GlobalCapital

THE VOICE OF THE MARKETS

www.globalcapital.com

Japan in the Capital Markets

May 2022

Sponsors:

NOMURA

DBJ Development Bank of Japan

JBIC

JFM

GlobalCapital
THE VOICE OF THE MARKETS www.globalcapital.com

Euromoney Institutional Investor PLC
8 Bouverie Street, London, EC4Y 8AX, UK
Tel: +44 20 7779 8888 • Fax: +44 20 7779 7329
Email: firstname.lastname@globalcapital.com
Printed by MethodUK

CEO, Financial & Professional Services division, Euromoney Institutional Investor PLC: Jeff Davis
CEO of NextGen Publishing, Financial & Professional Services division: Isaac Showman

Managing editor: Toby Fildes
Editor: Ralph Sinclair
Editorial product manager: Craig McGlashan

GlobalCapital Asia
Editor: Rashmi Kumar
rashmi.kumar@globalcapital.com
Tel: +65 8727 5697

LOANS
Reporter: Nancy Qu
nancy.qu@globalcapital.com
Tel: +852 2842 6953

BONDS
Deputy editor: Manju Dalal
Manju.dalal@globalcapital.com
Tel: +65 3158 9271

EQUITY
Equities editor: Jonathan Breen
jonathan.breen@globalcapital.com
Tel: +852 2912 8082

GlobalCapital China
Editor: Addison Gong
addison.gong@globalcapital.com
Tel: +852 2912 8076

Head of Sales, NextGen Events, Asia: Robert Ball
robert.ball@euromoneyasia.com
Tel: +852 2842 6996

Head of visuals: Gerald Hayes
Sub editor: Julian Marshall

Marketing
Claudia Reyes Marquez +44 20 7827 6428
Josh Pearson +44 20 7779 7388
Hind Farina +44 20 779 8505

Customer Success
James Anderson +44 20 7779 8338

Subscriptions & Licensing
Katherine Tapper +44 20 7779 8612

JAPAN IN THE CAPITAL MARKETS

Rate hikes and geopolitics concern Japanese issuers

After more than two years of dealing with the impact of the Covid-19 pandemic, Japan's leading credits are putting recovery and capital market access at the top of their agendas. But in 2022, they face fresh challenges — rising dollar interest rates amid continued low interest rates in Japan, as well as geopolitical conflicts that have added new bouts of volatility to global markets. In these difficult times, the country's top borrowers are making ESG a bigger focus, while emphasising the need to be agile and flexible.

Participants in the roundtable were:

Shino Kusunoki, assistant director, Japan Bank for International Cooperation (JBIC)

Shingo Kanatani, director, Development Bank of Japan (DBJ)

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

Junko Takahashi, director, budget, treasury and finance, and capital markets, Japan International Cooperation Agency (JICA)

Hiromi Yoshiura, director, bond section, budget division, bureau of finance, Met Tokyo

Masanori Kazama, head of international DCM, Nomura

Moderator: **Rashmi Kumar**, editor, *GlobalCapital Asia*

GlobalCapital: **How did you adjust your fundraising plans in 2021 amid the Covid-19 pandemic — and how are you positioning your firm and your funding plans for the year ahead?**

Shino Kusunoki, JBIC: The impact of Covid-19 continued to be felt for all of 2021. Until December last year, JBIC offered a special loan programme for corporations impacted by Covid-19, where we offered working capital loan support. This was very well received.

We also offered loan support in other non-major currencies like Thai baht, which represents one of our strengths.

Furthermore, in consultation with the Japanese government, the interest rate on our special lending programme was set at quite acceptable levels for customers, which served as a safety net for corporations.

In 2013, JBIC adopted the Paris Agreement and the Sustainable Development Goals. We also announced our ESG policy last year before COP26 to be net-zero by 2030 and to achieve net-zero emissions in our finance portfolio by 2050, so we are reinforcing financing activities for the greening of the environment. We have also focused on realising a decarbonised society in our fourth medium-term business plan announced in June 2021. JBIC sold its first dollar green bond in January 2022, which is fully aligned with our ESG initiatives.

So the outlook for 2022 is that this post pandemic environment will be fully normalised. We believe we have to be very active in our initiative, look at the yield curves and also other indicators in the midst of a bond issuance environment that is deteriorating. We have long-dated assets in our portfolio, so we have to be very agile and reactive when we consider long-dated funding.

Shingo Kanatani, DBJ: In 2021, we had to continue responding to the pandemic. Compared to the previous year, the demand for capital from the major Japanese corporations had stabilised, but restaurants and hotels were still hard hit by the pandemic. In 2021, DBJ, based on the request from the government, offered extensive support to Japanese corporations negatively impacted by Covid-19. Our sustainability activities were strengthened too in line with the government's carbon commitments.

In May 2021, we issued our fifth business plan, which is based on the GRIT strategy. G stands for green, R for resilience and recovery, I for innovation, and T for transition/transformation. It's a strategy to strengthen our initiative in these areas, especially investments and loans to be extended to our customers. In 2021, for example, we gave a transition loan to a major Japanese company.

In terms of fundraising in 2021, various countries in the world had monetary policies that were still accommodative. So we had abundant capital and the appetite of investors for bond issuance was very favourable. We issued bonds in foreign markets, as well as in the domestic Japanese market. We have been able to issue bonds in a sizeable manner, and the cost of capital was reasonable.

Takahiro Ando, JFM: Our evaluation of the market environment for 2021 is more or less the same as the other speakers: tackling Covid-19 and navigating different central bank policies were key. In this changing environment, how we are to be successful in fundraising is something we were really trying to figure out. For JFM, we deal with the capital demand of Japanese municipalities, so we raise funds that would source the projects of the municipalities. That is the major mission of JFM.

The tax revenue of the municipalities came down last year due to Covid-19, so in fiscal year 2021, the demand for capital from JFM went up so we had to respond to that rise in demand and boost our fundraising. That was the most important achievement for us during fiscal 2021.

In terms of a domestically issued bonds, we sold four benchmark sized bonds in the 2021 fiscal year. One of those was a green bond. We issued our first green bond in 2020 and our second last year. In terms of reporting on green bonds, we were able to satisfy various requirements for reporting and able to come up with very precise and detailed reporting standards on our green bonds, which was highly evaluated by investors.

