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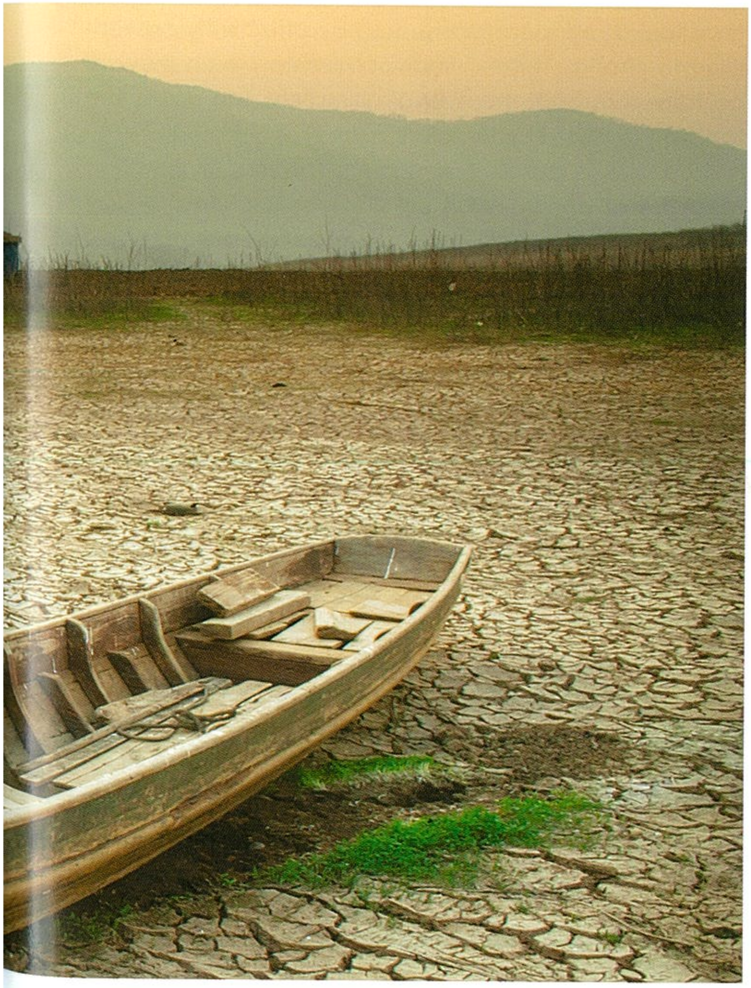
A Rising Fever: Why ASEAN Members Should Finance Climate Change Mitigation and How Its Financial Regulators Can Take the Lead Now

'The hardest thing to explain is the glaringly evident which everybody has decided not to see.'
– Ayn Rand, The Fountainhead

Climate change presents a clear and present danger, not just to the world, but also to the ASEAN region in particular, where greenhouse gas emissions have increased at unprecedented rates in the last four decades. ASEAN members have collectively set themselves the goal of raising their renewable energy target to 23 percent of their primary energy sources by 2025.[1] This is window dressing at best as primary energy reliance will still be predominantly fossil fuel-based. In the face of runaway temperature spikes, all ten ASEAN members' commitments under the Paris Agreement would be rendered resoundingly hollow. In any event, meeting this target would be totally contingent on adequate funding. The need of the hour is concerted regulatory effort, divorced from subversive political agenda, to fund the movement away from the overt dependence on fossil fuels. Even in the ASEAN Multi-Sectoral Framework on Climate Change as proposed in 2018 at Hanoi, climate financing is the last of the eight strategic thrusts, which speaks volumes on prioritisation and engagement. The hard truth is that without sufficient funding, even the loftiest of climate goals will never be achieved.



