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Japan in the Capital Markets

OCTOBER 2023

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Japanese Government Guaranteed International Bonds		
3.125%	3.250%	1.750%
due April 2028	due April 2027	due October 2031
EUR 1,000,000,000	USD 1,000,000,000	USD 1,000,000,000
Issued in April 2023	Issued in April 2022	Issued in October 2021

Sustainability Bonds		
0.105%	4.375%	2.125%
due August 2025	due September 2025	due September 2026
JPY 10,000,000,000	USD 600,000,000	EUR 600,000,000
Issued in August 2023	Issued in September 2022	Issued in September 2022

FILP Agency Bonds		
0.649%	0.245%	0.090%
due July 2033	due July 2028	due July 2026
JPY 35,000,000,000	JPY 30,000,000,000	JPY 30,000,000,000
Issued in July 2023	Issued in July 2023	Issued in July 2023

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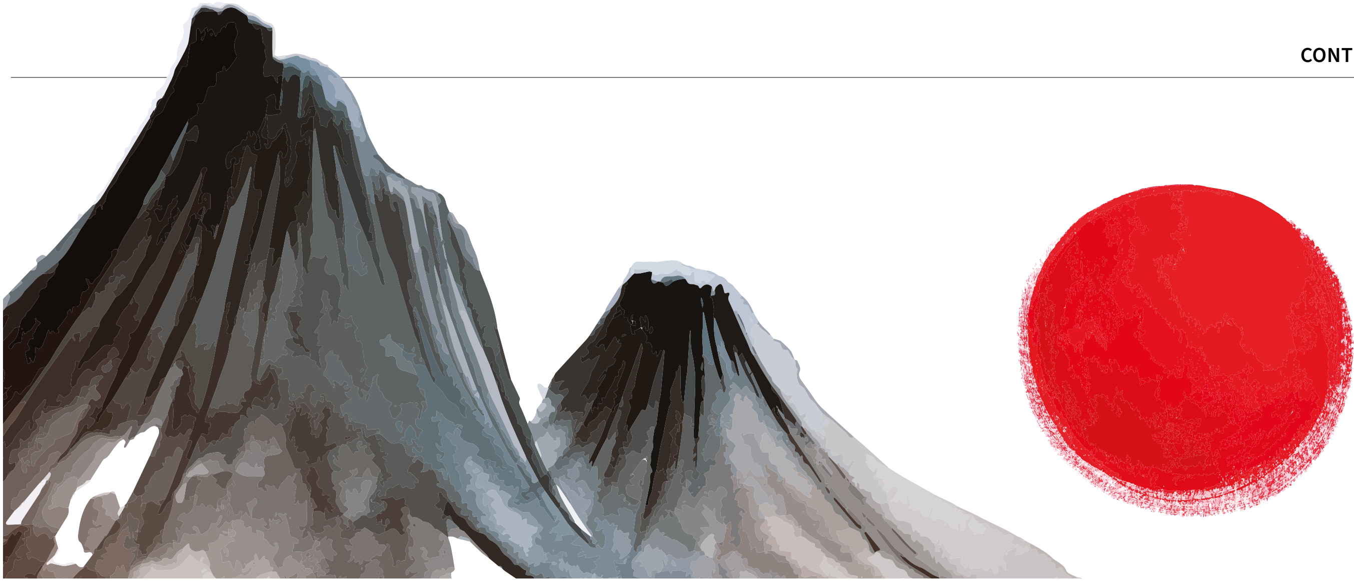

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Japan in the Capital Markets

Rising sun: yen bonds shine in funding toolkits

Yen bond issuance from non-Japanese borrowers has had a big revival this year amid a tough global funding environment, proving yet again the market's resilience, appeal and importance to treasury officials focused on diversification. **Rashmi Kumar** reports

Global financial markets have witnessed plenty of volatility and uncertainty over the past couple of years, forcing issuers to adapt rapidly to changing funding conditions and tighter monetary policy. This has prompted a resurgence in the Euroyen, Global yen and Samurai bond markets this year as non-Japanese issuers turn to the yen for the stability it offers and the diversification benefits it brings.

Yen-denominated bond volumes from non-Japanese issuers have soared to a four-year high in 2023.

Volumes stood at $11.1bn-equivalent from 32 deals by September 18 this year, versus $9.7bn during the same period in 2022, $8.4bn in 2021, and $8.3bn in 2020, according to Dealogic data. While volumes are still much lower than the $24.9bn raised over the same period in 2019, there is optimism that the yen bond market has plenty to offer international borrowers.

"We're certainly seeing more international issuers coming to the yen market, which is a great sign for the growth of the Japanese capital market overall," says Hiroshi Oikawa, head of Japan DCM syndicate at Bank of America. "Issuers are looking for diversification of their funding strategy, such as currency and geography, and want to cultivate the Japanese investor base."

Borrowers have a few structures they can use when tapping the yen bond market.

Both Global and Euroyen formats are designed to be issued and bought internationally. In both cases, the borrowers do not have to publish the prospectus or funding documents in Japanese, making for faster execution.

Samurai bonds, meanwhile, are sold in Japan to local investors, must be registered with the Tokyo Stock Exchange and issuers must print their offering documents in Japanese.

Plenty of choices

All three major formats each have their own loyal followers. For instance, US private equity firm KKR has long opted for global yen bonds, and did the same this year. In mid-May, it raised a total of ¥61.5bn ($449m) from a six-tranche outing spanning tenors of five years to nearly 30 years.

