

Financial Services and Sustainability Practices

Can Vietnamese banks seize the green-bond opportunity?

The market for financing climate-related projects through green bonds is surging, but Vietnamese banks need to act quickly to reap the rewards.

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Green bonds represent the largest segment of the sustainable finance market: global issuance of green bonds reached about \$620 billion in 2021, double that of the previous year, and the market has grown at a compound annual rate of about 60 percent for the past five years (Exhibit 1). The Institute of International Finance forecasts that by 2025, annual issuance could be as high as \$1.2 trillion.

Southeast Asia has been an active part of this growth, with banks in Indonesia, Malaysia, and Thailand collectively issuing more than \$43 billion in green bonds in the past five years. Yet Vietnam seems to be an exception to this trend: its banks have issued only \$216 million in green bonds in the past five years, despite environmental, social, and governance (ESG) projects seeking financing and investors looking for opportunities (see sidebar, “What makes a bond green?”).

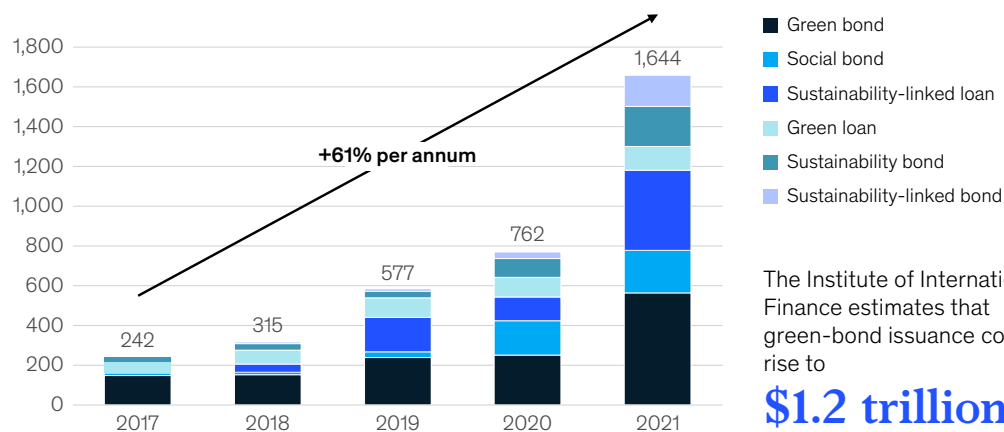
We estimate Vietnam’s financial institutions could earn about \$1.7 billion in revenue by 2025 from issuing bonds to finance ESG projects—with \$1.5 billion coming from transition finance and green bonds, funding the shift from carbon-intensive to green industries. So what obstacles remain between Vietnamese banks and this prize? And how can banks move past them?

With renewed urgency and improved regulatory guidance, Vietnam’s banks can catch up to peers in the region. We know from regional examples that banks acting early have led their local ESG finance markets, which means those that do not act could soon be left behind. In this article, we detail four preconditions that can enable Vietnamese banks to make the shift toward green bonds, as well as six core areas of their business that Vietnamese banks may need to address.

Exhibit 1

Green bonds make up the largest share of sustainable financing, and sustainability-linked loans and bonds share the strongest momentum.

Growth in sustainable instruments, \$ billions



The Institute of International Finance estimates that green-bond issuance could rise to **\$1.2 trillion** annually by 2025, about twice the value issued in 2021.

Source: Institute of International Finance

Driving Vietnam's development of the green-bond market

Our observation is that four preconditions lead to the growth of green-bond markets: demand for the financing of projects with environmental benefits, such as renewable-energy and green infrastructure projects; ensuring ESG finance products benefit banks and investors; building a legal framework; and banks responding to the first three points proactively to creatively establish a market. While the first three preconditions already exist to a certain extent in Vietnam, banks have not yet fully created the capabilities to participate in the green-bond market.

