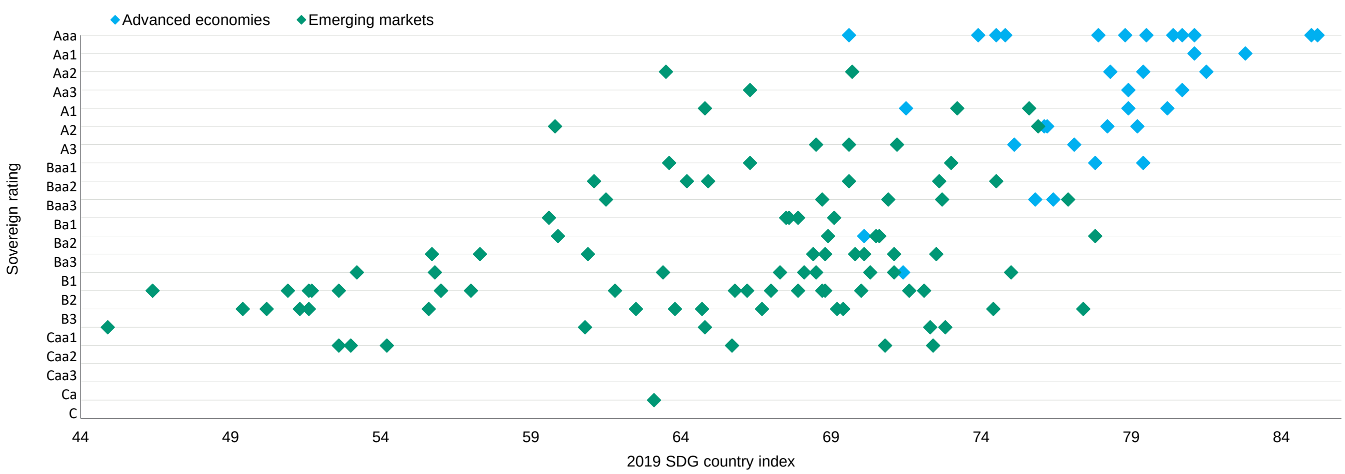
Beyond specific country and region initiatives, EM participation in global efforts – while less common than for their developed market peers – will also support the development of sustainable finance. For example, currently 18 of the 55 members of the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) are from EM countries. NGFS members seek to enhance the role of the financial system to manage environmental and climate risks and to mobilise capital for green and low-carbon investments in the broader context of environmentally sustainable development.

## The development of sustainable finance in lower-rated, illiquid EMs will rely on the support of MDBs

Many EM economies face additional hurdles in terms of growing sustainable finance. For instance, the fiscal constraints of many lower-rated EM governments limit their ability to make sizeable investments in sustainable development. Exhibit 11 shows the relationship between our global sovereign ratings and the SDG country index – or, in other words, where countries currently stand in terms of achieving the SDG objectives by 2030.[8]

EM countries with weaker sovereign creditworthiness tend to have much further to go to realise their SDG goals. Weaker sovereign creditworthiness also weighs on currency ceilings (the highest rating level that generally can be assigned to the obligations of issuers domiciled in a country). This can stifle demand for sustainable bonds, as international institutional investors typically seek investment-grade paper in hard currencies. According to a recent European investor survey by the Climate Bonds Initiative, the most common restrictions on buying EM green bonds relate to credit rating (69% response), currency (65%) and deal size (58%).[9]

Exhibit 11
**Many low-rated EM issuers face significant sustainable development challenges**
**Moody's sovereign ratings and UN Sustainable Development Goal Index 2019**




Sovereign ratings as of 20 February 2020. The SDG Index is a complement to the official SDG indicators and voluntary country-led review processes. It uses publicly available data published by official data providers and other organisations including research centres and nongovernmental organizations.
*Sources: Moody's Investors Service and Sachs, J., Schmidt-Traub, G., Kroll, C., Lafortune, G., Fuller, G. (2019): Sustainable Development Report 2019*

Beyond sovereign credit constraints, many EM capital markets are still underdeveloped outside government bond markets. Small, shallow and illiquid capital markets will inhibit the availability of private-sector finance needed for the SDGs. The local EM sustainable investor base, which would naturally have a greater tolerance and understanding of country-specific risks, is still developing in most EMs. EM asset owners and managers typically face less client and regulatory pressure to embed responsible practices and sustainability factors into risk management and investment decisions.