Among the challenges was addressing the large size of our funding during the pandemic. Direct contact and face-to-face discussions with investors were difficult. But by having very good web-based investor relations activities, we were able to assemble the necessary amount of funding to satisfy demand.

For 2022, uncertainty remains significant, due to ongoing Covid-19 cases, efforts by central banks moving towards normalisation, and the Russia-Ukraine situation that increased the volatility in the market. How to satisfy the demand that we face for capital in a stable manner is going to be one important issue for fiscal 2022.

Also, in January this year, we issued our third green bond and we intend to prepare detailed reporting on that. That's an important task for us going forward. Organising our data in a digital manner and having good engagement with investors so they can fully understand the business we're engaged in will also be critical.

Junko Takahashi
JICA

Junko Takahashi, JICA: JICA's efforts in 2021 were focused on Covid-19, especially providing vaccination and pandemic control to developing countries with fragile health systems. Also, we extended special emergency budget support programmes to developing countries with limited access to the capital market. The size of this totalled around ¥400bn globally. JICA's mission focuses on 'human security and quality growth'. We 'leave no one behind' and aim to help 'build back better' – these are our objectives and in line with the Sustainable Development Goals.

So in this context, for the first time in Japan, we issued a gender bond in 2021. The prolonged Covid-19 situation has unfortunately increased the gender gap, and thus we will focus the use of proceeds on projects addressing gender equality and improving empowerment for women. As for our funding plan in 2022, we also see greater demand for dollar-denominated loans. So we plan to double the annual amount of dollar bonds we have been issuing in the past.

Hiromi Yoshiura, Met Tokyo: In 2021, as in 2020, increasing public spending in response to the Covid-19 pandemic was a major issue for local governments.

On the other hand, particularly in the Tokyo Metropolitan Government (TMG), it was a great achievement that the Tokyo 2020 Olympic and Paralympic Games, which were postponed due to the pandemic, were successfully completed by welcoming athletes from all over the world, overcoming the difficulties of anti-epidemic measures and holding the games even without spectators.

This year is expected to be a year in which the Covid -19 pandemic comes under control and economic recovery is expected. Toward this end, we updated our long-term strategy announced last year in March 2022. We plan to promote various policies in order to link the fruits of the Tokyo 2020 Olympic Games to the development of the city of Tokyo.

GlobalCapital: From a DCM point of view, what trends and volumes have you seen in the bond market in Japan in the past year?

Masanori Kazama, Nomura: In 2021, quantitative easing continued globally, but funding activities have remained very stable. Interest rates are trending upward due to the inflationary trend in various countries, but the impact of that was not seen in the past year in funding activities.

In this setting, the Japanese institutions who are represented here are SSAs. In calendar 2021, they collectively raised roughly $16bn, which is slightly lower than in 2020 but sizeable compared to 2019 or 2018. These large bond issuances helped satisfy the needs of investors.

In 2021, Japanese companies had many M&A activities that needed to be financed and financial institutions also sold bonds in the market. In aggregate, we managed to top $100bn in full-year issuance.

But what about the next year? We are now heading into a higher interest rate environment. This means while fundraising may start to decline, investors still have a lot of cash. So the challenge for issuers will be how to capture the cash sitting with investors.

GlobalCapital: How are issuers expected to tweak their fundraising plans because of higher US interest rates, at at time when the Bank of Japan is still focusing on monetary easing?

Ando, JFM: We extend loans and raise funds for the local municipalities. In 2022, the demand for capital from Japanese municipalities compared to 2021 would go down. That is our outlook. In 2021, a total of ¥2.5tn was raised by JFM from foreign and domestic bonds. Our issuance forecast for 2022 is ¥1.8tn because the tax revenue of the municipalities did not deteriorate as much as we had originally anticipated, so the shortage of funds will not be very large.

So how are we to really respond to the capital demand of the municipalities going forward? We're not really sure how the market environment would be. We know very well that the central banks of the world and BOJ are trying to adjust their monetary policy, but the market environment is not very clear.

The BOJ governor may change towards the end of the year, so we have to take that into account as well, and there may be some major economic events towards the end of the year. So if it is possible in the first half of the year to raise funds, we would like to do that as much as possible. And the split between international and domestic bonds is going to be the same ratio as in 2021.

Takahashi, JICA: Inflation and rising interest rates do have an impact on our fundraising activities, but we worry more about our clients, the governments of developing countries. The impact on the economy of developing countries can be significant and we may see depreciation of local currencies, and thus capital flight by investors in developed countries. Needs for additional assistance to support developing countries may arise in that aspect.

Kanatani, DBJ: For the fiscal year 2022, we plan to issue close to ¥1tn bonds, of which 60% will be issued in the domestic market and the remaining 40% in the international market, and they will be combination of government guaranteed and non-government guaranteed bonds.

Since February, the interest rate environment has been unstable. The UK, the US and other European countries have balance sheet contraction and interest rate hikes in the horizon. The BOJ is going to maintain its monetary policy for a while still, but with interest rates going up in other countries, they would probably have to follow suit eventually. With a rise in rates, volatility will go up, then capital costs would go up too.

But recently for the first time since BOJ's negative interest policy, the negative yield of the five year Japanese government bond become positive. In Japan, DBJ has issued three year bonds and five year bonds but given their low yield, it prohibited some investors from investing in these bonds. But investors that were not allowed to buy bonds of that nature are now able to really invest in these new bonds due to the changing environment. It's also a good opportunity for us to capture new investors who didn't invest in our bonds in the last few years. But at any rate, the environment is volatile, and we have to be flexible in terms of the maturity and the currency of our bonds. We would like to, as much as possible, do our fundraising early in the year.

Hiromi Yoshiura
Met Tokyo

Yoshiura, Met Tokyo: In the 2020 and 2021 financial years, in light of increased fiscal demand for measures to counter the Covid-19 pandemic, we actively issued bonds with various maturities, which had been on a downward trend in issue amount, and expanded the scope of ESG bonds.

Our bond issuance plan is not necessarily significantly affected by interest rate levels, but is decided based on fiscal demand and other expected revenues, such as from metropolitan tax. From this point of view, we plan to reduce the total bond issuance amount from financial year 2021 to fiscal 2022, but plan to formulate an appropriate plan while paying close attention to the market environment.