The previous month US investment holding company Berkshire Hathaway, run by Warren Buffett, also took the global yen route, raising ¥164.4bn from a five-tranche deal. Berkshire Hathaway made its yen bond market debut in 2019 and has been a consistent issuer in the currency ever since.

French financial institutions have also found a welcoming investor base in yen. In July, BPCE sealed its largest ever Samurai bond, taking an impressive ¥197.7bn senior bond from eight tranches. It was also the largest ever FIG Samurai, following a ¥203bn deal from Crédit Agricole in 2017.

BNP Paribas returned to the Samurai market in August, after a five-year hiatus, with a ¥156.9bn four-tranche transaction.

Numerous other FIG names, like Lloyds Banking Group, Crédit Agricole, National Australia Bank (which chose the Euroyen format) and Intesa Sanpaolo, also tapped yen bond investors this year.

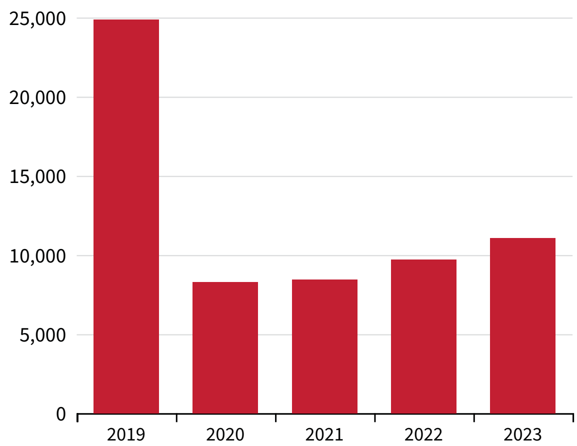
Akihiro Igarashi, a DCM syndicate banker at Nomura in Japan, tells *GlobalCapital* that foreign banks were among the biggest issuers of yen bonds in 2018. At the time, he says, Japan's Financial Services Authority allowed bank treasury investors to invest in eligible total loss absorbing capacity senior bonds at a modest risk rate of 20%, before hiking that to 150% the following year.

As a result, in 2018, solid Japanese investor demand for paper fuelled a deal spree in the currency from global financial institutions, with many opting to sell five-year bonds. "A lot of that 2018 paper is maturing this year, so lots of banks are accessing the yen market again to meet their refinancing needs," says Igarashi.

Additionally, the tapering off of loose monetary policy in European

Yen issuance from non-Japanese issuers has hit a four-year high

Deal value in $m



All data is year to September 18 Source: Dealogic

and US debt markets — after years of low-cost funding — has left banks with a funding hole that the yen market can help plug, say bankers.

Pricing dynamics

The rebound in yen bond issuance by non-Japanese borrowers, however, does not necessarily come with big pricing perks. Rather, bankers say yen pricing is "competitive" versus dollars and euros, but in most cases, issuers have to shell out a premium over deals in their home currencies.

Rentaro Hayashi, a DCM director in Citi Japan's banking, capital markets and advisory team, says the yen bond market "is not always the tightest for issuers", which may have to price their deals as much as 20bp wider than in the euro market.

Chad Karpes, co-head of Asia Pacific DCM at Bank of America in Sydney, says that when issuers swap yen deals into their local currencies, this currently comes at a premium to their outstanding curve in the local markets.

"But what we're finding now, particularly as volatility persists, is issuers looking to diversify their funding," says Karpes. "Naturally, their home market is going to provide them with a significant portion of their funding, but they are also acknowledging that in the context of their overall task it's important to diversify the investor base, and stay present in various markets to keep those markets active and supportive, notwithstanding the competitive pricing that can be achieved in their local market."

"Lots of banks are accessing the yen market again to meet their refinancing needs"

Akihiro Igarashi, Nomura

For example, Berkshire Hathaway is understood to have paid higher spreads across all five tenors of its April deal compared to its previous fundraising in yen in December 2022, while the all-in costs were also steeper.

Bankers say that while borrowers are always conscious of funding costs, the longer term appeal of the yen market helps them to navigate these pricing dynamics effectively.

It certainly helps that investors have embraced international issuers wholeheartedly. When US-based fintech group PayPal Holdings debuted in the yen market in June for ¥90bn, it received solid demand, as did deals for Berkshire Hathaway, BNP Paribas and BPCE.

Nomura's Igarashi says some of that strong demand is thanks to investors, particularly Japanese life insurance firms, shifting their focus from non-yen denominated bonds to yen bonds from global issuers, due to a rise in foreign exchange hedging costs on the former. "For those who enjoyed profits through low hedging costs before, it doesn't work anymore. So we're seeing lifers shifting money from non-yen bonds to yen bonds," he adds.

Citi's Hayashi also says that demand from investors for these yen bonds has been unexpectedly strong.

"First is because they are hunting for yield," he says. "But it's also because investors are now more willing to take risks. Before, Japanese investors thought government bonds were the safest asset, and then maybe agency bonds and then domestic corporates. But now, given the state of the market environment, they are more aggressive on taking higher-risk assets, including from international issuers."

Hiccups on the horizon

The pipeline for all the yen format bonds from global borrowers is building, say bankers, although issuance will hinge on market conditions and swap costs working in issuers' favour.

When it comes to structure, many firms will favour the Global and

"Now Japanese investors are more aggressive on taking higher-risk assets, including from international issuers"

Rentaro Hayashi, Citi

Korean renaissance

A fresh source of Samurai supply has come to the fore this year. In early September, the South Korean sovereign printed a four-tranche deal totalling ¥70bn as part of its efforts to mend its fraught relationship with Japan — and potentially sparking further yen deals from Korean issuers.