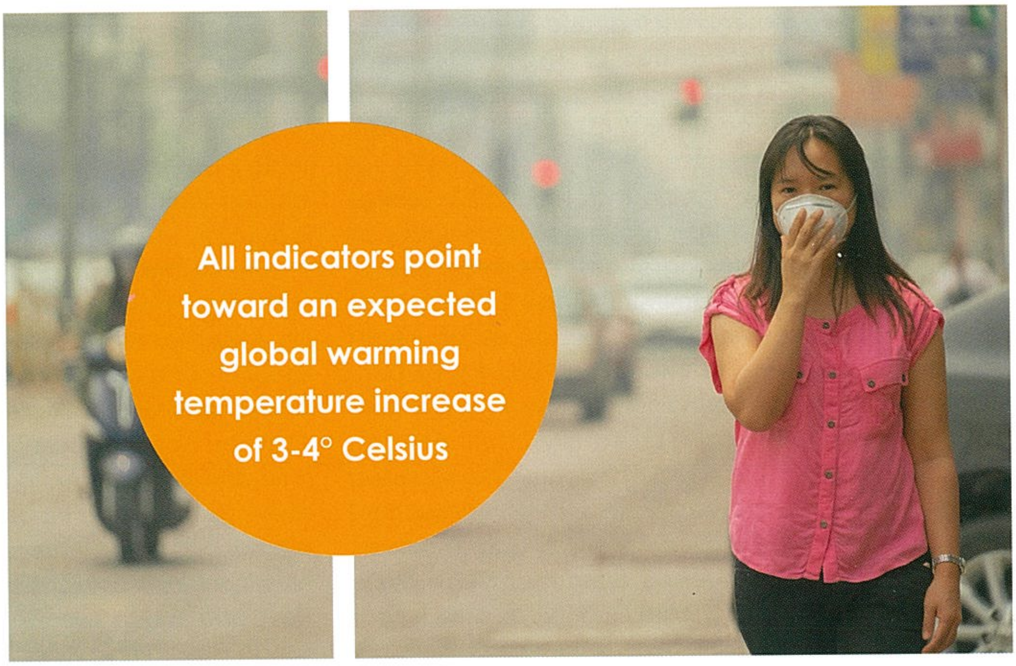
In stark contrast, global funding for coal is backed by the biggest institutional investors, banks and underwriters.[2] Tragically, Malaysia, the Philippines, Vietnam and Indonesia are looking at ramping up coal production with only Thailand looking to buck the trend.[3] From an ASEAN context, one would think that the looming spectre of catastrophic losses to agricultural, fishing and tourism industries, not to mention anything of abject food scarcity, oceanic acidification, inundation of coastal land and increasingly frequent cyclonic weather, would serve to galvanise incumbent financial regulators to present and enforce the required policies to deviate from historical trends applicable to fossil fuel-powered industrial development. To even term this as development would be an absurdity in itself, if the cost thereof necessarily entails ecological meltdown—the more appropriate term would be devastation. However, ignorance, uncertainty, risk undervaluation, mistrust, reactance and active denial prevail at this late hour, not only at the highest echelons of power, but also within our homesteads, much in keeping with the history of fallen civilisations.

The Problem; Right Here, Right Now

'Scientific evidence for warming of the climate system is unequivocal.'– Intergovernmental Panel on Climate Change

Popular, but misguided, perception holds that the climate crisis is an issue for the future. The most insidious of threats are the ones that creep up on us and, in this regard, climate change is no different. The Charney Report[4] was perhaps the world's first comprehensive analysis of the effects of carbon dioxide on climate, comprising the basis of the science behind global warming. The evidence for climate change is compelling[5] with a 95 percent probability that human industrial activity is the cause, regardless of what some leaders may have us believe.[6]

For the ASEAN economy, the financial risks are threefold: primary liability attributable directly to climate change events, secondary losses to the insurance system and the tertiary issue of stranded assets.[7] What is widely regarded by financial regulators and industry players as a tail risk today, may well mutate into the catastrophic normal of the future.[8] ASEAN's continued reliance on



fossil fuels will saddle its future generations with a debt that they will never be able to pay, which for the insurance industry is the worst case outcome. Globally, weather-related economic losses in 2018 came to a staggering US$225 billion,[9] a significant share of which occurred in Vietnam and Indonesia. Pertinently, the insurance gap is tremendous and is expected to widen with flawed risk assessment and impaired forecast models. The 2011 flood in Thailand cost the insurance industry US$10.8 billion,[10] ranking it as the highest loss worldwide at the time. Actual economic loss and damage was in the region of US$46.5 billion,[11] which represents an insurance gap in the region of 76 percent.

ASEAN financial regulators need to accept the fact that at a fast-approaching point in the future, climate change-related economic (read loss) implications will submerge and overwhelm existing market solutions. To aggravate matters, despite ostensible national energy goals set by ASEAN members to reduce fossil fuel dependence, there is a glaring dichotomy in terms of subsidisation policies for impoverished sections of society of the very same products that these members are attempting to rid themselves of.[12] All indicators point toward an expected global warming temperature increase of 3-4° Celsius, which in turn raises an infrastructure capital requirement of US$26 trillion[13] to not only sustain current growth rates and eradicate poverty, but also to incorporate climate change mitigation and adaptation costs for the period of 2016–2030. By itself, climate change measures represent a budget of US$3 trillion, which given the projected time period, is not insurmountable for the finance industry. However, time and tide wait for none.