Kusunoki, JBIC: The major currency demand for JBIC is dollars, so our funding activity is mainly conducted in dollars. The amount is usually around $6bn to $8bn every year. in 2022, some of our bonds will mature and will need to be redeemed, but in general, there is bigger demand for financing in dollars this year compared to fiscal 2021.

In terms of the outlook for the market, volatility has increased quite significantly, and uncertainty remains and will only grow going forward. As far as JBIC is concerned, in addition to the Federal Reserve's monetary policy, geopolitical risk is also heightened right now, and the market will be responding to that with higher volatility. We remain very cautious. We are monitoring the US and the Japanese markets closely. The interest rate differential between the two countries is likely to increase further and therefore the dollar-yen basis cost is expected to increase. The funding cost in dollar is likely to increase.

With that prospect for dollar funding, we might have to consider issuing bonds denominated in different currencies. There is strong demand on the asset side for extra-long funding. Higher funding costs are further expected to put emphasis on long-term bonds and when investor demand is expected to decrease, we might have to consider effectively making use of products like green bonds that can incite greater popularity among investors.

GlobalCapital: From the sounds of it, the only certainty seems to be uncertainty. Masanori, what is the bank's advice to issuers now? And what kinds of questions are you tackling from investors?

Masanori Kazama
Nomura

Kazama, Nomura: It's an extremely difficult question. The other members of the roundtable have mentioned that they do have some fundraising plans for the year, and at the same time, faced with the expectation of higher interest rates, they want to tap the market in the earlier part of the year. We expect this to happen, and it will enable issuers to take advantage of funding windows whenever possible.

Geopolitical risk is quite high. Nobody expected the Russian invasion of Ukraine at the beginning of the year. Of course, we don't want that sort of thing to happen, but it clearly indicates that no one knows what sort of risks will manifest themselves and at what timing, and so it makes sense for funding activities to be conducted in the early part of the year.

What would be the maturity, what sort of market conditions will issuers have and what will the timing be for funding activities are things we have to consider next. But these may not fully match or be aligned with the needs of different institutions. If a firm is funding with short term maturities, from the perspective of investors, it may be easier for investors to buy in. But if the funding is done in short-term maturities, says those institutions are engaged in long term lending, funding only in the short end would cause imbalance of the balance sheet. So I understand the desire on the part of those institutions to issue long-term bonds as much as possible.

When the market is not as volatile, we see that long term bonds can be issued. Since the size of the funds to be raised is very substantial, it would be important to ensure that the market segment doesn't become saturated. This means issuers need to balance both short and long term funding, as well as domestic currency and international market funding appropriately.

GlobalCapital: Let's move to the topic of ESG. What are your expectations for Japan's ESG bond market — in terms of volumes as well as innovation and new products?

Kazama, Nomura: Japanese ESG issuance has continued to increase year after year. It has grown from $6.6bn in calendar year 2018, to double that at $13bn in 2019, before hitting around $22.6bn in 2020 and growing to $36bn last year. So every year, it has either doubled or increased 1.5 times. It's just over three months since the beginning of this year. But already $11bn of ESG bonds have been issued. Compared with last year's level, I think the 30% or so of the issuance has been completed in the first three months and therefore this year the volume is expected to exceed the level of last year.

In terms of the product innovation, transition bonds have enjoyed government backing, so I hope this sort of issuance would be made by different sectors of the Japanese economy. The institutions represented here would be increasing their issuance outside of Japan, and firms issuing once a year may issue ESG deals twice a year or new institutions may be making their debut to take the ESG bond market further.

Takahashi, JICA: JICA's business is all about SDGs, so use of proceeds of our bonds is all in line with the SDG goals. The Japanese government has declared to become carbon neutral by 2050 and JICA, as a partner to developing countries, is strategising to assist their social transition and response to climate change in order to realise a resilient society.

JICA's specific actions include: assistances in human resource development of developing countries to enable preparation of Nationally Determined Contributions or target plans to implement and achieve the Paris Agreement; and assistances with 'co-benefit approach' for developing countries to achieve both sustainable development and climate change measures in sectors like clean energy, transport, water and sewage development, health, agriculture and disaster prevention.

JICA was the first entity to issue a social bond domestically in 2016 and we would like to continue to contribute more of in this direction going forward. The use of funds is in line with SDGs, and covers both green and social elements, so in essence, it is close to a sustainability bond. Within ESG bonds, we recognise that green related instruments are increasing being issued quite extensively. But when it comes to sustainability bonds or social bonds, they have not really made a mark yet compared to green bonds.

One bottleneck may be that the KPI of social issues are generally difficult to define or set, and guidelines or standardisation may be needed for the market to grow. Furthermore, each framework for social bonds is currently being evaluated on different interpretations by external reviewers with little disclosure of their reviewing methodologies. This may mislead investors and harm their interest. If the interpretation or methodology by reviewers becomes transparent, it will be easier for investors to assess the business quality of the bond issuers and thus enable them to invest more in such labels. I hope that as the ESG market matures, these things will evolve in the right direction.

Kusunoki, JBIC: We believe ESG bonds, including green bonds, will remain important. We will issue ESG bonds at least once a year. While the size of our dollar deals will be small relative to the overall dollar ESG market, we will be frequent issuers. Our ESG bonds are not limited to just green bonds, but include social bonds, sustainability bonds and transition bonds.

Shino Kusunoki
JBIC

When it comes to issuing transition bonds, appropriate KPIs need to be established, but for the issuance of the green bonds, we have managed to establish a very solid and robust framework. We would like to leverage this framework and gradually expand the amount of issuance of ESG bonds. That is our plan for ESG bond issuance. We will also work with the Japanese environment ministry to come up with a basic policy for transition bonds for each sector.

Kanatani, DBJ: We were the first issuer from Japan to issue a green bond in 2014. Since then, we have issued ESG bonds every year. In fiscal 2021, we issued two sustainability bonds in the foreign market and one sustainability bond in the Japanese market. Originally, we didn't issue so many foreign bonds, but with this labelling of sustainability bonds, we have attracted the attention of foreign investors. In the capital market, DBJ's sustainability initiative has come to be embraced gradually. Probably in fiscal 2022, we will issue similar sustainability bonds domestically and in foreign markets.

We would like to communicate DBJ's activities to the society and to Japanese corporations that are looking to transition. Japanese corporations would like to use various different approaches, but as a lender and investor through, we would like to support Japanese corporations to transition.

