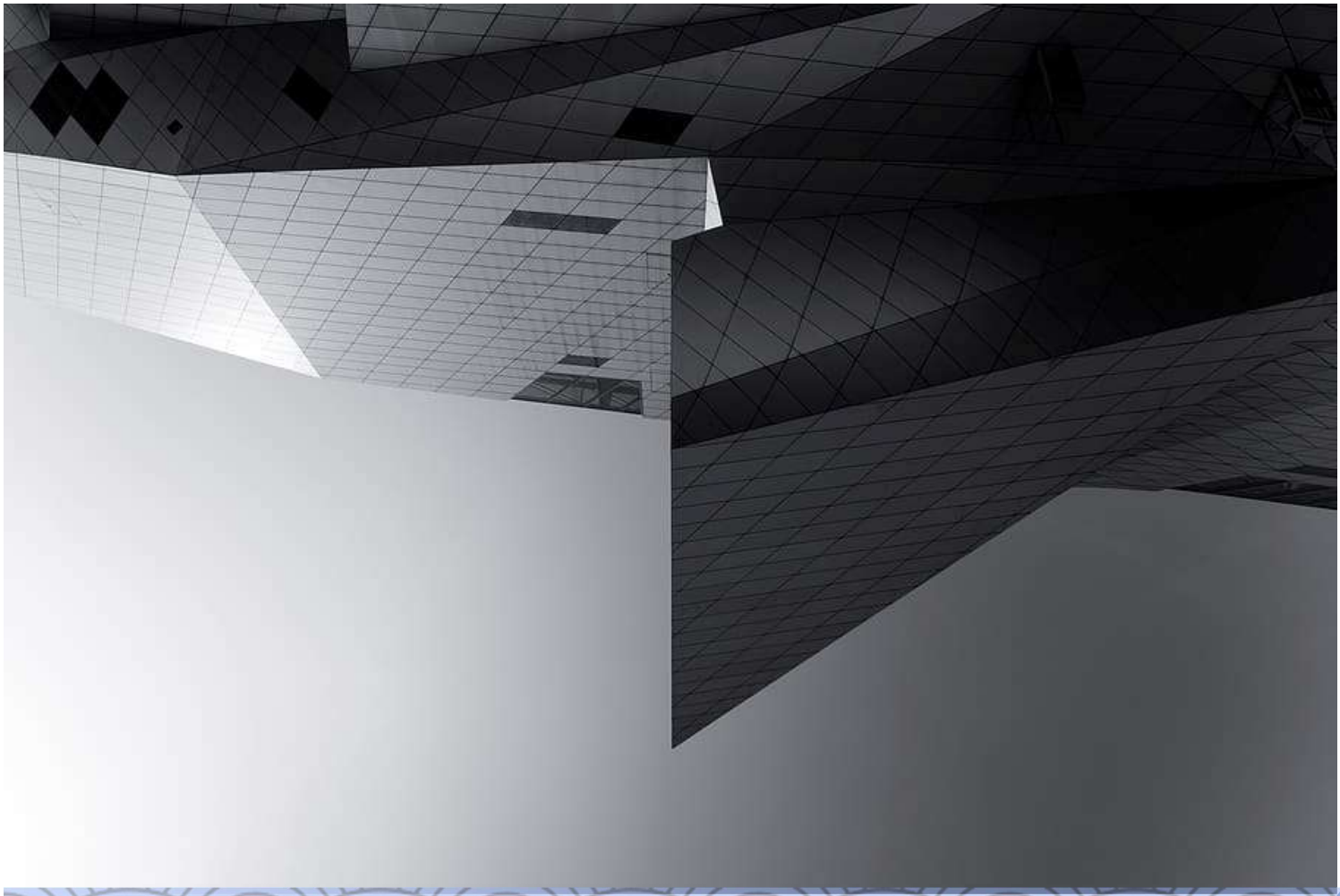

Bridging the Gap: Funding of Sustainable Infrastructure in ASEAN

May 2020

EU-ASEAN BUSINESS COUNCIL

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Executive Summary

Some of the most crucial investments in ASEAN to be made in the short to medium-term are around that of infrastructure, and making the right decisions will enable economies to grow in a sustainable, inclusive way, contributing to the achievement of the UN SDGs. Imagine Switzerland without its railways or a UK without Heathrow Airport. These systems are integral to the economic vibrancy of their countries, and even now continue to be developed to ensure a robust and resilient foundation for future economic and social prosperity.

Across the EU, both good and hard lessons have been learnt. These are lessons that can and should be shared with ASEAN to facilitate and accelerate growth and development.

Sustainable infrastructure, and the financing of this are two sides of the same coin – ultimately the objective is for ASEAN countries to put the infrastructure building blocks in place to enable sustained investment and growth, creating a legacy that will benefit ASEAN and its many citizens, businesses and nations for generations to come. In a post-COVID 19 world this becomes even more important, as having the right sort of infrastructure, sustainably funded and operated, will form one of the critical blocks for the region to attract further investments.

Sustainable financing is an important aspect and much has already been written on it, including in a sister paper to this one from the EU-ABC[1]. With this paper we want to further the discussions around the decision factors across all types of infrastructure project, focussing on how the plethora of projects needed across ASEAN can be financed. However, a project is financed, we want to encourage decision-makers to embrace two important aspects when considering the finances of sustainable infrastructure.

First is to take a total cost of ownership approach. The planning and construction of a project is but one aspect of total cost. Other considerations are the technologies that improve operations, functionality, efficiency, security to increase the contribution that such investments will make to economies, and hence should be considered in the cost-benefit analysis. In the long run, the costs associated with this can easily exceed the initial capital investment, lasting decades and outliving various political administrations. As such, in considering cost it is the lowest total cost of ownership, rather than that capital cost alone that is pertinent.

Time and time again, and not only in ASEAN, there are infrastructure projects that have failed due to decisions based only lowest capital cost, compromising quality and efficiency, and incurring both unexpectedly higher project and operational costs at a later stage.