This calls for a radical approach, much opposed to the traditional macro prudential regulatory method usually adopted by regulatory authorities with financial stability as the touted but often questionable objective. Instead, financial regulators within the ASEAN region should be looking to completely abolish (not merely reduce) fossil fuel dependency and thereby effectively prevent climate change-related financial disaster which they will be forced to bear the cost of ultimately. The stakes are too high to even contemplate failure.

The ASEAN Elephant A.K.A The Obvious Solution

'We have managed to bring famine, plague and war under control thanks largely to our phenomenal economic growth, which provides us with abundant food, medicine, energy and raw materials. Yet this same growth destabilizes the ecological equilibrium of the planet in myriad ways, which we have only begun to explore. Humankind has been late in acknowledging this danger, and has so far done very little about it. Despite all the talk of pollution, global warming and climate change, most countries have yet to make any serious economic or political sacrifices to improve the situation. When the moment comes to choose between economic growth and ecological stability, politicians, CEOs and voters almost always prefer growth. In the twenty-first century, we shall have to do better if we are to avoid catastrophe.'

– Yuval Noah Harari, *Homo Deus A Brief History of Tomorrow*

Rather than replicate historical models for development as followed by western powers, financial regulators across ASEAN would do well to assess what their counterparts are currently up to,[14] that is, evaluate what they are doing now as opposed to what they did in the past, which is exactly what led us to the economic precipice we find ourselves at. This way they could be ahead of the curve. The vantage point offered by history is that one does not have to repeat the mistakes of others if only one is willing to learn and pivot. In this vein, it is expedient to borrow a page from the Network for Greening the Financial System ('NGFS') playbook,[15] where it is recognised by those central banks (including two ASEAN members: Thailand and Malaysia) that 'climate-related risks are a source of financial risk. It is therefore within the mandates of central banks and supervisors to ensure the financial system is resilient to these risks'. This only serves to underscore the imperative need for the financial regulators of those remaining ASEAN members to also step up to the plate by way of coherent regulatory action.

NGFS recommendations, if applied to ASEAN, translate into cogent regulatory policy articulation as follows:

1. integrating climate-related risks into financial stability monitoring and micro-supervision;

2. integrating sustainability factors into own-portfolio management;

3. bridging data gaps;

4. building awareness and intellectual capacity and encouraging technical assistance and knowledge sharing (which ASEAN excels at);

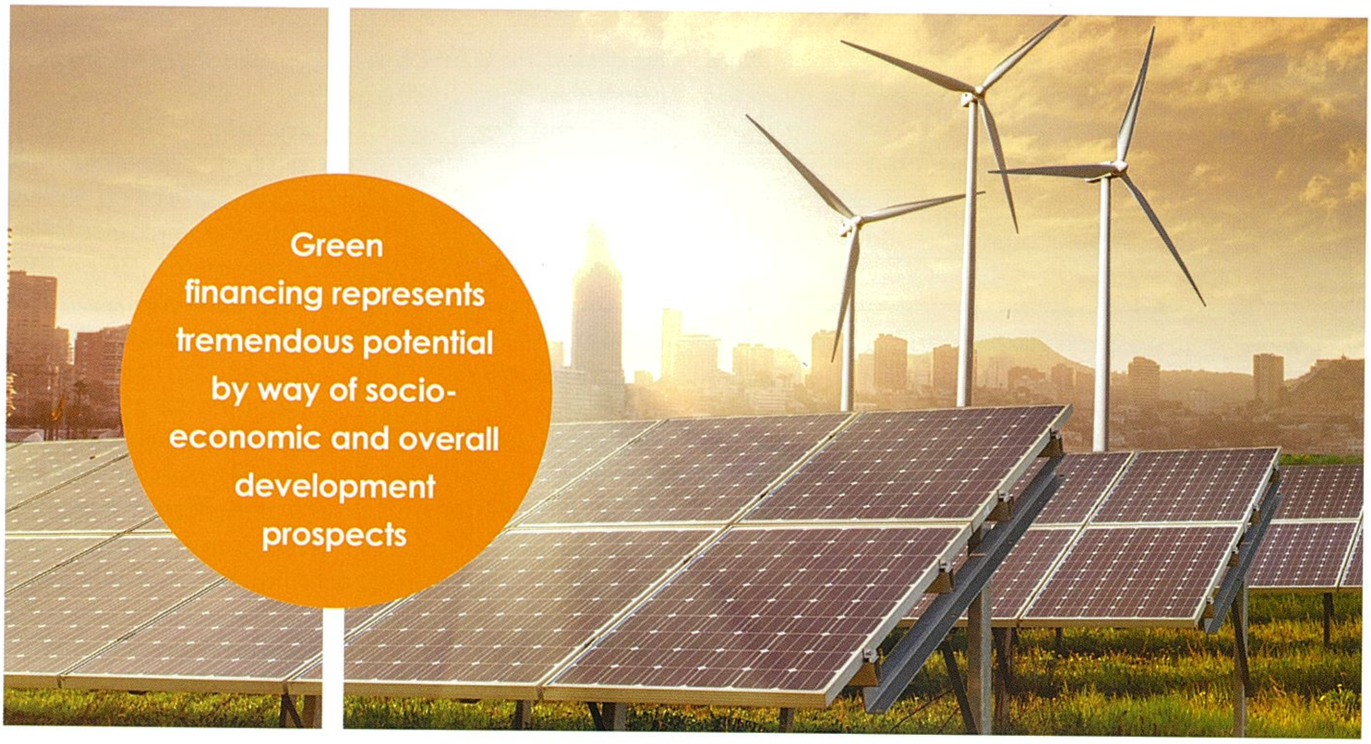
5. achieving robust and internationally consistent climate and environment-related disclosure; and