Takahiro Ando
JFM

Ando, JFM: For fiscal 2022, JFM would like to continue issuing green bonds as we have done in the past, in line with the ESG market that we expect to continue to grow. But considering this future growth, we ask ourselves: what sort of activities can we engage in through the ESG segment? Is there any opportunity for us to issue debt in a different form or through ESG bond issuance? What sort of ideas or information should be communicated to the market or society at large?

We have established a research department to deal with these communication activities, and they are also looking into market conditions and the form of ESG issuance we can have. In the local government segment, the track record of issuing ESG bond has been increasing. For instance, in the 2021 fiscal year, the Kawasaki prefecture sold its first sustainability bond, while other local governments are also selling ESG bonds. The frequency of issuance, and also the number of local governments issuing those bonds, has been on the increase.

So how are we going to accelerate and expand the issuance of this segment of bonds? It is difficult to have a clear answer because the motivation of governments in issuing ESG bonds is by a decision made by the top executives of those local governments.

They can enjoy premium pricing, but it raises the question: what the value of that ESG bond for residents? That needs to be examined closely. Also, the requirements of administrative activities to enable labelled issuance is a hurdle for increased issuance. We have issued a report on green bonds and their reporting requirements that can be referred to by other institutions.

Shingo Kanatani
DBJ

Yoshiura, Met Tokyo: Regarding the issuance trend of ESG bonds in 2022, especially in the municipal bond market, several municipalities announced that they would issue new ESG bonds from the 2022 financial year, and the number of deals is expected to increase. Although it is difficult to predict an unprecedented issuance pattern, we deem it likely that the issuance of existing ESG labelled bonds will continue to expand, as the national government is developing guidelines for each label, such as transition bonds.

GlobalCapital: What are investors looking for when they think of Japan and ESG debt?

Kazama, Nomura: In the world of ESG, I think the Japanese market is lacking some things compared with the overseas market, mainly the efforts on the part of investors. Here in Japan, there are very few funds specialising or dedicated to ESG. Since around 2014, throughout the world, the ESG concept has been accepted widely, but there has been very little improvement in the Japanese market. The end investors behind those funds may have the needs for investing in ESG, but is often not enough and therefore the asset managers who are expected to respond to end investors are not establishing funds dedicated to ESG.

Also in Japan, the size of financial assets in the hands of retail investors is quite substantial. Those funds need to be channelled to ESG and that is a challenge. But there are initiatives being taken on that front by a number of securities or brokerage houses, which are encouraging retail assets into ESG investment rather than deposits. That's something we need to continue working on. If that is accelerated — that is the transition from deposit to investment — then new products focusing on ESG issues will become more active.

GlobalCapital: What are you most optimistic about and what are you most concerned about for the rest of 2022?

Kusunoki, JBIC: Given the pace of interest rate hikes, long maturity bond issuance is going to be more difficult because capital costs and funding costs are going up. That will be a major source of concern.

We also have geopolitical risk rising with the Russian invasion of Ukraine. If there are unexpected geopolitical events that may arise going forward until the end of the year, we have to respond to that as well, while approaching capital markets in a timely manner for our fundraising activities.

On a positive note, in January this year, we issued a government guaranteed green bond for the first time and reporting around that is going to take place. At least once a year, we would like to issue green bonds. The global trends of ESG are something that we are capable of fully capturing and appealing to investors.

We take this difficult timing of funding with great volatility in the market as a chance to challenge ourselves. When the dollar funding cost is sharply increasing, we have to come up with some other ways to secure enough funds. In this sense, we are very flexible in ways of funding. We are doing some online IR activities already to develop JBIC's investor base.

Kanatani, DBJ: The greatest concern is normalisation of monetary policy, together with the geopolitical event in Ukraine. We're not really sure how this will come to an end, so this is a major source of concern for us. It's not just the problem in Ukraine though. The whole world is now really coming to a point of transition.

In terms of bond issuance, in the domestic as well as in foreign markets, as long as we have the right timing, demand from investors will be healthy.

Domestically, because of the low level of yield, there were investors who couldn't invest in our bond, but now is really a good opportunity for us to widen the investor base.

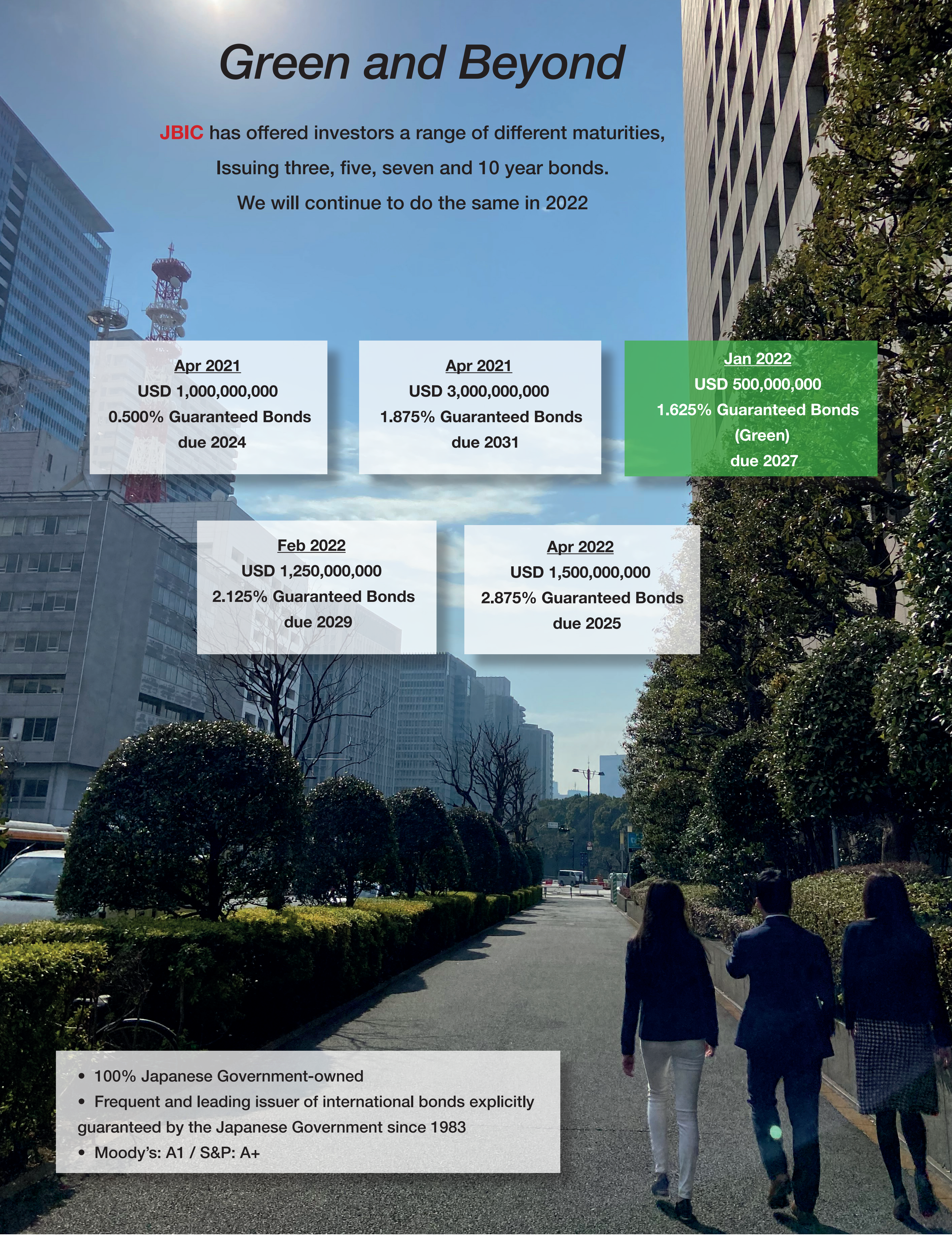
Takahashi, JICA: At the risk of repeating what others have mentioned, volatile markets, rate hikes and geopolitical risks surrounding Ukraine are generally also our big concerns. But let me get into the latter issue. Now increasing number of countries are facing a humanitarian crisis, whether it be the coup d'état in Myanmar last year, the situation in Afghanistan, or Ukraine. So how are we to help overcome this?