Hence, an appreciation of the investments needed to bring out the best in capital infrastructure investments, to make a defining difference to the economy and to bring tangible value – both directly to users but also indirectly by stimulating business and community development, is needed.

Secondly, ensure that the decisions truly do contribute to sustainable economic development in its broadest sense. The UN Environment Programme defines sustainable infrastructure as integrating "ESG aspects into a project's planning, building and operating phases while ensuring resilience in the face of climate change or other shocks such as rapid migration, natural disasters or economic downturns"[2] . With any infrastructure investment, we believe in the power and potential of the connectivity it will bring – whether it's connectivity to resources, people or places. This is critical both within a country – for example Indonesia - but also for cross-ASEAN trade and exchange.

[1] See: www.eu-asean.eu/publications for "Financing ASEAN's Future: Developing Cohesive & Responsive Policies for Sustainable Finance

[2] See: http://unepinquiry.org/wp-content/uploads/2016/06/Sustainable_Infrastructure_and_Finance.pdf p.22

As in the EU, there is no one size fits all model of infrastructure or financing in ASEAN. However, what is universal is that the achievement of SDGs/ ESG remain central to infrastructure investment decisions and the need for projects / investments to be considered as part of a dynamic and inter-related eco-system across the region. After all, the potential of growth across ASEAN, with all the interconnections between systems and countries, will be dependent on ensuring that the weakest links are kept to a minimum.

Table of Recommendations

Recommendation Area	Recommendation
Capital Market Development	➢ Standardisation in terms of reporting, documentation and benchmarking will help to develop the market. Greater urgency to improve investment ecosystem and the offering of non-discriminatory regulatory regimes that encourage greater participation by insurers in long-term investments.
	➢ Encouraging consistency in treatment of projects through international/local rating agencies.
	➢ Creation of a regional capital market hub that can build critical mass behind a new infrastructure asset class. Such a hub would act as a magnet for institutional investors, build liquidity and lead to better pricing
	➢ Grow domestic capital markets and the domestic long-term investment sectors (insurance, pension funds, mutual funds) through encouraging asset securitisation, promoting product innovation, regulatory clarity on investment restrictions and removing tax disincentives
	➢ As market investors are looking at what makes a financial market investable from an operational perspective, the level of standardisation and automation remains a key differentiator factor in ASEAN. Achieving international standards with ISO 20022 and harmonisation of market practices across territories will improve the quality, the richness and the timely exchange of data and will increase efficiency in the classic reconciliation, reporting, settlement and asset servicing processes. Having a single platform access across markets and the ability to easily interconnect with local platforms and vendors enhances direct presence and reach in local markets for the global players.
Long Term Investment Rules & Regulations	➢ The EU-ABC seeks greater urgency to improve investment conditions and the offering of non-discriminatory regulatory regimes that encourage greater participation by insurers in long-term investments. Current regulatory treatment of infrastructure investment is largely based on asset class, focusing on limitations/prohibitions on the instrument for investment instead of the overall risk profile of the underlying substance. Varied regulatory treatment has constrained the ability of insurance companies to make long-term investments.
Expanding Blended Finance Initiatives	➢ Create a toolbox of instruments tailored to meet common financing impediments found in project finance. This requires a systematic analysis to produce a taxonomy across: a) the different risks; b) the different sources of finance (pension, insurance, Sovereign Wealth Funds), and the risk/return characteristics required for them to invest; and c) the appropriate intervention in terms of risk mitigation or credit enhancement that can crowd-in that finance, without reducing returns to a level that fails to remunerate capital.
	➢ Simplify access to risk mitigation instruments. These financial instruments should be standardised and "industrialised" to promote take up by project sponsors and financiers. We propose that a series of facilities be established at regional or global level. Such facilities might be run and part-funded by MDBs, as proposed by the World Economic Forum, but funding could also come from philanthropic organisations and national development agencies.
	➢ Construct the project pipeline to use these instruments. Institutions such as the Global Infrastructure Hub and the Global Infrastructure Facility, formed to establish best practices in project development, should help project designers use these instruments in combinations tailored to the risk profile of specific projects.
	➢ The Role of InfraAsia as a catalyst and a matching platform for projects in the region should be encouraged and used by ASEAN countries as a way of bringing projects from their sponsors to markets.

The Infrastructure Need & SDGs

Prior to the ongoing COVID-19 pandemic ASEAN is growing and growing rapidly. GDP growth had been averaging around 5% for the past few years and was expected to remain so in the next few years, with some ASEAN Member States expected to enjoy GDP growth rates in excess of 6.5%[3]. There is every reason to suspect that growth rates will rebound to similar levels once the post-pandemic economic recovery takes effect, assuming that ASEAN works collectively to ensure the best possible recovery.

The rates of development, particularly in urbanisation, have been astonishing. And this has put an enormous strain on existing infrastructure across the region, and is accelerating the need for new infrastructure: not just road, railways and airports, but water systems, sewage systems, schools, hospitals, housing, power systems etc. The need for further investments in health systems and the provision of clean water and waste management has been further highlighted by the COVID-19 pandemic.

As the region becomes more prosperous, and middle classes grow further, the demands on the region's infrastructure, and the pressures on the natural environment, will only grow further. According the ASEAN Masterplan on Connectivity 2025 (MPAC2025) there are already more than 80 Million households in a "consuming class" in the region[4]. The McKinsey Global Institute have predicted that number to increase to more than 160 million households by 2030[5] - based on 4 persons per household that amounts to more than five times the population of the United Kingdom moving into a "consuming class".

Infrastructure needs for the region will only continue to grow as ASEAN adds an estimated 40 million to its working population (aged 15 – 64)[6] and 77 million people move into cities across ASEAN between 2019 to 2030.[7]

Indeed, the ADB has estimated that the annual average infrastructure spending need in ASEAN is at least US$184bn for the period 2016-2030[8] or 5% of GDP (see Table 1 below). To put this in context, current spending across the region (excluding Singapore, Brunei and Lao PDR) is merely US$55 billion. Set against an estimate for required infrastructure spend going forward to 2030 for the same 7 ASEAN Member States (i.e. still excluding Singapore, Brunei and Lao PDR) of around US$147 billion per year through to 2030, it would appear that there is a funding gap of at least US$92 billion per year[9]. The Global Infrastructure Hub, an initiative from the G20 group of Governments

WHAT IS ASEAN'S INFRASTRUCTURE NEED?