Korean policy banks like Korea Development Bank and Export-Import Bank of Korea have sold yen bonds before, but this cross-border deal flow has been muted. The government's outing — in tenors of three, five, seven and 10 years — is widely expected to reopen this market.

Rentaro Hayashi, a DCM director in Citi Japan's banking, capital markets and advisory team, says his firm has had inquiries from Korean issuers looking to follow in the sovereign's wake. "Diversification is one reason," he says. "It's also because some of the issuers have funding needs in yen."

Akihiro Igarashi, a DCM syndicate banker at Nomura in Japan, says that the sovereign's issuance "will surely affect other issuers in Korea". He says the yen market offers a stable funding source, even if it cannot quite give issuers the sizes they can easily achieve in dollars or euros.

"Every year we see new issuers in yen and in Samurai," says Igarashi. "This will only continue with more Korean issuers too coming out in the future."

Non-Japanese yen bond issuance (2023)

Issuer	Deal Value $mn (Face)	Deal Type	Issuer Nationality	Pricing Date
CABEI	52.8	Supranational	Honduras	12-Jan
Novuna Vehicle Solutions	38.5	Corporate Bond-High Yield	United Kingdom	27-Jan
DNB Markets	94.4	Corporate Bond-Investment-Grade	Norway	14-Feb
Intesa Sanpaolo SpA	177.8	Corporate Bond-Investment-Grade	Italy	03-Mar
Fondo Financiero para el Desarrollo de la Cuenca del Plata - FONPLATA	54.1	Supranational	Bolivia	17-Mar
Federation des caisses Desjardins du Quebec	257.0	Corporate Bond-Investment-Grade	Canada	13-Apr
Berkshire Hathaway Inc	1237.2	Corporate Bond-Investment-Grade	United States	14-Apr
CIBC	180.6	Corporate Bond-Investment-Grade	Canada	14-Apr
Cantor Fitzgerald LP	29.7	Corporate Bond-Investment-Grade	United States	20-Apr
Ganyu Urban Development (BVI) Ltd	43.2	Corporate Bond-Investment-Grade	China	26-Apr
Bank Gospodarstwa Krajowego-BGK	683.1	Non-US Agency	Poland	17-May
KKR Group Finance Co XI LLC	448.6	Corporate Bond-Investment-Grade	United States	18-May
Indonesia	759.0	Sovereign, Local Authority	Indonesia	19-May
Lloyds Banking Group	449.0	Corporate Bond-Investment-Grade	United Kingdom	19-May
PayPal Holdings Inc	642.7	Corporate Bond-Investment-Grade	United States	02-Jun
Credit Agricole	1126.9	Corporate Bond-Investment-Grade	France	02-Jun
Electricite de France SA-EDF	232.6	Corporate Bond-Investment-Grade	France	22-Jun
Korean Air Lines	140.5	Corporate Bond-Investment-Grade	South Korea	23-Jun
Santander Consumer Finance SA	216.5	Corporate Bond-Investment-Grade	Spain	30-Jun
ESR Group Ltd	207.5	Corporate Bond-Investment-Grade	Hong Kong (China)	30-Jun
Dyson Finance Ltd	170.8	Corporate Bond-Investment-Grade	United Kingdom	30-Jun
Neijiang Investment Holdings Group Co Ltd	72.7	Corporate Bond-Investment-Grade	China	03-Jul
BPCE	1368.0	Corporate Bond-Investment-Grade	France	06-Jul
Korea Investment & Securities	98.5	Corporate Bond-Investment-Grade	South Korea	13-Jul
Hanrui Overseas Investment Co Ltd	114.9	Corporate Bond-High Yield	China	21-Aug
Hongkong Yunlin International Co Ltd	89.1	Corporate Bond-Investment-Grade	China	22-Aug
Rizhao Chengtou (BVI) Co Ltd	38.6	Corporate Bond-Investment-Grade	China	30-Aug
BNP Paribas SA	1073.5	Corporate Bond-Investment-Grade	France	31-Aug
National Australia Bank	395.1	Corporate Bond-Investment-Grade	Australia	01-Sep
Shandong Binda Industrial Group Co Ltd	48.5	Corporate Bond-Investment-Grade	China	05-Sep
South Korea	474.5	Sovereign, Local Authority	South Korea	07-Sep
Zouping Finance International Co Ltd	51.7	Corporate Bond-Investment-Grade	China	13-Sep
	11,068.7			

Excludes ABS, MBS, MTNs and short-term bonds. Data as of September 23 2023

"As volatility persists, issuers are looking to diversify their funding"

Chad Karpes, Bank of America

Euroyen formats for the agility they offer, while the success and growth of the Samurai market will depend on its pace of execution.

International yen deals can typically be executed over about four days, spanning soft sounding to marketing to pricing. However, Samurai bonds are a different story. A debut Samurai issuer must register its Japanese language prospectus with the regulator and will then need to wait at least 15 days before it can start the execution process.

Repeat issuers do not quite need that long, but execution can still take days — especially if they are targeting regional Japanese investors who may take longer to obtain internal approval to buy the bonds. This leaves borrowers open to market risk for longer, which is harder to navigate in an environment of high rates volatility and foreign exchange fluctuation.

Samurai issuers also need to make frequent regulatory disclosures in Japanese, dampening some of the appeal for the product — and fuelling a call for a possible change in requirements.

"Something needs to be improved," says Igarashi. "Either the execution process should be shortened or the preparation work made easier. The market needs to think of this collectively, and we are also talking to investors to see if we can shorten the marketing process for Samurai bonds." GC

Japan's SSA issuers set sights on better funding balance

Picking the right currency and tenor for a new bond has never been more important for Japan's SSA issuers, which saw dollar funding costs rise over the past year, pushing them to venture into euros and shake up their currency and maturity mix. Market conditions in this financial year have improved, but funding officials are constantly on the lookout for upheavals that may disrupt their access to capital markets.