When there is an international crisis, JICA takes action to support developing countries that are negatively impacted, so programmes and projects are being formulated as we speak.

Looking into the ESG market, 'human rights' is treated as 'materiality' and the EU recently released a report on social taxonomy, which is centred on protection of fundamental human rights. This inclination is expected to become stronger.

JICA hopes to disseminate the social needs of developing countries and communicate more with the capital market about our involvement and related assistance for such issues.

Ando, JFM: We believe the fundraising environment would be quite different in the future, amid volatile markets and rising interest rates. We have to be sensitive and careful and monitor how investors react around their investment decisions. We are also keen to increase the appeal of our ESG bonds and embark on activities to expand our domestic debt base. GC

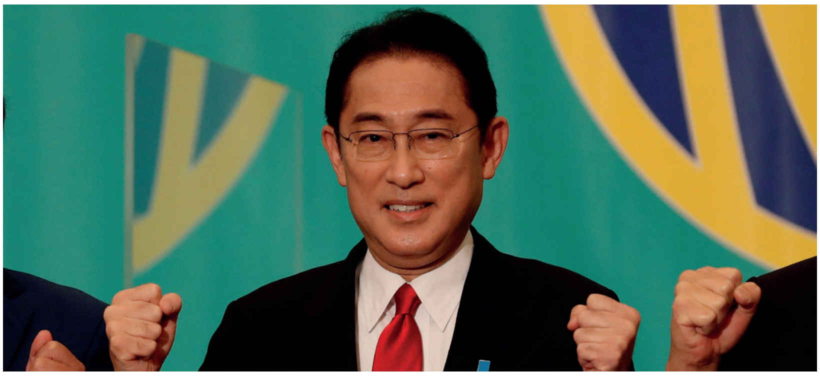


JBIC
JAPAN BANK FOR INTERNATIONAL COOPERATION

web: www.jbic.go.jp/en
E-mail: C0290@jbic.go.jp

Japan's ESG debt market is ripe for growth

Japan has made big strides in embracing developments in the ESG market in the past year — putting it in prime position to grow the asset class even further, writes **Rashmi Kumar**.



Japanese prime minister Fumio Kishida has made ESG a priority

LAST YEAR WAS a watershed one for Japan's environment, social and governance (ESG) related bond market.

Green and sustainability bond volumes surged to nearly ¥2.9tr ($22bn), an almost nine-fold increase from 2017 when the country's Ministry of Environment unveiled its green bond guidelines, according to research by Clifford Chance.

There has been no looking back since. From a regulatory point of view, Japanese authorities have only opened the ESG market more.

The environmental ministry updated the green bond guidelines in 2020 to increase visibility of the product and to help reduce the cost and administrative burden of selling green deals. In 2018, the Tokyo Stock Exchange launched a platform to allow issuers to publish information about their ESG bonds directly on the Pro-bond market website.

Last year was even more critical. During the United Nations Climate Change Conference in November 2021, held in Glasgow in Scotland, Japanese prime minister Fumio Kishida highlighted Tokyo's goals to cut greenhouse gas emissions by 46% by 2030 and achieve net-zero emissions 20 years later.

This support to the global ESG agenda is propelling Japan's corporations, governments and financial institutions to also do their bit.

In a Japan ESG-focused roundtable published in this report, market participants said that issuers that had initially tapped the ESG bond market as a diversification play are increasingly changing their tune as they realise the importance of tackling global issues like climate change, and more domestic concerns like Japan's ageing population.

Kazuyuki Aihara, senior officer, head of ESG products in Nomura's debt capital markets team, said in the roundtable that sustainability-linked bonds and transition bonds are the "new types of bonds being issued" in addition to green bonds, social bonds or sustainability bonds.

"The market is seeing a full-fledged expansion," he reckons.

The growth of social bonds in Japan is particularly significant. A range of institutions — like West Nippon Expressway Company, the Tokyo Metropolitan Government and the Welfare and Medical Service Agency (WAM) — have all issued social bonds in the past year.

Social fillip

In a country like Japan, social bonds are of growing importance — and for good reason.

The country has one of world's oldest populations and has big challenges around tackling gender diversity and female empowerment, while the Covid-19 pandemic has also continued to highlight inequalities that require creative solutions and the financing to implement them.

According to estimates from the Welfare and Medical Service Agency, one out of four people in Japan will be over the age of 75 by 2060. Those aged 85 or more will need nursing care, "suggesting an increase in both quantitative and qualitative needs for welfare care in the future," said Takashi Igarashi, director, fund management, in the accounting department of WAM, speaking at the roundtable.