Between

US$2.8 TRILLION

AND

US$3.1 TRILLION

from 2016 to 2030 (baseline estimate & climate adjusted estimate respectively)

This translates to

US$184 BILLION PER ANNUM

meaning a

US$92 BILLION

FUNDING GAP PER ANNUM IN ASEAN

*Source: **Understanding infrastructure opportunities in ASEAN: Infrastructure Series Report 1, PwC, 2017 after ADB 2017 Report "Meeting Asia's infrastructure needs"***

[3] See Table 1.1, p.39, OECD (2019), *Economic Outlook for Southeast Asia, China and India 2020: Rethinking Education for the Digital Era*, OECD

[4] See MPAC2025, Chapter 3, p. 29. Consuming Class is defined as a household with an annual income of more than US$7,500 (in 2005 purchasing power parity terms).

[5] Southeast Asia at a Crossroads: Three paths to prosperity. P.79, McKinsey Global Institute, November 2014

[6] United Nations, World Population Prospects 2019. https://population.un.org/wpp/

[7] United Nations, World Urbanization Prospects 2018. https://population.un.org/wup/

[8] Meeting Asia's Infrastructure Needs, ADB, 2017

[9] Understanding infrastructure opportunities in ASEAN: Infrastructure Series Report 1, PwC, 2017, after Meeting Asia's infrastructure Needs, ADB, 2017 – see p.50

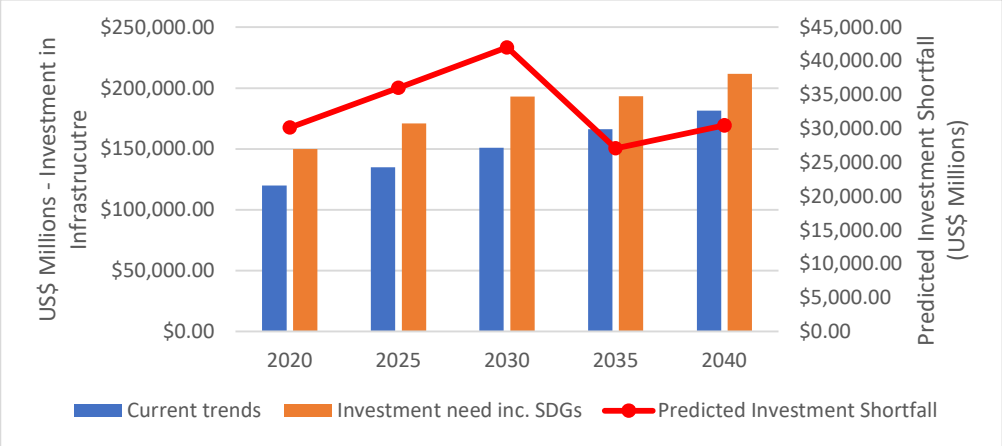
aimed at working with the public and private sectors to improve the flow of quality infrastructure projects, also estimated a significant funding gap in ASEAN between current spending trends and the amount needed to match the performance of the best performing peers, and to ensure 100% coverage for access to clean water, sanitation, and electricity as per UN Sustainable Development Guidelines (known as the "Investment Need including SDGs").

For Indonesia alone, the ADB has predicted that under its baseline scenario, the country will need to invest US$70 billion in infrastructure annually between 2016 and 2030 (or 5.5% of its projected GDP)[10]. The Global Infrastructure Outlook sets 2020 infrastructure spending by Indonesia at around US$54 billion against what it sees as an investment need of US$61 billion[11]. Overall, by 2030, the Global Infrastructure Outlook sees a short fall of US$42 billion across ASEAN between current spending trends and what needs to be spent to meet SDG goals.

Table 1: Estimated Infrastructure Investment Needs in Southeast Asia 2016-2030[12] (2015 Prices)

Projected Annual GDP Growth		5.10%
2030 UN Population Projection		723 million
2030 Projected GDP per capita (2015 US$)		7,040
Baseline Estimates	Investment Needs	US$2,759 billion
	Annual Average	US$184 billion
	Investment Needs as % of GDP	5.00%
Climate Adjusted Estimates	Investment Needs	US$3,147 billion
	Annual Average	US$210 billion
	Investment Needs as % of GDP	5.70%

Chart 1: ASEAN Infrastructure Investment Needs vs Current Trends[13]



Investment in sustainable infrastructure can help ASEAN to meet the challenge of climate change and realise the benefits of transitioning to a low carbon economy, as well as close gaps that are holding back long-term growth[14].

[10] Meeting Asia's infrastructure Needs, ADB, 2017, p.43 (all at 2015 Prices).

[11] https://outlook.gihub.org/countries/Indonesia Extracted 26/1/2020

[12] Meeting Asia's infrastructure Needs, ADB, 2017, p.xiv

[13] After Global Infrastructure Outlook using data extracted on 26 January 2020. See: https://outlook.gihub.org/ for more information. Data only includes 8 ASEAN Member States as data for Brunei and Lao PDR was not available.

[14] HSBC Report, 'FINANCING SUSTAINABLE INFRASTRUCTURE IN ASEAN' 2019

Over the next 50 years a new global urban system is being set in train. This means establishing more connected trade routes, advanced mobility, and digital connectivity in urban hubs in Southeast Asia. Infrastructure investment can enable ASEAN countries to mitigate and adapt to the challenges of climate change, transition to a lower carbon economy and promote growth. These investments can also contribute to meeting ASEAN countries' Nationally Determined Contributions under the Paris Climate Agreement.