6. supporting the development of a taxonomy of economic activities.

To commence, ASEAN financial regulators would need to implement policies so that data pertaining to climate-related risks can be disclosed and disseminated in a uniform manner by private and public sector incumbents (in the form of existing strategies, responses, management and the target metrics thereof). Once collated and made known, these risks would be divided primarily into two baskets, risks presented by climate change and the risks that transition to renewable energy would entail, thereby allowing the financial sector across ASEAN to take stock of climate issues on the basis of reliable data. Thereafter, three high-level actions as part of the planning and evaluation phases would be called for, that is: budgetary analysis, review of public expenditure and budgetary tagging or coding so that disbursements can be tracked during implementation of adaptation and mitigation measures. Given that ASEAN's banking systems and capital markets continue to remain discrete, an integrated approach may appear daunting.

To bolster and sustain climate-related investment, regulators would be faced with the challenge of introducing and increasing demand and corresponding supply of climate risk products and services together with fostering innovation so that state-of-the-art technology can be harnessed for resilience. No doubt, this is an overt simplification—implementation would entail ensuring myriad compliance requirements such as minimum data disclosure requirements which should made explicit across the region; mapping of financial sources; development of regional, national and local level investment plans; execution of public private partnerships if needed; promulgating tax exemptions and incentives to reduce the cost of transition and ensuing risk; continually improving access to public data and ensuring quality standards of the same; engaging technical assistance and routing access to capital especially for early stage funding; regulating new financial and corporate structures as required; enforcing appropriate insurance and supply chain financing. At local and national levels, this may seem a Sisyphean task and even more so for ASEAN to cohesively administer as a regional bloc, but the fact remains that financial regulators have been known to move heaven and earth when necessary. As quipped by Baron Healy, 'World events do not occur by accident. They are made to happen, whether it is to do with national issues or commerce; and most of them are staged and managed by those who hold the purse strings.'

In order to end dependence on carbon, regulators across the board must resolve to unequivocally end consumption. Even with the sobering cost of transition to renewable energy sources, the commercial opportunity is quite salubrious.[16] To ease such transition, it would make sense for regulators to impose controls whereby the price of fossil fuels is raised to match the cost to



the environment, both by way of extraction as well as utilisation; this could be by way of roll back of subsidies and the levy of carbon taxes in a prudent manner[17] once suitable alternatives have matured along with sufficient deployment of requisite support infrastructure. The energy transition will constitute the largest capital mobilisation the world has ever seen and ASEAN must either lead the movement or at the very least keep abreast of the latest technologies which would necessarily imply a sustained long term investment. This brings home the dire need for funding through the issuance of long-term debt instruments by public investment banks or directly by national governments. It is at this juncture that the role of ASEAN's financial regulators, specifically their respective central banks, comes to the fore. In keeping with their supervisory state function, central banks have managed the secondary markets for public debt. It also not unheard of for central banks to depart from convention.[18] As such, they must rise to the occasion by facilitating the movement from carbon energy to renewables as buyers of last resort for the aforesaid long-term debt instruments.