Social bonds fit the picture. These are bonds where the proceeds are specifically earmarked for projects with measurable social benefits. They can be anything from healthcare and women's issues, to education, poverty or special needs.

"The funds raised through social bonds are used for loans for welfare and medical care, indirectly contributing to the support of elderly people who use the facilities covered by the loans," reckons Igarashi. "Issuance of social bonds to support ageing is expected to increase going forward."

In 2021, Japanese issuers sold social bonds worth about $8.29bn collectively, according to Statista Research. That number is expected to spike in 2022 as government agencies across Japan jump on the ESG bandwagon, with a particular focus on social bonds. Yet, issuers and investors will have to tackle some roadblocks on their way to push the broader ESG market forward.

Bank of Japan, which is chaired by governor Haruhiko Kuroda, conducted a survey in December 2021 to assess how climate change risks and opportunities were impacting asset prices.

The survey, which had a total of 45 respondents, found that greenwashing concerns are growing in ESG-related bonds from Japan — like in many other markets in the world. There have even been suggestions to integrate climate factors into credit ratings to reflect bond pricing better. If and when that will happen, though, remains a question.

If Japan is serious about brandishing its ESG credentials further, not just in Asia but globally, it will need to tackle any problems that may arise at the onset to pave the way for a stable and growing asset class.

The foundations have already been laid. Now it is time to build on them. GC

ESG bonds flourish in Japan

Japan's environmental, social and governance bond market has gone from strength to strength in recent years, moving away from just green bonds to seeing a spurt in social and sustainable bonds too. In a roundtable featuring some of Japan's major ESG bond issuers and bankers, participants focus on the way forward for the market — and the roadblocks that are hampering growth.

Participants in the roundtable were:

Hiromi Yoshiura, director, bond section, budget division, bureau of finance, Met Tokyo

Takashi Igarashi, director, fund management, accounting department, Welfare and Medical Service Agency (WAM)

Shuji Tahara, director, fund management, accounting department, The Okinawa Development Finance Corporation (ODFC)

Yosuke Murai, finance division, accounting and finance department, West Nippon Expressway Company (Nexco West)

Kazuyuki Aihara, senior officer, head of ESG products, debt capital markets, Nomura

Moderator: **Rashmi Kumar**, editor, *GlobalCapital Asia*

GlobalCapital: How big has ESG-related fundraising been so far — and how is it likely to grow further?

Takashi Igarashi, WAM: The Welfare and Medical Service Agency has issued a social bond. What triggered the issuance was the expansion of the infection of Covid-19. Also, the Japanese government had started initiatives for the realisation of carbon neutrality and people's awareness of ESG had heightened. We made a declaration in our business plan to support the activities of the communities and to improve the level of health and welfare in the country. WAM administers a variety of operations to promote and improve social welfare and medical services. Specifically, we provide low-interest long term loans to private social welfare institutions and private medical institutions for construction, maintenance and operation of facilities. Social welfare promotion grant activity is also implemented by WAM.

To expand our investor base, we established a framework for the qualification of issuance of ESG bonds. In line with the content of this framework, we have issued an ESG bond. It was a social bond, and in the process of marketing, we identified the demand of investors. We had 32 investors clarify their willingness to invest in the social bond. Going forward, we would like to appeal the social contribution of our business to more investors.

Shuji Tahara, ODFC: The Okinawa Development Finance Corporation, as its name suggests, is a government affiliated financial institution with the aim of promoting the development of industries in Okinawa. We promote the economic development and social development of Okinawa Prefecture and contribute to the social development of Okinawa by solving social and environmental problems that need to be solved.

Okinawa is emphasising SDG activities and the ODFC is supporting SDG activities from a financial aspect. In December 2021, we issued a sustainability bond, the first type of ESG bond we have issued. The mission we support is carried out only in Okinawa prefecture. Therefore, our deal was something not easily understood by investors outside of Okinawa.

It was one of our aims to do more IR activity — to explain what kind of business we are doing, and our efforts and contributions to solving environmental and social problems in Okinawa— to help people understand, not just within Okinawa, but also outside of Okinawa, and so we issued an ESG bond.

Since this was going to be an investment in an ESG bond with an extensive base of investors, we thought it would be a good method to base this on medium to long term capital. That was one of the major reasons we decided to issue an ESG bond. Another reason is that we are a government-affiliated financial institution and contribute to the development of the ESG bond market. We received an SPO from DNV that qualified the ESG bonds, which led to the issuance of the sustainability bonds.

To be more specific, in the prefecture of Okinawa, the livelihood is mainly based on tourism. The leading industry, tourism and resort, needs to be promoted and developed further so we are extending support to these sectors and industries. There are also small and medium sized enterprises that need to be supported for further business growth. Okinawa is an island, an isolated island, that requires economic support. Child poverty is an issue in Okinawa and there are many single parent families in Okinawa. The support we extend is one of the social issues that should be covered by the social bond. We printed a sustainability bond, mainly because with the label, the money can also be used to protect the forestry and the environment.

In fiscal 2022, we are going to issue an ESG bond that will be a sustainability bond. Considering the nature of our business, we have a social nature and a green attribute that is fulfilled by sustainability bonds. We recognise ourselves as a qualified issuer of sustainability bonds and will continue to issue sustainability bonds.

Hiromi Yoshiura, Met Tokyo: The proceeds of our green bonds have been allocated to projects that contribute to both climate mitigation and adaptation, such as development of heat insulation and water absorption, greening along waterfronts, and development of new parks. For social bonds, the proceeds are allocated to projects that provide support for residents of Tokyo and business owners who are in need of social support, such as removal of utility poles, instalment of platform doors at Toei subway stations, improvement of schools for special needs education, and reconstructing aging public housing.

For green bonds, we have played an important role in the development of the ESG bond market by constantly issuing green bonds since 2017 ahead of other municipals in Japan with increase in size and expanding the use of proceeds, and implementing policies that provide support when issuing.

As the ESG bond market expands, we expect to see proceeds head towards environmental programmes and people who are in need of social support. In addition, as it provides opportunities of socially responsible investment to investors, we expect to raise awareness among corporates for environmental and social issues which should be tackled, as well as to establish systems that allow corporates to receive recognition for their effort among investors.