A variety of regional and international partners are already working within the region to support sustainable infrastructure development in urban areas. The Belt and Road Initiative (BRI), as one example, is expected to pivot towards investing in urban infrastructure development in addition to its original focus on energy and transport. The World Wide Fund for Nature (WWF) has released a series of principles and recommended actions to guide future BRI investments to ensure that sustainability is fully integrated into new projects, which could be leveraged to support ASEAN's sustainable urbanisation efforts.[15] The Asian Development Bank has also set out in its Urban Operational Plan 2012-2020 an approach for urban development and investments that prioritises environmental sustainability.[16]

Closing the Infrastructure Finance Gap – Public vs Private funds

It is a fact that most countries in the World, including in Southeast Asia, have insufficient public funds available to either meet the demand for new infrastructure, or indeed in some cases to meet the requirements for upgrading or maintaining existing infrastructure to meet increased needs driven by urbanisation and increased economic activity. The ADB noted, in fact, that "in many countries, power outages restrain economic growth and underdeveloped transportation networks restrict the flow of people, goods and services within cities and between urban and rural areas. City traffic congestion alone costs huge amounts of money in lost productivity and wasted fuel and adds to human stress"[17].

Sources of funds for infrastructure are either largely from the public purse or from private sector sources. Pressure on public finances in Southeast Asia is significant and infrastructure spending is competing against other very real public policy needs. It has been estimated that in Asia as a whole government financing contributes around 90% of total expenditure on infrastructure. The global average is around 40%[18]. Clearly this points to finding alternative funding sources, especially at time where public finances have been stretched due to economic stimulus packages required following the various economic shutdowns across ASEAN.

The Public Purse

It is clear that there is insufficient money in the various exchequers around Southeast Asia to adequately and sensibly fund the requirement for more infrastructure. But that does not mean that governments should automatically seek outside support. Policy makers need to examine how much they can afford to spend on developing their national infrastructure given other spending priorities. The ADB outlined a three-stage approach for governments to first follow[19], namely:

- Examine to what degree they can increase government revenues via taxation and other revenue sources;
- Examine existing spending to see where policy priorities can be re-orientated (i.e. switch government spending from one area to support increased infrastructure investment, such as removing fuel subsidies or removing support for loss making SOEs)
- Borrowing, so long as it does not unduly increase public debt to unsustainable levels.

[15] WWF "Greening the Belt and Road Initiative", https://www.sustainablefinance.hsbc.

[16] Asian Development Bank "Urban Operational Plan 2012-2020", 2013

[17] Meeting Asia's Infrastructure Needs, ADB, 2017 -p.3

[18] Financing Sustainable Infrastructure in ASEAN, SIIA, April 2020 – p.1

[19] Meeting Asia's Infrastructure Needs, ADB, 2017, p.55

The ADB has noted that in many countries in the region there is some scope for increasing government revenues through reforms of the tax system and more vigorous tax collection. The IMF and World Bank estimated that, for the Philippines, tax reform could increase government revenues by the equivalent of 2%-3% of GDP[20]. However, such reforms will not be sufficient to plug the finance gap for infrastructure on their own, especially as not all increased revenues from such reforms would be channelled directly to infrastructure development. Competing needs will always exist. There is, therefore a clear need to look to other sources for funds. The ADB has highlighted that even if reforms were carried out by governments in ASEAN with regards to public finances, the public sector could cover less than 50% of the total investment required[21].

Multilateral Development Banks and ODA funding

In recent years there have been a number of new developments in multilateral financing institutions which are targeting infrastructure development. They are no doubt a good alternative source of infrastructure funds. Indeed, "Multilateral Development Banks have financed an estimated 10% of infrastructure needs in developing Asia (excluding China and India)"[22], and with institutions such as the Asia Infrastructure Investment Bank and the ASEAN Infrastructure Fund, as well as longer established institutions such as the World Bank and the ADB, looking to investment more, the percentage of projects supported by them looks set to increase. Another example comes from a joint initiative between the World Bank and the Government of Japan who have formed a Quality Infrastructure Initiative (QII) which three ASEAN Member States (Vietnam, the Philippines and Cambodia) have all benefited from. The QII seeks to focus on quality aspects of infrastructure including economic efficiency, safety, environmental and social sustainability and resilience against natural disasters amongst other areas[23].

However, funds from such institutions or from aid partners is not free money. The monies normally come in the form of loans – sometimes at discounted rates – which will eventually need to be repaid and which, in the meantime increase levels of public debt. Governments need to look at these debt levels, and the terms and conditions of the loans or grants, carefully to determine whether accepting such monies is truly in the long-term interest of the country.

MDB and ODA funding can play an important part in development of projects. However, as MDBs and ODAs compete to provide financing it is important that such money is focused on where there are gaps (i.e. private sector support is not feasible) and not focused on more feasible projects where use of MDBs or ODA funding would crowd out the private sector. Multilateral organisations such as the ADB could also play an important role in local capital market development beyond lending, for instance by giving a first loss guarantee to make more projects bankable.

At the same time, it will also be important that such funds are applied to well considered infrastructure projects and that ODA money is not considered a 'quick' route to develop infrastructure without the need for best practice in project selection/design.

In terms of sustainability, as was noted in a recent report from the Singapore Institute of International Affairs, "European banks, pension funds and multi-lateral development banks which tend to have more stringent Environmental and Social standards could make a difference"[24]. Utilising funds from such organisations could lead to improved adherence to sustainable practices across the entire project, though ensuring that all parties involved, including all sub-contractors, abide by such

[20] Meeting Asia's Infrastructure Needs, ADB, 2017, p.56

[21] Financing Sustainable Infrastructure in ASEAN: Seizing the Moment – Opportunity to Curb Climate Change and Promote Growth, HSBC Group Public Affairs, April 2019 – after ADB "Meeting Asia's Infrastructure Needs, 2017

[22] Meeting Asia's Infrastructure Needs, ADB, 2017, p.xi

[23] Financing Sustainable Infrastructure in ASEAN, SIIA, April 2020 – p8

[24] Ibid – p.17

standards is not easy, particularly where contracts are entered into post-financing and where local laws and regulations might not be as vigorously applied.