GlobalCapital sat down with some of Japan's leading state-backed issuers to discuss their funding plans, the challenges they face, and how to navigate volatile markets.

***GlobalCapital*: We last spoke in March about your 2022/2023 funding plans and the outlook for the year. Have things gone according to expectations?**

Reo Kato, Japan Bank for International Cooperation: Compared to last year, volatility in the US dollar market stabilised this year and the outlook for interest rate hikes in the US was quite foreseeable. Demand from investors for our bonds has been quite robust. Last year, volatility was relatively high, and the outlook was not very visible, particularly for long term bonds, so we were carefully observing the market. This July, we issued a five year US dollar bond and in April we issued a three year bond. I believe we have been able to execute our issuance plans. We're still in the middle of the fiscal year, so in the autumn and early next calendar year, we still have a window for issuance. We would like to leverage that window to raise the necessary level of capital.

Almost 90% of our assets are in foreign currency, which is why we will continue to be centralised in non-yen currencies in the autumn window and in the January/February window. For example, once in a fiscal year we issue green bonds. This fiscal year too, we plan to issue green bonds. We do a lot of infrastructure lending with long tenors, so the majority of our loans are long-term. As a result, in principle, our bonds are focused on tenors of five years and longer. We have done five years and seven years during calendar year 2022/2023 and have seen steady demand.

On currency, last fiscal year the US dollar market was tough, so we sold a euro denominated bond after an absence of 18 years. We sold two euro bonds last fiscal year and were able to create a yield curve, and we would like to continue keeping this as an option. But as our asset base is mainly in dollars, the US dollar will continue to be our majority funding currency.

Takahiro Ando, Japan Finance Organization for Municipalities: For this fiscal year [beginning April 2023], a total of ¥1.75tr ($11.7bn) needs to be raised. But in March, we couldn't clearly foresee what would happen in fiscal year 2023. Usually, 75% of our funding is done through domestic bonds and 25% is raised through foreign currency denominated bonds. Both are important funding sources.

Last fiscal year, it was not easy to raise the necessary capital through domestic bonds and our foreign currency plans were also impacted by the Russia-Ukraine war. It was very difficult to access the market and we struggled in smoothly issuing bonds for funding. But now, reflecting on the first half of this year, we have been able to issue bonds and the level of demand from investors has been quite high. As a result, our bond issuance has exceeded what we originally planned. In April, a US dollar denominated five year bond was issued, and then in September a three year dollar bond was issued. In the global market, issuing foreign bonds has fared quite smoothly.

But I would like to add that the yen has become cheaper than we originally anticipated and this depreciation has impacted our issuance plan. Once a year, a $1bn bond is usually issued, and on top of that, about 500m dollar or euro green bonds. But now that yen has depreciated quite extensively, the $1 billion is converted into a higher amount of yen funding than we originally planned. So what we issued in April was not a $1bn bond but a $750m bond, and the outcome

Roundtable participants

Reo Kato
Deputy director, capital markets and funding division, treasury department, Japan Bank for International Cooperation (JBIC)

Takahiro Ando
Director, finance department, Japan Finance Organization for Municipalities (JFM)

Shingo Kanatani
Director, treasury department, Development Bank of Japan (DBJ)

Moderator
Rashmi Kumar
GlobalCapital

> *"Investors tend to prefer green bonds because the use of proceeds is very clear. Therefore in the area of ESG, we plan to continue issuing green bonds"*
>
> ***Reo Kato, Japan Bank for International Cooperation***

was good. We were supported quite extensively by investors.

In the domestic and foreign markets, we have to carefully observe market conditions and how central banks throughout the world might implement monetary policy that will impact on our funding plans. We also have to watch the Bank of Japan's (BoJ) yield curve control and how that might change. At the end of July, it raised the yield curve ceiling to 1%. Up to that point, it was quite lenient in terms of controlling the yield curve. So the Japanese government bond yield is gradually rising as a result. The investor mindset would change, too, under such circumstances, so communication with investors is critical. In the domestic market, as well as in the foreign market, we meet investors, in person or remotely, for good communication. We like to explain our bond issuance plan and our philosophy so that they understand it.

Shingo Kanatani, Development Bank of Japan: In the first half of this year, we progressed steadily with our bond issuance. For this fiscal year, we plan to raise a total of ¥1tr from both domestic bond issuance and overseas bond issuance. When talking about overseas issuance, in March when Silicon Valley Bank collapsed and the Credit Suisse merger [with UBS] happened, we were concerned. But in April, we issued a five year euro denominated government guaranteed bond and then in August a dollar denominated non-guaranteed bond and in September, we issued a euro denominated non-guaranteed bond. We have seen very stable demand.

On the domestic front, there has been a change in monetary policy. We thought that the situation would be more difficult for us. However, with the yield curve range going to 1% from 0.5%, it has solved the curve distortion problem in Japan. I think that it is much easier for investors to buy bonds in three, five or 10 year tranches. We see investor demand for all of that.

GlobalCapital: How are you dealing with duration risk among investors?

Kato, JBIC: We issued our five year bond in July. As this was our first five year fixed bond since July 2020, excluding green bonds, we had been carefully following the market but fortunately we saw more demand than we expected. In the near term, we don't know what's going to happen, but we can expect that rates are not going to jump as aggressively as last year. That is why, on the investor side, there is a continuous demand for longer tenors versus last year when SSAs were mainly doing two and three year bonds. We are starting to see demand in the longer term.