We plan to issue green and social bonds during the next fiscal year, like in the past year, and do not plan to change the type of ESG bonds we will issue.

Yosuke Murai, Nexco West: Many investors have long requested us to issue social bonds. In October 2020, the government announced its carbon neutrality target. In that context, we had an issuance target of ¥470bn. As a public institution, we decided to issue social bonds to contribute to social challenges, like aging infrastructure and the frequent occurrence of natural disasters.

Western Japan, our business area, tends to see more natural disasters such as typhoons or flooding than other areas. We thought that issuing social bonds could address these important social issues.

Our social bonds are used for construction related to road asset, such as new construction of expressways, rebuilding projects such as four-lane widening, large-scale repair projects, and disaster recovery. In terms of the advantages of issuing social bonds, we believe that investors will be able to gain a deeper understanding of our business and recognise the importance of expressways.

I think that many people recognise that expressways are only for achieving rapid transportation, but they are also one of the most important social infrastructures in terms of disaster prevention and mitigation. Therefore, we are making various efforts to strengthen our disaster response capabilities.

By contributing to the development of the ESG market in Japan, we believe that our activities will be widely recognised not only for Japanese investors but also for expanding the investor base of international investors. There are diverse roles to be played by issuers in continuing to fund through the issuance of ESG bonds.

We also focus on CSR activities and pay attention to the opinions obtained through discussions with stakeholders. We believe that promoting our business and tackling social issues while expanding our contribution to the achievement of the SDGs will lead to the further development of the ESG market.

Kazuyuki Aihara, Nomura: Total ESG issuance in the Japanese market in the 2021 fiscal year was ¥4.3tn, which was a decisive moment as it hit this number for the first time since ESG related bonds were first sold in 2014. Originally, issuers using this market considered that it important as a diversification play, but investors are increasingly having a different perspective on this asset class, which has accelerated the expansion and development of the market. Investors are now focused on ESG investment, and are expanding their investment in those areas.

To access the ESG capital, some issuers are opting to issue ESG bonds or ESG related bonds, which clearly indicates that investor interest in ESG bonds is influencing the expansion of this market. In addition to green bonds, social bonds or sustainability bonds, sustainability-linked bonds and transition bonds are the new types of bonds being issued. The market is seeing a full-fledged expansion.

GlobalCapital: If you have plans to come back to issue ESG bonds again, would it be a similar social bond or would you be looking at other products as well?

Yosuke Murai,
Nexco West

Murai, Nexco West: In fiscal 2021, we issued bonds worth ¥540bn. With regard to green bonds or sustainability bonds linked to certain projects, it is difficult to meet the expectations of many investors because the use of funds is limited and it is not possible to raise a large amount. But with social bonds, we'll be able to satisfy investors requirement, which is why we chose social bonds. We believe that the business we are working on can contribute to solving social issues, and we plan to continue issuing all corporate bonds as social bonds.

GlobalCapital: Are issuers seeing any pricing advantage by selling ESG bonds versus conventional bonds. If not, is that likely to change in the future?

Aihara, Nomura: As the Japanese interest rate environment is still a low interest rate environment, it's very difficult to have a big gap between the yield of ESG bonds and traditional bonds. When the market was relatively soft last year, green bonds and social bonds were more attractive to investors because the yield was more visible. In Europe, a greenium is more conspicuous, but in Japan, the difference between green bonds and conventional bonds is not necessarily very conspicuous.

Tahara, ODFC: This was a major factor we had to consider when deciding on issuing ESG bonds: is there going to be a pricing advantage? In this very low interest rate environment in Japan, the difference is not very visible. However, because ESG bonds are attractive for investors to invest in, they have helped to narrow the spread between our bonds and local municipal bonds.

In the future, if Issuers are to issue similar bonds, when interest rates rise, the pricing advantage would be much higher. But it's not just the pricing advantage to be emphasised, because this is not necessarily the ultimate goal of these ESG bonds. If investors can fully evaluate ESG bond attributes and characteristics, it would be much healthier market with more pricing benefits.

Igarashi, WAM: I agree with the others that in this low interest rate environment, we cannot really enjoy pricing benefits with ESG bonds. That's a fact. But as a result of issuing ESG bonds, we were able to at least see bigger demand from investors. This is quite promising for the future issuance of ESG bonds. But the history of the market is still very short; it's a young market so going forward the ESG bond market would be differentiated from the traditional bond market. That is what I am expecting.

GlobalCapital: Social bonds are slowly gaining traction in Japan, which is tackling the world's oldest population. Is this segment of the ESG bond market expected to take off further in 2022?

Murai, Nexco West: It is difficult to predict whether ESG bonds targeting elderly support will expand. Our efforts are not intended only for the elderly, but as part of the evolution of the expressway business, we have set the goal of developing standards for road spaces that support autonomous driving. In Japan, which is a super-aging society, pursuing the affinity of all people will place more emphasis on supporting the elderly, so I think the Japanese social bond market will evolve further.

Shuji Tahara,
ODFC

Tahara, ODFC: Japan is suffering from ageing and a low birth rate. This applies to the Okinawa Prefecture as well. We are no exception. In the context of our own business, Our own business also includes businesses that focus on the elderly. There are some senior citizens who are very active in business or economic activities, and who want to start or engage in business.

We have programmes that support such business to be conducted by elderly people. Indirectly, if there is a company wanting to build housing for elderly people, we also have a programme to support them. Our business does have social characteristics.

But support for elderly people itself is not necessarily the dedicated purpose of our bond issuance, because that is likely to be quite limited in reach.In the future, we are expecting a substantial increase in that segment of fundraising, specifically targeting the aged population. First of all, we believe that the number of ESG bonds that use support for senior citizens as part of their funds will increase, rather than ESG bonds that use support only for senior citizens.

Igarashi, WAM: WAM's business has social characteristics and our activities are fully aligned with social purposes. According to our estimates, one out of four people in Japan will be over 75 by 2060. In addition, there is an increase in the number of people aged 85 and over and a trend toward more severe nursing care, suggesting an increase in both quantitative and qualitative needs for welfare care in the future.

The funds raised through social bonds are used for loans for welfare and medical care, indirectly contributing to the support of elderly people who use the facilities covered by the loans. Issuance of social bonds to support aging is expected to increase going forward.