Private Sector Funding

Many governments in Southeast Asia see the private sector playing a key role in financing further infrastructure development in the region. There is no doubt there is a significant interest from both financial institutions, such as banks and insurance companies, and infrastructure construction and operating companies, to be more involved in the region. However, governments still need to ensure that the right conditions are in place to attract private sector support. The ADB has noted that the "…discussion on infrastructure finance highlights the huge increase required in private infrastructure financing and the critical public- sector role in helping make that happen"[25] and went on to the highlight the fact that "with the private sector estimated to invest around US$63 billion at present, expanding private finance by the required level is no doubt a major challenge"[26]. The lower than desired levels of private sector infrastructure investment is a result of many factors, such as policy decisions, lack of bankable projects, weak governance, dominance by inefficient and monopolistic state owned enterprises and a lack of transparency[27].

There is no doubt that the private sector has considerable funds available that could be invested in infrastructure projects. It has been noted by McKinsey & Company that globally, banks and institutional investors hold approximately US$120 trillion of assets under management[28]. Putting in place the conditions that would allow access to those funds is key.

> DEEPENING OF BOND MARKETS IS CRITICAL TO ATTRACT LONG-TERM INSTITUTIONAL INVESTORS... BOND FINANCING MUST ASSUME A GREATER ROLE TO COMPLEMENT BANKS. CREDIT ENHANCEMENT THROUGH BOND GUARANTEES CAN ALLOW LONG-TERM CONTRACTUAL INVESTORS LIKE PENSION AND INSURANCE FUNDS TO INVEST IN INFRASTRUCTURE BONDS
>
> Meeting Asia's Infrastructure Needs, ADB, 2017, p.xvii-p.xviii

Capital Market Development

Modern banking regulations such as the Basel III Framework discourage banks from making long-term loans or equity investments in infrastructure because mismatching of short-term deposits with long-term loans creates both risk for individual banks and systemic risk for the banking sector. In contrast, deep, liquid and efficient capital markets address this problem by promoting non-bank sources of credit for infrastructure projects. However, nine out of ten markets in ASEAN are either classified as an emerging or frontier market or not classified by MSCI due to stock market constraints.

There are a number of obstacles that limit investors' confidence to invest in companies via capital markets: Shortage of information around company operations and corporate governance to investors and public; lack of credit rating agency and of data on bonds,; and regulations which restrict bond issuances.

[25] Meeting Asia's Infrastructure Needs, ADB, 2017, p.85
[26] Meeting Asia's Infrastructure Needs, ADB, 2017, p.85
[27] Understanding infrastructure opportunities in ASEAN: Infrastructure Series Report 1, PwC, 2017, p.18
[28] Bridging Global Infrastructure Gaps, McKinsey & Company, June 2016

Capital market development, as well as bringing non-bank funds into play, will also provide alternatives to the current domination of project finance. A huge volume of funding is available in the global capital markets. The global amount of assets under management has been estimated to stand at US$120 trillion. In 2018 alone, new issuances in Asia reached more than US$2.7 trillion. It is clear that there is plenty of institutional capital available for investment in the capital markets.

Securitisation financing, through the transfer of project assets into one or more special purpose vehicles, and assignment of the revenues generated by those assets, will open up a wider range of investment possibilities than providing funding on a project-by-project basis. By transforming infrastructure investments from illiquid project finance to liquid, tradable securities, such as bonds, Sukuk, or equity, insurance companies, asset managers / mutual funds, and pension funds will be much more able to invest. Most insurers and pension funds have limited tolerance for holding illiquid private assets because these attract significant capital charges under risk-based solvency frameworks. That means it is difficult for insurers to invest a large proportion of their assets in private assets (debt or equity), whether directly or through unlisted funds. The securitisation approach also facilitates the recycling of existing assets, so that the capital invested in maturing infrastructure can be freed up for use in new projects.

Standardisation in terms of reporting, documentation and benchmarking will help to categorise projects and make rating easier. This in turn will help to develop the market for all types of investment, debt and equity, listed and unlisted. Securitisation financing will create investment vehicles with a range of size, tenor and risk profiles that make them easier for investors to assess than individual projects. This approach also helps bridge the gap between relatively short-term capital in the greenfield and construction phases, typically from banks, and long-term patient capital e.g. from insurance, pension funds and mutual funds, in the brownfield and operation stages.

It is our view that the ASEAN Markets would benefit from a greater standardisation in local currency credit pricing. The standards in Europe and the United States Markets are rising, and the gulf between these markets and the local currency ones is widening. Standardisation of documentation would help the local currency market to improve and ease the steps for borrowers who wish to tap the offshore markets[29].

To enable insurers, pension funds and mutual funds to better meet ASEAN's infrastructure funding needs, ASEAN's domestic capital markets need to be larger and provide liquidity in public and private bonds, Sukuk, asset-backed securities and stocks of state-owned and private companies. ASEAN should also consider nature-based solutions and the use of natural resources and assets when planning their infrastructure projects. It should be noted that, in general, life insurance and pension companies do not face a local currency risk, as they typically have liabilities (their promises to their customers) in the local currency. Solvency regulations need to reflect this reality, and not have a 'one-size fits all' approach based on banking regulations.

In addition to expanding the size of domestic capital markets, it is important that stocks and bond markets innovate ways to finance infrastructure. Some ASEAN markets have made or are making these innovations: Thailand has securitised and listed numerous infrastructure assets, Indonesia issued new regulations in July 2017 for pooled infrastructure funds (DINFRAs), and the Philippines' Ayala Land Inc. has filed the country's first REIT in February 2020. These innovations, as well as regulatory clarification to ensure domestic long-term institutional asset owners like insurance and pension funds can invest in these vehicles, will be important next steps. Removing tax disincentives such as investor tax and lender tax for both domestic and non-resident investors will also encourage participation and channel funds towards sustainable infrastructure finance.