GlobalCapital: How have your bond funding costs evolved over the past year?

Ando, JFM: In general, costs have risen this fiscal year compared to last fiscal year. For us, we have to carefully consider how fundraising costs will be if we issue domestically or internationally — will they be higher or lower? That's one important criterion we look at. And in that sense, which currency are we going to choose and what tenor? It depends on costs, of course. Last fiscal year, we issued only twice, both in euros. This fiscal year, we have issued two dollar bonds, so the currency is different. That's why it's not easy to compare between last fiscal year and this.

Having said that, compared to last fiscal year, our dollar funding costs are higher this fiscal year than our domestic funding costs. But overall, we do think it's starting to improve on dollars. This fiscal year, to some extent, dollars have been tighter than before, so we are able to refresh our curve. The currency swap rate will impact us too. That is why we can't just reflect on the market situation. But I think that the overall situation is improving versus last fiscal year, especially in the dollar market. We see more demand and so can price tightly and are able to refresh our curves.

We have a robust situation where we can continue to issue in dollars, but for the remainder of this fiscal year — from April 2023 to March 2024 — we only have one non-Japanese bond issuance planned. Usually it's in the January-February window and will be in green format. We haven't decided on the currency or the tenor, but we will choose that based on investor preference. That's our plan.

Kanatani, DBJ: We are funding in yen and international currencies and checking the funding costs of all the bonds on the basis of yen. Compared to the last fiscal year, funding cost in dollars and euro is rising on a yen basis, and recently domestic bond issuance has been a bit cheaper. Going forward, the spread of our international bond might tighten further, but we don't know what would happen to the currency swap basis. And given the change in the yield curve control policy by the Bank of Japan, the cost is gradually rising in yen too, so we cannot say domestic bond issuance will be cheaper continuously, so we have to carefully observe the changes.

GlobalCapital: What has led to the unexpected rise in investor demand for yen bonds, particularly from life insurance firms? Have there been any specific triggers for that?

Ando, JFM: Life Insurance investors are returning to yen denominated bonds; they're returning to the domestic bond market. But for SSA issuers like us, we have to see investor movements — if they are buying Japanese government bonds (JGBs). If they are solely investing in JGBs, it really won't improve demand for SSA issuers. That is something that we have to be careful about. Life insurers prefer long dated bonds like 30 years.

The impression that we had in the first half of the year is that demand had improved for bonds issued by agencies like us. But on the other hand, towards the second half of the year, the more flexible yield curve control policy by the BoJ led to a rise in the JGB yield. The spread on bonds that we issued was narrowing. So the importance and the significance of the spread may be different between the first and the second half.

For example, take the 30 year bond. If it has a spread of 10bp, the scale would be different if that 10bp is on top of 1.4% yield or 1.7% yield. The scale is different, and the perspective is different. So how would this volatility impact us going forward? Those institutional investors coming back to the Japanese bond market, would they be willing to invest in SSA bonds like ours, or would it be just JGBs? That's the point that we have to carefully observe.

Kanatani, DBJ: Life insurance companies are returning to the domestic bond market, but they prefer long term bonds. Our main products are three, five and 10 year bonds, so life insurers won't really prefer a bond like ours. But interest on the yield we offer is improving, so those invested in longer maturities in the past are now gradually more willing to invest in bonds that we issue. For the three year and five year bond, there is a certain yield that would be satisfactory to some investors. Investors who couldn't invest before because of their internal criteria are now able to invest as a result of the improvement in yield. For example, investors who could invest only in 10 year bonds for the yield can now invest in five year bonds as well.

***GlobalCapital*: What are some of the key questions investors raise about SSA issuance from Japan? And have you seen any big changes to the investor base?**

Ando, JFM: We issue benchmark public bonds and have continued with that. On private placements, we want to issue one this year but we haven't been able to just yet. It will also be a benchmark sized deal. What we have seen in our fundraising so far is that the size of our global dollar and euro denominated funding is becoming smaller, but on the other hand, the market itself is improving. We do see robust demand from investors. Given these dynamics, dialogue with investors is very important. At the time of Covid, it was difficult to have face to face meetings with investors. We didn't have any opportunity for that, but we are now regaining that opportunity. We love to continuously have these kinds of dialogues. And what I feel as a result is that investors are keen to buy our bonds. They are interested in us and they definitely want to be involved during bookbuilding.

They ask us questions about our organisation, who we are, and we try to explain to them how we are established and the strong ties that we have with the government. That is a very important message that we want to communicate to the global SSA investor base. We see a recovery in markets, so I think this situation is an opportunity for us and we want to bring in demand. For our private placement bonds, we look at multiple currencies like dollar, euro, the pound, and Australian and New Zealand dollars. With these five currencies, we are able to meet investor demand and use the private deals as a trigger to get investors interested in our benchmark bonds.

Kato, JBIC: We have been able to overcome Covid and to have direct investor relationship opportunities and dialogue with investors. We mainly hear two kinds of questions from them. First, what is your plan for long term bonds? In the past, we sold a 10-year bond quite frequently. In this kind of a high interest rate environment, investors want to have coupons for the longer term and so they ask us about our long-term bonds.

The second, needless to say, is our plans and our actions towards ESG. I think that is a continuous question. We have issued green bonds twice and we want to keep working on this kind of product.

Kanatani, DBJ: When it comes to global bonds, we are a little bit different from JBIC and JFM. This is because we sell both government guaranteed and non-government guaranteed bonds. On currencies, we sell in dollars, euros and sterling every year; we are continuously issuing all those currencies. That is a big difference.