1. Demand for financing of projects with environmental benefits

Governments, organizations, and individuals are increasingly prioritizing sustainability, spurred on by severe global weather events and the narrowing opportunity to limit the increase in global temperatures. This, in turn, fuels demand from borrowers seeking ESG and renewables finance to fund their projects. In a separate report, we estimated that a significant increase in capital

expenditure on physical assets, in part through project financing, is required to reach net zero worldwide by 2050.¹

In Vietnam, project finance has grown year over year, from around \$3 billion in 2018 to \$38 billion in 2021, spanning energy, transport, telecommunications, and water projects (Exhibit 2). Demand for the financing of renewable-energy projects has led this growth, which totaled more than \$10 billion annually from 2018 to 2020 and \$21 billion in 2021. Offshore wind is the largest segment driving demand in this area, with photovoltaic solar also a large contributor.²

Based on market momentum and the renewables targets set in the latest draft of Vietnam's Power Development Plan, demand for financing these projects should continue to grow exponentially. Furthermore, at the 2021 UN Climate Change Conference (COP26), the Vietnamese government pledged to reach net-zero CO₂ emissions by 2050, and its targets for renewable-energy-generation capacity have grown consistently. Wind and solar assets will be commissioned to meet these targets—

¹ *The net-zero transition: What it would cost, what it could bring*, McKinsey Global Institute, January 2022.

² IJGlobal Project Finance Deals.

What makes a bond green?

Green bonds are defined as adhering to the Green Bond Principles from the International Capital Market Association. These principles offer guidelines along four key points:

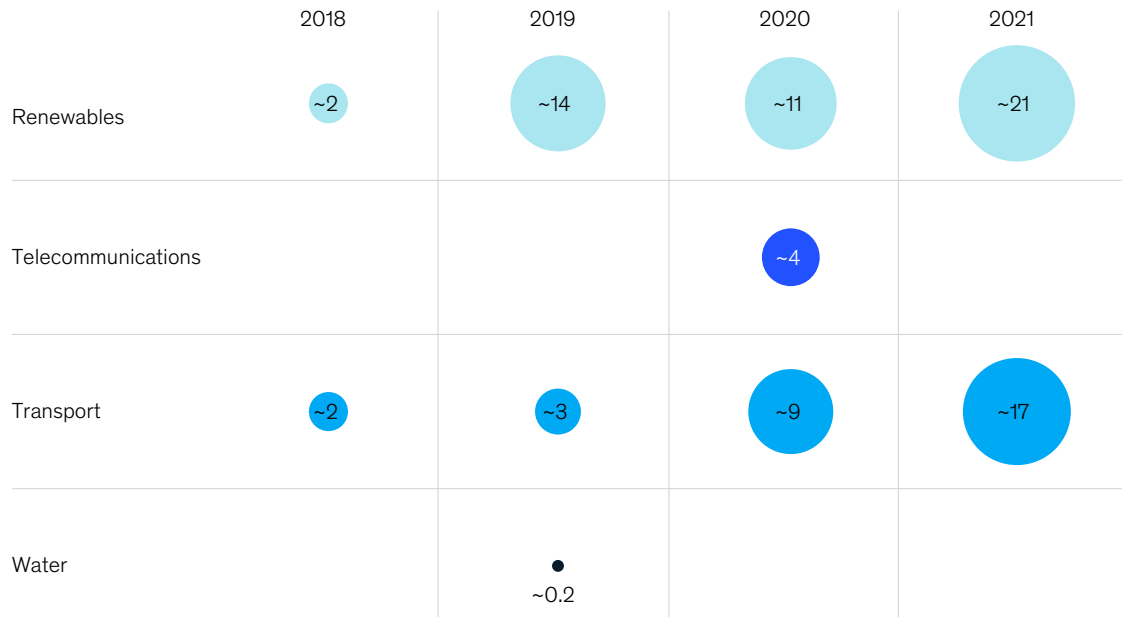
1. Proceeds from the bonds must go to green project categories, and the issuer must explain the environmental benefits.
2. The issuer must share their decision-making process to decide if an investment is eligible for green certification.
3. Proceeds must be included in a subportfolio.
4. Reporting on the investments must occur at least annually.

The ASEAN Capital Markets Forum also established ASEAN green-bonds standards in 2017, announcing the Association of Southeast Asian Nations (ASEAN) will take other widely used green-bond taxonomies into consideration.

Exhibit 2

Renewables finance has been the largest component of project finance in Vietnam in recent years.

Project finance in Vietnam by category, \$ billions



Source: IJGlobal

and these projects will need to be funded, creating more opportunity for a green-financing market to develop.