[29] See: "Mind the Gap", HSBC policy paper, October 2017

Furthermore, we propose creating a **regional capital market hub** that can build critical mass behind a new infrastructure asset class. Such hubs would act as a magnet for institutional investors, build liquidity and lead to better pricing. This is something that HSBC has also recommended[30] and the recent report by the SIIA highlights the role that Singapore has been playing in supporting financing of infrastructure across Southeast Asia, including through the establishment of Infrastructure Asia.

Recommendations:

- Standardisation in terms of reporting, documentation and benchmarking will help to develop the market. Greater urgency to improve investment conditions and the offering of non-discriminatory regulatory regimes that encourage greater participation by insurers in long-term investments.
- Encouraging consistency in treatment of projects through international/local rating agencies.
- Creation of a regional capital market hub that can build critical mass behind a new infrastructure asset class. Such hubs would act as a magnet for institutional investors, build liquidity and lead to better pricing.
- Grow domestic capital markets and the domestic long-term investment sectors (insurance, pension funds, mutual funds) through encouraging asset securitization, promoting product innovation, regulatory clarity on investment restrictions and removing tax disincentives
- As market investors are looking at what makes a financial market investable from an operational perspective, the level of standardisation and automation remains a key differentiator factor in ASEAN. Achieving international standards with ISO 20022 and harmonisation of market practices across territories will improve the quality, the richness and the timely exchange of data and will increase efficiency in the classic reconciliation, reporting, settlement and asset servicing processes. Having a single platform access across markets and the ability to easily interconnect with local platforms and vendors enhances direct presence and reach in local markets for the global players.

Regulatory Framework to Facilitate Financial Innovation and Risk Transfers

Insurance companies and pension funds play an important role not only as capital providers but also in increasing societal resilience to major events and act as a financial shock absorber for unforeseen losses for individuals and institutions alike. For instance, insurance has a positive effect on macroeconomic growth after a natural catastrophe and creates incentives for risk mitigation before a natural catastrophe strikes. A study by the Bank of International Settlements analysed the extent to which risk transfer to insurance markets facilitates economic recovery after a natural catastrophe. The study underscored the role that insurance plays in financing reconstruction efforts and recognised the positive contribution of insurance arrangements to disaster management prior to the catastrophe.[31]

Insurers can provide unique insights for policymakers into the value of preventive investments in certain types of natural catastrophes. Insurers have also built global databases to capture information on data losses. Due to its expertise in natural catastrophe modelling and the ability to incentivise preparedness for a natural catastrophe, insurance solves the moral hazard problem and reduces the need to rely on public funds in disaster situations (and consequently reduces stresses of fiscal positions). As a result, both governments and homeowners benefit from lower costs and reduced damage in a post natural catastrophe environment.

[30] See: "Mind the Gap", HSBC policy paper, October 2017

[31] BIS ,Unmitigated disasters? New evidence on the macroeconomic cost of natural catastrophes

While (re)insurers should be responsible for offering efficient natural catastrophe solutions, governments should play an important role in taking action to prevent and mitigate climate risk and establish appropriate market frameworks (incl. incentives) for asset owners. The public sector, for example, should ensure that new buildings/infrastructure reflect building codes and best practices. There is also a need to develop risk zoning maps, build appropriate defences, and provide effective emergency responses. Risk prevention measures are crucial in ensuring that risk can be insured. However, some governments have focused purely on prevention and mitigation efforts and have not focused sufficiently on financial resilience, such as access to insurance. Since no country can fully protect itself against extreme natural disasters, there is a need for both risk prevention and risk transfer. Each reinforces the other.

Lastly, given the speed of technological developments in the industry, regulators and policymakers will have a huge influence over whether the industry is able to develop new products and services that are relevant to customers' evolving needs in the face of technological change. Technology opens up new opportunities for "parametric" insurance products where claims pay-outs are not determined based on manual assessments of resulting damage, but on the occurrence of predefined triggers, usually based on data, such as for example drought insurance where the pay-out is linked to measures of lack of rainfall. Currently, in many markets across the region, parametric products are not recognised by the national Codes of Insurance, and therefore, such solutions cannot be offered as insurance to consumers in these markets. Such products could eliminate all complexity of a loss investigation process and can give customers the confidence when it comes to liquidity and speed of payout in emergence situations. There is a need for action by regulators and policymakers to ensure that such innovation solutions could be offered to consumers in ASEAN.

Regulatory treatment of Term

We have highlighted the need to increase the role of insurance companies and pension funds in providing long-term investment, as public funding, bank finance and current capital market capacity cannot meet ASEAN's infrastructure financing needs. In the insurance sector, a holistic approach to the asset class of infrastructure projects does not really exist. Varied regulatory treatment and the lack of a holistic approach have constrained the ability of insurance companies to make long-term investments in these projects. **The EU-ABC seeks greater urgency to improve investment conditions and the offering of non-discriminatory regulatory regimes that encourage greater participation by insurers in long-term investments.** Current regulatory treatment of infrastructure investment is largely based on asset class, focusing on limitations/prohibitions on the instrument for investment instead of the overall risk profile of the underlying substance. Varied regulatory treatment has constrained the ability of insurance companies to make long-term investments.

Currently capital charges focus on the instrument of investment, which can impose very high capital standards on long-term assets. This can be as high as 50% for unlisted equities and exceeding 20% for unrated bonds and loans, which makes investing in long-term assets costly for insurance companies. This is inappropriate as insurance companies, unlike banks, do not engage in maturity transformation – investing short-term deposits in longer term assets. Life insurance policies are typically long-term instruments, and so the companies tend to hold bonds to maturity to match their liabilities.

Public and Multilateral Action to Expand Blended Finance

The best ways to increase attractive investment options are either to create them yourself by issuing in green format, or to use public funds to reduce project risk – so-called 'blended finance' – and 'crowd in' private investors.