However, the timing is not always frequent and the amount we tend to raise is not too big. But we do see many investors coming in. They often ask us: are you going to continue with euro-denominated bonds or with sterling? We hear those kinds of questions from investors on our currency preferences. The other is DBJ's actions around ESG. For example, when it comes to greenhouse gas emissions, what are DBJ's actions, our targets and how are we supporting Japanese enterprises with ESG? Compared to the big Japanese commercial banks, we are a bit slow in disclosing information but we make efforts to improve disclosure.

"The overall situation is improving versus last fiscal year, especially in the dollar market. We see more demand and so can price tightly and refresh our curves"

Takahiro Ando,
Japan Finance Organization for Municipalities

"It is much easier for investors to buy bonds in three, five or 10 year tranches. We see investor demand for all of that"

Shingo Kanatani, Development Bank of Japan

GlobalCapital: What direction is the Japanese ESG market headed and how has your ESG issuance evolved — and what impact will the government's planned sale of transition bonds have?

Kato, JBIC: We have sold benchmark green bonds, but for the time being, other products like sustainability, sustainability-linked or transition bonds are not necessarily in our issuance plan. As a result of issuing green bonds, we have been very fortunate to see a high level of interest and demand from investors. When we discuss this with investors, they tend to prefer green bonds because the use of the proceeds is very clear. Therefore, in the area of ESG, we plan to continue issuing green bonds.

Ando, JFM: JFM started issuing green bonds in 2020 and we have continued to sell them. Regarding future ESG-related bond issuance, at the moment we don't have a specific ESG label in mind to issue in the global market. This year, we sold a $500m deal, but the question you may have is, why not do a $1bn bond?

The concern is that, in relation to the environmental assessment report, we are emphasising disclosures. But there is a lot of administrative burden in compiling this report. We on-lend proceeds from our ESG bonds as loans to Japanese municipalities, so we have to analyse the effect of the municipalities making use of our capital on the environment. We have to state this in the environmental report, we have to conduct a questionnaire survey among the municipalities concerning the outcome of the investment that they have made, which is an extra step on top of other financial institutions issuing ESG bonds. If we have a bigger bond, the reporting burden would be too much.

The demand for green bonds in the market is still very high. Of course, we want to satisfy that demand. One possibility is to expand the size of our green bonds. But on the other hand, reporting the impact on the environment to investors should maintain a certain level of quality so we have to strike a good balance. That is what we have to bear in mind in issuing green bonds in the future. On top of that, DBJ mentioned that, as an SSA, as an agency, scrutiny on ESG is being enhanced. With the issuance of green bonds, what is the use of proceeds and what is the impact? How did the issuer contribute to ESG and environmental improvement? That is being scrutinised by investors and therefore the ESG rating of JFM is still relatively low.

MSCI gives us an ESG rating and for JFM this is not very high. We have analysed the reason. While our green bond issuance disclosures are considered robust and have a good rating, our governance related documents are not necessarily translated into English, so that leads to the low evaluation of governance of our organisation. So naturally, we have to improve the quality of governance but on top of that, we have to really communicate the high level of governance to investors and that requires disclosures in English. That is what we are now trying to do in response.

Kanatani, DBJ: From 2015, we have been issuing a sustainability bond every year. Some investors say that green bonds are easier to understand and easier to invest in. But we are probably going to issue sustainability bonds going forward. In the domestic market, many Japanese corporates have already issued transition bonds, and the Japanese government may issue transition bonds this fiscal year as well. We are actively supporting the evolvement of the transition finance market.

GlobalCapital: What are you most worried about in the year ahead and what are you most optimistic about?

Ando, JFM: I'm optimistic about the funding amount that we scheduled to raise for the full year, which has already been funded. We are optimistic that we can raise the necessary amount of capital and don't need to worry about that.

Going forward, I would say that we're worried about our green bond issuance plans in the new year. People's attention on green bonds is still high, and with the issuance of green bonds, we want to have a better understanding of the investors in our bonds. JFM's brand awareness should be raised, which would lead to a higher level of interest among investors. In fiscal year 2022, we couldn't issue dollar-denominated bonds so our balance of issuance was disturbed. We have to strike a good balance through meetings with our investors. That is our challenge for the future.

Kanatani, DBJ: For DBJ, I think the good funding situation will continue both domestically and globally, but there are still a lot of unknowns around what's going to happen to rates and the market environment. So, we don't want to just relax, we want to continue to focus and work on our funding.

Kato, JBIC: It's difficult to foresee the future. However, compared to last year, I think investor demand is steady and I hope this will be the case next year and beyond and that this sentiment will continue. One concern may be matching the duration with our assets. Last year, we were mainly working on three year bonds, but not much on five year and longer. We want to issue more five year plus bonds, and 10 year bonds if any, to refresh our yield curve and liquidity in the market. So, in the long term, five year plus issuance is something that we should consider. I won't say it's a challenge, but it's one target that we will aim for. GC

Apr 2022 USD 1,500,000,000 2.875% Guaranteed Bonds due 2025	**May 2022** EUR 1,000,000,000 1.500% Guaranteed Bonds due 2029	**Sep 2022** USD 1,500,000,000 3.875% Guaranteed Bonds due 2025
Sep 2022 USD 500,000,000 4.375% Guaranteed Bonds (Green) due 2027	**Jan 2023** USD 2,500,000,000 4.250% Guaranteed Bonds due 2026	**Feb 2023** EUR 1,000,000,000 3.125% Guaranteed Bonds due 2028
Apr 2023 USD 2,500,000,000 4.250% Guaranteed Bonds due 2026	**Jul 2023** USD 1,500,000,000 4.625% Guaranteed Bonds due 2028	

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Greenium and transition push bolster Japan's ESG debt market

Japan's sustainable financing debt market has experienced some major developments in the past year that are set to propel further growth in ESG products — so long as authorities balance the expansion with maintaining high market standards. By **Rashmi Kumar**

For a case study on how best to tackle the push towards cleaner energy, decarbonisation and transition financing, one does not need to look much further than Japan, whose government has put environmental, social and governance growth among its core priorities.