Yoshiura, Met Tokyo: The proceeds of social bonds that we issued this fiscal year was allocated to projects that promote nursing home services, aimed at enhancing nursing service system. The more the ageing society progresses and addresses social issues such as providing supporting systems for the elderly, the more we see potential expansion in use of ESG bonds as a key to tackle such problems.

Aihara, Nomura: As far as social bonds are concerned, we have Social Bond Guidelines that are well understood and facilitate the growth and development of this market. I think an environment that facilitates issuance of social bonds is now being nurtured by Japan's regulators like the Financial Services Agency. The issue relating to social bonds specifically relates to reporting and therefore, the outcome expected from social bond issuance needs to be explicitly presented. The KPI for social bond proceeds impact is now being compiled and defined by FSA.

Kazuyuki Aihara,
Nomura

But alongside the ageing population, Japan also has a shrinking working age population and a disparity in gender equality that need to be addressed. We need a system to support the female labour force in Japan. It's a different phenomenon compared to ageing, but to maintain a certain level of economic status in Japan, gender gap is an important issue to tackle and social bonds can play a role there.

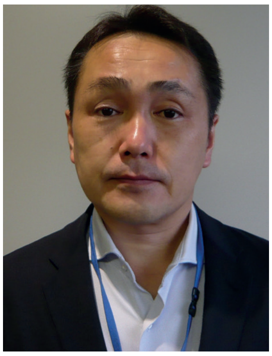
GlobalCapital: What needs to be done to grow the ESG market further to make Japan relevant on the global scale? Where are the opportunities and what are some of the roadblocks?

Murai, Nexco West: The ESG bond market is expected to continue expanding, but it will be necessary to deal with greenwashing in the future.

From the perspective of impact investment, I think it will have a significant negative impact on the credibility of issuers and the investment decisions of investors. I think it is important to visualise and quantify the impact to ensure transparency. It is also important for issuers to increase the transparency of their business to investors, as it is necessary to avoid concerns and suspicions among investors.

Regarding the expressway business, the funds procured will be used for projects such as the construction of expressways, so it will be easier to understand what kind of business the procured funds are being invested in.

We believe it is important to inform stakeholders, including investors, of the use and effects of our funds through CSR reports and other means.



Takashi Igarashi,
WAM

Igarashi, WAM: We only recently issued our debut ESG bond so we are not worried about greenwashing. If you cannot satisfy the requirement or the expectation of investors, you are considered to be greenwashing. In our business, we evaluate that the funds raised are applied to the resolution of social issues, and investors have also evaluated our bond use of proceeds. We have fully sorted these issues and clarified how ESG bonds differ from other traditional bonds. It is important to accurately disclose information to investors and clarify how the proceeds are being applied.

Tahara, ODFC: To issue ESG bonds, we get a second party opinion. We also have guidelines around what corresponds to social bond and what corresponds to green bond. The business that we are running is qualified for a specific labelling of ESG bonds, so making investors understand that is necessary to avoid greenwashing concerns.

We also need to be clear about the use of proceeds post issuance. Impact reporting also needs to be considered. Should we report the impact generated from the proceeds of our bond issuance? Is it really contributing to resolving issues in the society or greening the environment? We have to have a report that is fully understood by investors, and I think there is still room for improvement there.

I believe compliance with guidelines is important, to make clear what qualifies some issuers to issue ESG bonds to ensure transparent reporting.

Yoshiura, Met Tokyo: We believe one of the difficulties for issuers to issue ESG bond is additional work that needs to be done in order to align with ICMA standards, such as selecting eligible projects that need to take into account post-issuance reporting and acquiring of second party opinion. We believe support to overcome such obstacles, for example introducing a database that provides case studies for use of proceeds from past issuance, and financial aid programmes for acquiring second party opinions, which have been introduced, will reduce the additional workload for issuers. This will promote the expansion of the market.

Hiromi Yoshiura,
Met Tokyo

We think the bonds being aligned with standards and acquiring second party opinion are valid measures to prevent greenwashing. When they are implemented appropriately, it should serve as a check function.

Aihara, Nomura: Japan's ESG market is going to continue expanding. But to maintain this lively market environment, we have to secure the confidence of investors and win the trust of investors. The impact and achievements of ESG bonds have to be accurately reported. When it comes to greenwashing or social washing, of course these are a concern. So to enable investors not to worry about greenwashing or social washing, there has to be healthy market development.

One idea can be to reward the practice of transparent reporting in some way. At the issuance stage, awards may be given to issues for their concept and potential impact. Maybe if there is a mechanism established to reward issuers that have best practice of reporting, that would lead to a healthy market development. When issuing ESG bonds, we often receive questions around the reporting requirement. Because of the workload of reporting, sometimes issuers become hesitant to really go ahead with issuance. With an improvement in the reporting environment, issuers would feel more comfortable issuing these bonds. And with greater number of issuers in the market, investors would have a greater sense of security for investment.

Issuance of the bond is not the end game, because the issuer and the investor would have to continue with their dialogue, which I think is very important. If this mechanism works smoothly, the market would see an improvement in quality and reliability.

GlobalCapital: Does that mean something like sustainability-linked bonds in Japan, with interest rate step ups or downs?

Aihara, Nomura: Yes, we already have examples of such issuance. But Japan's market is slightly different. Internationally, for SLBs, if sustainability performance targets are met or not met, the coupon decreases or increases. But in the case of the Japanese domestic market, instead of increasing coupons, it is necessary to respond in other ways, such as by donating to NPOs. That's the sort of mechanism used, and such bond issuance has been increasing. GC


Applying Financial Expertise to Design the Future
Japanese Government Guaranteed International Bonds
1.750% due October 2031 USD 1,000,000,000 Issued in October 2021
1.250% due October 2026 USD 900,000,000 Issued in October 2021
1.250% due January 2031 USD 1,000,000,000 Issued in January 2021
Sustainability Bonds
1.750% due February 2025 USD 700,000,000 Issued in February 2022
0.010% due September 2025 EUR 600,000,000 Issued in September 2021
0.500% due March 2024 USD 520,000,000 Issued in March 2021
FILP Agency Bonds
0.214% due January 2032 JPY 20,000,000,000 Issued in January 2022
0.005% due March 2027 JPY 20,000,000,000 Issued in January 2022
0.001% due March 2025 JPY 20,000,000,000 Issued in January 2022