In this context, MDBs and supranational agencies will continue to play a pivotal role as sponsors of sustainable finance development in EMs. Such sponsorship can take various forms.

Development banks and institutions will continue to issue sustainable bonds directly in local EM currencies, providing a road map for domestic issuers to follow. MDBs issued the equivalent of roughly $550 million in local currency sustainable bonds across nine EM currencies last year in a bid to stimulate local market development.

MDBs will also provide anchor investments and technical guidance to support sustainable bond issuance in EMs. The debut green bond offering of Lebanese financial institution Fransabank SAL's (unrated, GB1) in March 2018 benefited from an explicit green bond project agreement with the IFC. As part of the arrangement, the IFC purchased 75% of the $60 million private placement and provided considerable technical expertise, such as the use of its external consultants and climate assessment tool.

MDBs can collaborate with global investors to channel private sector capital into climate-related finance, such as the Amundi Emerging Green One Fund. This fund launched in 2018 with $1.42 billion, including a $256 million cornerstone commitment from the International Finance Corporation). As of June 2019, the fund's portfolio included 15 EM green bonds from seven countries across Asia, Latin America and the Middle East.[10]

Finally, the concept of blended finance – defined as the strategic use of development finance for the mobilisation of additional finance toward sustainable development in EMs – is also starting to gather momentum as a means to build capacity and unlock private sector investment. Financial instruments that embed some form of credit enhancement or risk mitigation will become more commonplace, as multilateral agencies seek to "crowd-in" institutional capital into lower-rated emerging and frontier markets. For example, in October 2019, Acorn Project (Two) LLP successfully launched Kenya's first green bond to finance the construction of green and environmentally friendly student accommodation buildings in Nairobi. Acorn's Medium Term Note Programme is rated (P)B1, one notch higher than Kenya's sovereign rating (B2 stable), because of the presence of a partial guarantee of principal and interest provided by GuarantCo (A1 negative). This guarantee provides for recovery on up to 50% of principal and interest payment shortfalls in the event of default.

## Appendix

### Sustainable debt instruments defined

Throughout this report, we refer to a variety of sustainable debt instruments. These include "use of proceeds" green bonds, social bonds and sustainability bonds ("sustainable bonds") whose proceeds are typically earmarked to finance eligible environmental and social projects, as well as "sustainability-linked" instruments for which proceeds can typically used for general corporate purposes but whose interest rates are tied to the achievement of various sustainability targets. These instruments include:

» **Green bonds:** Bonds where the proceeds will be exclusively applied to finance or re-finance new and/or existing eligible "green" projects such as renewable energy, energy efficiency, clean transportation, sustainable water management and green buildings. Typically issued in accordance with the Green Bond Principles.

» **Social bonds:** Bonds where the proceeds will be exclusively applied to finance or re-finance new and/or existing eligible "social" projects such as affordable basic infrastructure, access to essential services, affordable housing and food security. Typically issued in accordance with the Social Bond Principles.

» **Sustainability bonds:** Bonds where the proceeds will be exclusively applied to finance or re-finance a combination of new and/or existing eligible green and social projects. Typically issued in accordance with the Sustainability Bond Guidelines.

» **Sustainability-linked loans:** Loan instruments and/or contingent facilities which incentivise the borrower's achievement of predetermined sustainability performance objectives. Typically issued in accordance with the Sustainability-Linked Loan Principles.

» **Green loans:** Any type of loan instrument made available exclusively to finance or re-finance new and/or existing eligible green projects. Typically issued in accordance with the Green Loan Principles.