The Japanese government published the Basic Guidelines on Climate Transition Finance as early as May 2021. Since then, the Ministry of Economy, Trade and Industry (Meti) has been at the forefront of transition finance, putting together sector roadmaps for hard-to-abate industries and offering subsidies to give its ESG agenda a bigger fillip.

Capital markets financing has been a critical component of Japan's drive towards transition. Slowly but surely, the proportion of ESG-labelled bonds in the country's primary markets has grown, as has the diversity of the issuer base.

"Japan's ESG market is not as big as in Europe or elsewhere, but the proportion of ESG bonds in the primary market has been growing," says Hitoshi Kawamura, head of sustainable finance department at Nomura Securities in Tokyo. "Some 40% of primary bonds are now ESG labelled bonds."

In the year to September 23, Japanese issuers had raised $24.3bn-equivalent via 112 yen green, social or sustainability bonds, according to Dealogic data. The amount raised was nearly 50% more than the $16.4bn over the same period in 2022, and easily surpassed volumes in 2021, 2020 and 2019 year to date, shows Dealogic.

Government-backed entities have been among the biggest drivers of ESG bonds, particularly social bonds, as they need to meet an annual funding budget dedicated to ESG debt. There has also been a flurry of issuance from Japan's financial institutions.

Two of the leading state-owned ESG bond issuers this year were the Japan International Co-operation Agency and the Japan Expressway Holding & Debt Repayment Agency, both of which have tapped the yen market multiple times in 2023, according to Dealogic. Firms focused on state infrastructure, like highway operators East Nippon Expressway Co and West Nippon Expressway Co, have also been stable issuers.

A further top-down impetus for the ESG market is also on the way. Japan's government, led by prime minister Fumio Kishida, is planning to issue the world's first sovereign transition bond in the second half of this fiscal year, which started in April 2023. This is a clear indication of how Japan's ESG market is likely to evolve — with debt designed to help industries with high emissions become more energy-efficient and reduce greenhouse gases.

The government has tagged the potential issuance as a "green transformation economic transition bond". It aims to raise ¥20tr ($135bn) from the ESG instruments — to be called GX bonds — over the next decade, including about ¥1.6tr in the current financial year, mainly with maturities of 10 or 20 years.

"Japan's ESG market is not as big as in Europe or elsewhere, but the proportion of ESG bonds in the primary market has been growing"

Hitoshi Kawamura, Nomura Securities

Its timing could not be better, given recent changes in Japan's ESG landscape.

Emerging greenium

One of the biggest developments in Japan's ESG debt market is the arrival of a greenium (cost savings for an issuer for selling ESG deals versus conventional bonds).

Yusuke Sutani, director of Bank of America's Sustainable Banking Solutions Group in Japan, says a greenium started to emerge in the domestic market last year and the trend has continued since.

"This is mainly because Japanese investors are becoming more sophisticated and tend to buy labelled bonds, even with a slightly lower spread," says Sutani.

He says that around 2021 or before, Japan had a negative interest rate environment but as the Bank of Japan is attempting to increase rates, the higher government bond yields have made investors more focused on labelled bonds.

Nomura's Kawamura adds that "some investors know and understand how popular ESG can be so they are receptive to a greenium in certain issues".

On average, say bankers, issuers are able to achieve a 1bp-2bp greenium on five year or 10 year ESG deals.

A clear example emerged in February this year when Hiroshima Prefecture sold a dual-tranche transaction worth ¥10bn. It was split between a ¥5bn 0.73% 2033 green note and a ¥5bn 0.75% 2033 conventional bond, printed at spreads of 23bp and 25bp, respectively — showing the 2bp pricing advantage achieved on the ESG-linked portion.

"Japanese investors are becoming more sophisticated and tend to buy labelled bonds, even with a slightly lower spread"

Yusuke Sutani, Bank of America

Such pricing perks come despite the fact that the evolution and structure of Japan's ESG market are vastly different from that of global peers.

Unique Japan

In many markets, including in Europe, China and the Asean countries, authorities have established a taxonomy for green and sustainable finance, clearly defining the metrics to consider when judging whether a deal or asset is ESG tied or not.