The EU-ABC would like to see more initiatives to expand blended finance to support sustainable infrastructure development in ASEAN. At present, a key barrier for financing sustainable infrastructure projects is the lack of opportunities that are defined as investment grade by credit rating agencies, not the lack of projects themselves. **Sovereign wealth funds and development institutions**

could do more to attract private finance by absorbing some of the risks beyond the appetite of private investors

Pension funds, asset managers, insurance companies and Sovereign Wealth Funds are seeking yield in new investment opportunities, and they can be key actors in financing ASEAN's infrastructure needs, but the level of risks involved in many projects mean that such sources of potential funding remain untapped or under-utilised. A system of blended finance, which will involve the sharing of key risks between the public and private sectors, will help to unlock more funds for sustainable infrastructure projects. Whilst there have been some examples of this in ASEAN, a more standardised approach to the issue would help to increase availability and scale.

The EU-ABC suggests that ASEAN collectively works with the private sector and development banks to develop an ASEAN Blended Finance Toolbox to help standardise instruments that address common risks associated with sustainable infrastructure projects and meet the investment requirements of different sources of financing[32]. A positive example of this is in Indonesia, which created a Viability Gap Fund (VGF) . Through the VGF, the government would partially contribute towards construction costs in cash to PPP projects that are economically feasible, but not yet financially feasible[33]. Furthermore, the region should also work with various actors in this area to introduce a blended finance approach to structured finance in order to crowd in a wider class of investors looking for long term returns, and establish ASEAN focused facilities and programmes for blending, including capacity to carry out the financial engineering successfully.

Recommendations

Ensuring these risks are picked up may require provision of guarantees or credit enhancement facilities. According to HSBC[34], and others, the key question for policy makers is how to bring scale and a degree of simplification to what are often complex, and bespoke transactions. In our view this requires three things:

- First, create a toolbox of instruments tailored to meet common financing impediments found in project finance. This requires a systematic analysis to produce a taxonomy across: a) the different risks outlined above; b) the different sources of finance (pension, insurance, Sovereign Wealth Funds), and the risk/return characteristics required for them to invest; and c) the appropriate intervention in terms of risk mitigation or credit enhancement that can crowd-in that finance, without reducing returns to a level that fails to remunerate capital.

- Second, simplify access to risk mitigation instruments. These financial instruments should be standardised and "industrialised" to promote take up by project sponsors and financiers. We propose that a series of facilities be established at regional or global level. Such facilities might be run and part-funded by MDBs, as proposed by the World Economic Forum[35]. But funding could also come from philanthropic organisations and national development agencies.

- Third, construct the project pipeline to use these instruments. Institutions such as the Global Infrastructure Hub and the Global Infrastructure Facility, formed to establish best

[32] HSBC Report, 'FINANCING SUSTAINABLE INFRASTRUCTURE IN ASEAN' 2019

[33] Financing Sustainable Infrastructure in ASEAN, SIIA, April 2020 – p.11

[34] See: "Mind the Gap", HSBC policy paper, October 2017

[35] WEF report on "Risk Mitigation Instruments: Infrastructure Gap Assessment" (July 2016) concluded that a significant scale-up in the use of risks mitigation tools would require, the establishment of a global or regional risk mitigation facility with or without direct participation of the MDBs, offering a standardised set of products. Such a facility would have the potential to strengthen local capital markets if applied to local currency bond financing.

practice in project development, should help project designers use these instruments in combinations tailored to the risk profile of specific projects.

- Fourth, develop alternatives to project finance, in particular making better use of the capital markets to raise funds for infrastructure build.

- The Role of InfraAsia as a catalyst and a matching platform for projects in the region should be encouraged and used by ASEAN countries as a way of bringing projects from their sponsors to markets

> AN ENABLING ENVIRONMENT THAT DELIVERS WELL-PREPARED, VIABLE PROPOSALS FOR PRIVATE INVESTMENT IS CRITICAL FOR PPPS
>
> Meeting Asia's Infrastructure Needs, ADB, 2017, p.xvii

Public sector finance alone cannot be sufficient to finance infrastructure development. With the above successful examples as guide, multilateral bodies and governments need to create more capacity and facilities, specialist capabilities supported by clear rules for public/private collaboration, including common dispute resolution, to reward "crowding in" of private finance and promote the best use of resources.

Public-Private Partnerships

Public-Private Partnerships (PPPs) undoubtedly have a significant role to play in helping ASEAN finance more infrastructure development. All 10 of the ASEAN Member States have been, or are intending to, developing frameworks to allow for more PPP projects. Indeed, ASEAN has developed a framework for PPP projects[36] which provides some general guidance to ensure successful project structures for PPP projects. Some countries in the region, notably the Philippines, have established PPP offices and a growing tradition of PPP infrastructure projects.

PPPs can play a pivotal role in financing infrastructure projects, especially when compared to traditional capital investments from the government. This is because in PPP projects financial and operational risks can be more effectively allocated to the private sector, who tend to be able to manage such risks more efficiently. Furthermore, PPPs also allow governments to tap on the innovative ability and managerial talent in the private sector as well as free up public resources, in turn allowing them to invest available resources in other infrastructure projects or other areas of society and economy[37].

PPP projects can be complex and difficult to structure and procure as potential investors and operators will require certain assurances and guarantees over areas such as public policy, changes to rules and regulations, contract length, usage rates and charging levels etc. to be sure of the viability of the project. Governments, therefore, will need to consider carefully whether the provision of such assurances and guarantees is in their long-term interest, especially if they are seen as a precedent setting for other projects. However, PPPs should represent a "win-win" scenario for all stakeholders involved – the government, the private sector funders and operators, and the general public. To achieve this, a general principle for arriving at the best available structure is to apportion the risks to the stakeholders best able to handle them. In order to do so, the nature of inherent project risks in the first place must be identified[38].