In a commendable effort that began in 2016: ASEAN members have already explored and taken active steps toward green financing, having raised US$5 billion as of November 2018, with Indonesia leading the way[19] despite the Philippines and Singapore being the pioneers in this regard. Green investment sectors within ASEAN currently are energy, buildings, transport, water, waste, land use, industry and information communications technology. The financial instruments are fairly sophisticated and not unlike those issued in more popular markets[20] consisting of an assortment of debt, equity and credit enhancement mechanisms. However, the sheer scale and magnitude of the climate change ramifications leave little time for accolade; rather, matters should be moved to a war footing and the only parties who have the heft and capacity to do this are financial regulators.

Conclusion

'Bold climate action is in the national interest of every single country represented at this conference. The time for brinksmanship is over.'

– Ban Ki-moon, COP21 Leaders' Summit Speech.

Green financing represents tremendous potential by way of socio-economic and overall development prospects given the scale of transformation that is required. It augurs well that foundations have been laid and the timing is ideal for financial regulators to give impetus and facilitate the transition to renewable energy in earnest. This would bring the requisite visibility to springboard and further finance other climate change mitigation and resilience measures. To paraphrase Thiers' law, good money will drive out bad (with specific reference to fossil fuels).

As a consequence, hypothetically speaking, ASEAN member commitments under the Paris Agreement would appear a more achievable and less forlorn a target. The backing of financial regulators would serve to draw multilateral financial institutions of the likes of the World Bank, International Financial Corporation and the Asian Development Bank, among others and establish much needed familiarity to anchor investors as well as boost the credibility of local financial institutions and borrowers. A coordinated policy initiative beginning at the regional level of ASEAN, percolating down to local markets with improvised implementation guidelines, would render transparency to transition efforts and, as a result, sustain the same. ASEAN is already an established platform for dialogue, negotiations and technical knowledge proliferation, which if used effectively can serve to scale up financing as required. However, the efficacy of these transition efforts will be directly hinged on the pricing of carbon as concluded by the Report of the Secretary-General's High-level Advisory Group on Climate Change Financing, 'The higher or lower the carbon price, the larger or smaller the revenue and the stronger or weaker the price signal to reduce emissions.' Determining the most suitable course, that is, taxation, carbon markets or liberation of existing price controls, would be a decision point for ASEAN member financial regulators.

In terms of success of meeting objectives, regardless of what critics may suggest, ASEAN is second only to the European Union as a regional group, which was founded for ostensibly economic reasons but in reality to prevent another war. ASEAN too, was predicated on routing communism and was rife with mistrust when established in 1967. To lend perspective, it took 40 years to ink a foundational charter. ASEAN now ranks the fifth largest economy by way of GDP, having trounced conflict and poverty to establish itself as a model organisation of peace and prosperity underpinned by diversity. From being dismissed as recently as 2016 by The Economist[21] as 'having no mechanism to enforce the group's many agreements and treaties', the ASEAN way[22] is unconventionally inspirational. In 1967, with naysayers of the likes of Justice William Douglas and Nathaniel Peffer, ASEAN's current achievements, without any written charter document for most part of its journey, would have been dismissed as impossible; yet time and time again, ASEAN has overcome a host of hurdles with quiet aplomb. In the context of the current climate change challenge and the overall regulatory procrastination thus far, that is precisely what ASEAN must pull off today: the impossible!

Note : The Author was assisted by Simon Z Rajan, DFDL (Thailand) Limited.

Notes

[1] http://www.aseanenergy.org/programme-area/re/.
[2] https://coalexit.org/node/1142.
[3] http://www.aseanenergy.org/blog/energy-insight/how-does-asean-coal-sector-look-in-the-first-quarter-of-2019/.
[4] https://www.bnl.gov/envsci/schwartz/charney_report1979.pdf.
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[14] https://www.bloomberg.com/news/articles/2019-04-17/with-climate-losses-rising-central-banks-push-greener-finance.
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Vinay is based in the DFDL Bangkok office and serves as the head of the India Desk, head of the Indonesia Practice and leads the regional banking and finance practice. With 13 years of transactional and advisory experience, over half of which has been spent in Southeast Asia with DFDL, Vinay has advised multinational clients on complex transactions related to energy, infrastructure, mining, information technology, telecommunications, transport and logistics and agriculture. Vinay also serves as the chief point of contact at DFDL for all fintech-related matters advising several clients operating in the realm of blockchain and cryptocurrencies.

Vinay has extensive experience with Indian court litigation and international dispute resolution. He is a regular speaker at international industry conferences, seminars and workshops and has also authored articles and papers in various publications.