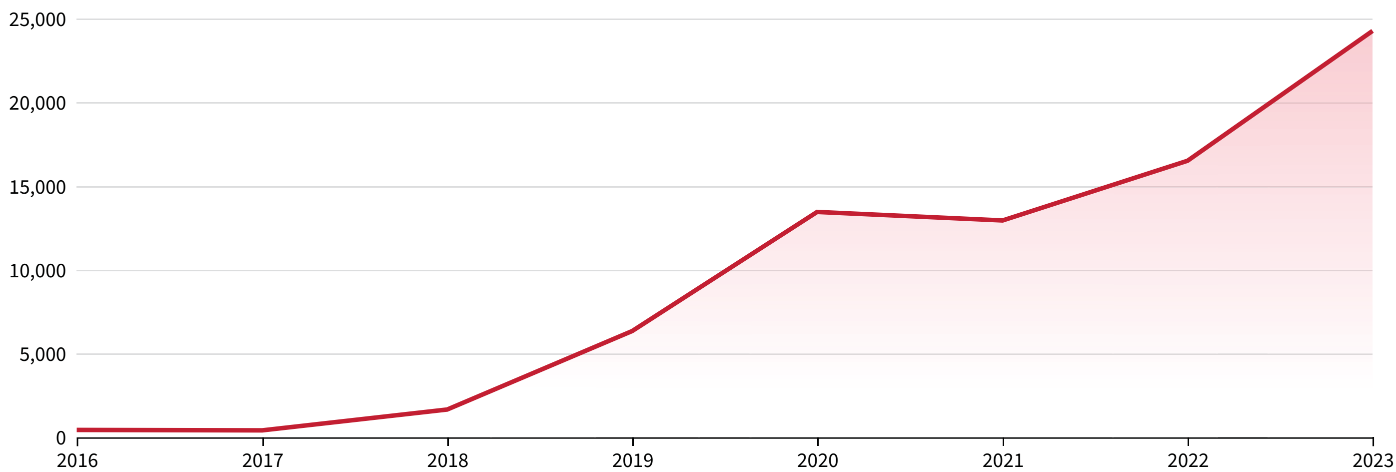
However, in Japan, issuers have been mainly guided by Meti's transition roadmap for hard-to-abate sectors like oil and gas, power, steel and chemical.

Hiroaki Aoki, Japan ESG and sustainability champion for Citi Japan's banking, capital markets and advisory team, says Meti's transition roadmap has helped the country become "the biggest market for transition finance in terms of number of transactions and the amount of capital raised".

One reason why Japan has veered away from having a taxonomy-style

Yen green, social and sustainability bond volumes

Volume (in $m-equivalent)



Includes only green, social and sustainability bonds
Data is year to September 23 each year

Source: Dealogic

framework is to cater to its unique transition journey.

"Japan has a lot of hard-to-abate sectors and due to Japan's geographic location, we are heavily dependent on fossil fuel energy from abroad," says Aoki. "So our pathway to decarbonisation is not the same as what other European countries are pursuing. It's because Japan needs a more realistic approach to energy transition."

That kind of forward thinking has come in conjunction with efforts to stem greenwashing concerns early on in the market.

Japan has not had serious greenwashing issues so far, say market participants, unlike other nations where key performance indicators (KPIs) on sustainability-linked bonds have been criticised for not being chosen well or the targets for not being ambitious enough.

In December 2022, Japan's FSA unveiled the Code of Conduct for ESG Evaluation and Data Providers, which bankers say is a big step for the country's ESG journey. The FSA offers voluntary adoption of the code, giving ratings agencies and data providers some flexibility on how best to implement the code based on circumstances.

In a note in February 2023, Hazel Ilango, energy finance analyst, debt capital markets, at the Institute for Energy Economics and Financial Analysis, wrote that the FSA's code was "not perfect" but it took Japan "one step closer to improving the transparency and function of ESG ratings".

In another important move, in June, Meti, the FSA and the Ministry of Environment jointly published follow-up guidance to improve communication between ESG issuers and investors to help transparency and mitigate greenwashing fears. The aim is to help investors follow up with borrowers in a targeted way so that all parties are aware of any changes in ESG fundraising objectives.

'Immense waste of capital'

"It's a very comprehensive list," says Kawamura. "It allows investors to ask detailed questions of borrowers when deciding whether to invest in their ESG bond or not. It's a way for the government to recognise the important role that financiers play in supporting this market, and the need to strengthen engagement between investors and issuers."

Global investors consider this important. Japan's economy is heavily dependent on fossil fuels, with coal and natural gas accounting for some 68% of electricity generation.

While its attempt to tackle this has been lauded, some elements of its transition journey have come under intense scrutiny.

"Japan needs a more realistic approach to energy transition"

Hiroaki Aoki, Citi

The main criticism is that Japan plans to use ammonia to co-fire its coal plants, claiming it's an effective emissions reduction strategy.

But research from TransitionZero found in April this year that this would be an "immense waste of capital that could do more harm than good", and that co-firing ammonia "could even be worse for the environment than burning unabated coal".

TransitionZero's authors — Seb Kennedy, Jacqueline Tao and Joo Yeow Lee — write: "Under the euphemism of 'clean' or 'advanced' coal, proponents are using ammonia co-firing to extend the use of thermal power generation assets that would otherwise need to close. They claim that this is compatible with emissions reductions goals, a false assertion that could legitimise newbuild coal in the eyes of financiers and lenders. The truth is that widespread adoption of ammonia co-firing in existing coal fleets is strewn within [sic] transition risks that could create a new generation of stranded assets."

Additionally, Japan is part of the Asia Zero Emission Community, through which it is supporting and prescribing Asean countries to use ammonia and hydrogen to co-fire their coal plants.

Sustainable Fitch wrote in a report in July that investors it had contacted about this had "criticised Japan's approach, saying it is insincere as it largely aims to protect its own thermal-powered industries to ensure they remain competitive".

That means Japan's planned transition bond will be closely watched. Details on exact timing, use of proceeds and structuring are still limited, but the plans have raised many questions.

"One of the challenges for the upcoming Japanese government transition bond is whether it gets credit from international investors for its transformation strategy," says Aoki from Citi. "Japan's energy policy is a little different from other advanced nations, for example, its use of ammonia for co-firing in coal power plants. So its success, or not, will be critical for Japan's sustainable finance market, not just for the government, but it can also have a significant impact on the future cost of sustainable finance in Japan." GC