Other labels are also emerging. For example, the proceeds from transition bonds are typically used to help carbon-intensive companies become more sustainable over time. Sustainability-linked bonds, meanwhile, are typically general corporate purposes borrowing structures where the cost of capital can fluctuate based on predetermined sustainability targets, such as the issuer's ESG score. While currently lacking in internationally recognised standards and/or principles, the emergence of these new labels and structures will support growth in sustainable finance beyond green, social and sustainability bonds and loans over time.

### Note on our sources

We use the Climate Bonds Initiative as our primary source for global green bond market data throughout this report. Climate Bonds Initiative data are widely used in the market and include detailed information on green bond transactions across the globe. Our analysis is based on data provided by the Climate Bonds Initiative on January 24, 2020.

Green bond data from the Climate Bonds Initiative include labeled bonds that meet the organization's criteria for inclusion in its dataset. The data exclude issuance that does not conform to the Climate Bonds Initiative's criteria, including bonds with more than 5% of proceeds being allocated to "non-green" uses and bonds potentially financing projects that do not align with Climate Bond Standards.

Our primary source for other sustainable debt data – including social bonds, sustainability bonds, green loans and sustainability-linked loans – is Dealogic. We have also used data from Dealogic to calculate overall global bond issuance.

## Moody's related publications

### Compilation

» ESG Focus: January 2020, January 15, 2020

### Sector In-Depth:

» ESG – Global: Key ESG themes influencing credit in 2020, February 10, 2020

» Sustainable Finance – Global: Green, social and sustainability bond issuance to hit record $400 billion in 2020, February 3, 2020

» Sovereigns – Global: Sea level rise poses long-term credit threat to a number of sovereigns, January 16, 2020

» Emerging Markets – Global: Outlook negative as political, policy and trade uncertainties increase risks, November 21, 2019

» ESG – Global: Heard from the market: ESG relevance in global credit markets is accelerating, November 19, 2019

» Coal mining - Indonesia: Refinancing risk will rise closer to 2022 because of large debt maturity wall, November 11, 2019

» ESG – Global: Heat map: Social considerations pose high credit risk for 14 sectors, $8 trillion debt, October 31, 2019

» Environmental Risks – Global: Heat map: 11 sectors with $2.2 trillion debt have elevated environmental risk exposure, September 25, 2018

To access any of these reports, click on the entry above. Note that these references are current as of the date of publication of this report and that more recent reports may be available. All research may not be available to all clients.

## Endnotes

1 Our definition of emerging markets is adopted from the International Monetary Fund (IMF). The main criteria used by the IMF's World Economic Outlook to classify the world into advanced economies and emerging market and developing economies are (1) per capita income level, (2) export diversification and (3) degree of integration into the global financial system. For details, see Frequently Asked Questions: World Economic Outlook (WEO), International Monetary Fund, October 2019.

2 World Investment Report 2014: Investing in the SDGs, United Nations Conference on Trade and Development, May 2014.

3 Climate Investment Opportunities in Cities — An IFC Analysis, International Finance Corporation, 2018.

4 Cumulative additions based on the International Energy Agency's Stated Policies Scenario. For details, see World Energy Outlook 2019, International Energy Agency, November 2019.

5 Allianz, AXA, Swiss Re, Munich Re, Zurich: Retreat from coal reduces liability and stranded asset risk, credit positive, February 2020.

6 2018 Global Sustainable Investment Review, Global Sustainable Investment Alliance and Islamic Financial Services Industry Stability Report 2019, Islamic Financial Services Board.

7 Climate Bonds Initiative, Sovereign Green Bonds Club: Mexico, Egypt, Spain set to join: Who else is in the 2020 pipeline: And who else should be? February 24, 2020.

8 The Sustainable Development Report (including the SDG Index) is a complement to the official SDG indicators and voluntary country-led review processes. It uses publicly available data published by official data providers and other organisations including research centres and nongovernmental organizations. See sdgindex.org/about.

9 Green Bond European Investor Survey 2019, Climate Bonds Initiative, November 2019.

10 Green Bond Impact Report — Financial Year 2019, International Finance Corporation.

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