[36] See: http://www.asean.org/storage/images/pdf/2014_upload/Attachment-ASEAN%20%20PPP%20Principles.pdf
[37] Understanding infrastructure opportunities in ASEAN: Infrastructure Series Report 1, PwC, 2017, p.32
[38] http://www.eria.org/PPP_in_General_ERIAsummary_2015.pdf

Currently, the pipeline of approved investment-ready projects is in short supply to bridge the infrastructure gap. **Projects can be prioritised, with the projects that can be designed to be investible with only private funding accelerated.**

Green Bonds

Green Bonds are playing an increasingly important role in sustainable financing initiatives across ASEAN and are usually issued to raise finance for climate change solutions. Indeed, according to a report by DBS and UNEP, it is estimated that green finance opportunities in the infrastructure sector in the region could amount to around US$1.8 trillion between 2016 and 2030[39]. To meet the Paris commitments on climate change, private finance needs to be mobilised at scale and at speed. There is a shortage of sustainable assets for issuers and investors. Green loans and green and sustainable bonds can help bridge this gap. The launch of the ASEAN Green Bond Standards in November 2017 by the ASEAN Capital Markets Forum; and the ASEAN Social Bond Standards and ASEAN Sustainability Bond Standards in October 2018, together created a common framework to promote the growth of a new green asset class while enhancing transparency, consistency and uniformity of new issuance.

However, more needs to be done to build strong green financing capabilities, capacity and ecosystems to support ASEAN low-carbon transition. Barriers continue to exist, particularly in the area of potential lenders having sufficient capacity or expertise to ensure that relevant ESG standards are being met or will be met. Also, there are variations in the definitions used to assess "greenness" of projects.

A Pipeline of Bankable Projects? Projects Under The Masterplan On Asean Connectivity

ASEAN has conducted a review of various projects that were originally listed in the Masterplan on ASEAN Connectivity 2010 or in Member States' own infrastructure lists connected to ASEAN connectivity. That review was undertaken by ASEAN with assistance from the World Bank and Australian Aid[40]. An initial review of projects produced a list of 40 projects that might be "bankable". However, a second stage review reduced the list to only 8 projects that were seen as being deliverable and which met the needs of ASEAN Connectivity. ASEAN has since developed a longer list of "priority projects", which totals 19 in number, of which only 9 are now listed as being truly viable for PPP or private sector funding support. The 19 priority projects are:

Table 5: 19 Priority Projects under the Masterplan for ASEAN Connectivity

Project Name	Sector	Country
Jalan Rasau Upgrading	Road	Brunei Darussalam
Siem Reap to Ratanakiri Road Upgrading	Road	Cambodia
Kuala Tanjung International Hub Port and Industrial Estates Phase II	Port	Indonesia
Expansion of Hang Nadim International Airport	Airport	Indonesia
Development of Kijing Port	Port	Indonesia
Lao PDR National Road No.2 Upgrading	Road	Lao PDR
Lao PDR National Road No.8 Upgrading	Road	Lao PDR
Lao PDR-Viet Nam Power Interconnector	Power	Lao PDR
Lao PDR-Myanmar Power Interconnector (Lao PDR Section)	Power	Lao PDR
Myanmar-Lao PDR Power Interconnector (Myanmar Section)	Power	Myanmar
Nay Pyi Taw – Kyaukpyu Expressway	Road	Myanmar
Muse – Tigyaing – Mandalay Expressway	Road	Myanmar

[39] Lee, Chui Fong and Baral, Prajwal (2017) "Green finance opportunities in ASEAN", November 2017, See: https://www.dbs.com/iwov-resources/images/sustainability/img/Green_Finance_Opportunities_in_ASEAN.pdf

[40] See http://asean.org/storage/2016/09/Project-Briefs-for-Selected-PPP-Projects.pdf for the full report.

Yangon – Mandalay Expressway	Road	Myanmar
Tarlay – Kyainglat Road Upgrading	Road	Myanmar
ASEAN Digital Hub	ICT	Thailand
Hay Yai – Sadao Motorway	Road	Thailand
Bangkok – Nong Khai HSR – Phase II	Rail	Thailand
Southern Coastal Corridor Project – Phase II	Road	Viet Nam
Ho Chi Minh City – Moc Bai Expressway	Road	Viet Nam

One of the biggest issues facing ASEAN is not so much the lack of funds to support infrastructure investment, but the lack of suitable projects that could attract funding from a variety of private sector sources.

About the EU-ASEAN Business Council

The EU-ASEAN Business Council (EU-ABC) is the primary voice for European business within the ASEAN region. It is formally recognised by the European Commission and accredited under Annex 2 of the ASEAN Charter as an entity associated with ASEAN.

Independent of both bodies, the Council has been established to help promote the interests of European businesses operating within ASEAN and to advocate for changes in policies and regulations which would help promote trade and investment between Europe and the ASEAN region. As such, the Council works on a sectorial and cross-industry basis to help improve the investment and trading conditions for European businesses in the ASEAN region through influencing policy and decision makers throughout the region and in the EU, as well as acting as a platform for the exchange of information and ideas amongst its members and regional players within the ASEAN region.

The EU-ABC conducts its activities through a series of advocacy groups focused on particular industry sectors and cross-industry issues. These groups, usually chaired by a multi-national corporation, draw on the views of the entire membership of the EU-ABC as well as the relevant committees from our European Chamber of Commerce membership, allowing the EU-ABC to reflect the views and concerns of European business in general. Groups cover, amongst other areas, Insurance, Automotive, Agri-Food & FMCG, IPR & Illicit Trade, Market Access & Non-Tariff Barriers to Trade, Customs & Trade Facilitation and Pharmaceuticals.

Executive Board

The EU-ABC is overseen by an elected Executive Board consisting of corporate leaders representing a range of important industry sectors and representatives of the European Chambers of Commerce in South East Asia.

Membership

The EU-ABC's membership consists of large European Multi-National Corporations and the nine European Chambers of Commerce from around South East Asia. As such, the EU-ABC represents a diverse range of European industries cutting across almost every commercial sphere from car manufacturing through to financial services and including Fast Moving Consumer Goods and high-end electronics and communications. Our members all have a common interest in enhancing trade, commerce and investment between Europe and ASEAN.

To find out more about the benefits of Membership and how to join the EU-ASEAN Business Council please either visit www.eu-asean.eu or write to info@eu-asean.eu .

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