2. Benefits of ESG finance products for banks and investors

Banks and investors need to be confident they will not lose out by creating and investing in these products. First, banks will not lose fee income because they choose to issue green bonds—in fact, green bonds enjoy a slight premium (a “greenium”) compared with their conventional equivalents because of their “green” nature.³ Research also suggests green bonds slightly outperform their conventional peers (for both municipal and corporate bonds).⁴ This bullishness is worth caveating, however, by noting market volatility and investor sentiment affect the greenium. For instance,

fund managers have warned that the war in Ukraine may reduce ESG-linked products’ outperformance. The quantity and cost of the resources deployed can also affect returns to the banks themselves. However, there remains a nonfinancial reputational benefit: banks offer green bonds because customers want to use the proceeds for green projects.

We estimate Vietnam’s banks could realize a total of \$1.7 billion in revenue from ESG financing by 2025, with around 90 percent coming from transition finance and green bonds (Exhibit 3). This pool includes revenue from green-project financing (such as funding renewable-energy projects) and environmentally linked loans, with the balance largely concentrated across ESG-linked capital markets, M&A, and trade finance.

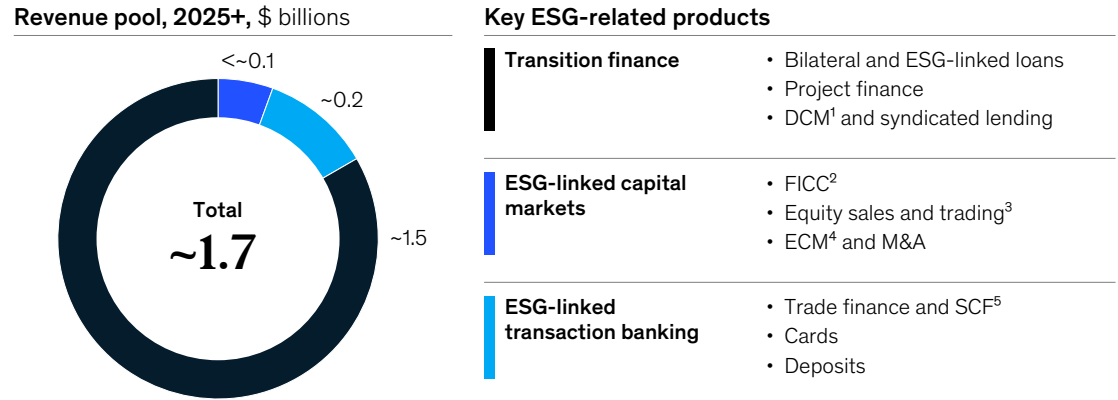
³ Julio Suarez, “Q4 2021 and 2021 Full Year ESG Finance Report: European Sustainable Finance,” AFME, February 23, 2022.

⁴ Yevheniia Antoniuk and Thomas Leirvik, “Climate Transition Risk and the Impact on Green Bonds,” *Journal of Risk and Financial Management*, Volume 14, Number 12, December 10, 2021.

Exhibit 3

Vietnamese banks have a sizable revenue opportunity related to environmental, social, and governance matters.

Annual Vietnamese banking revenues related to environmental, social, and governance (ESG) opportunities



Note: Figures may not sum, because of rounding.
¹Debt capital markets.
²Fixed income clearing corporation; includes climate-related derivatives.
³Includes prime brokerage.
⁴Equity capital market.
⁵Supply chain finance.
 Source: Dealogic; McKinsey Global Banking Pool

But the timing of this opportunity must be somewhat nuanced. In another Southeast Asian market, sustainable finance grew rapidly in the first years of the market as investors rushed to claim the most lucrative, easiest opportunities. That growth is now expected to slow because the opportunities that remain are more complicated to implement. Vietnam’s sustainable-finance market may follow a similar pattern: explosive early growth while easy opportunities are available, followed by a more gradual scale-up as opportunities grow in complexity. Regardless of the precise market timing, we expect this market to develop.

3. Building a legal framework

In 2015, Vietnam’s government tasked the state bank with furthering green financing tools, passed supportive green finance regulation, and in 2018 declared all banks must take internal steps to consider environmental risk by 2025.⁵ For example, the Green Financial Policy Framework tasked the Ministry of Finance with creating incentives for green capital. Most recently, in its National Strategy

for Climate Change,⁶ the Vietnamese government urged the review of “policies to create favorable conditions to attract investment capital flows to respond to climate change.” The objective of this review is to “attract ... green financial flows of financial institutions.”

It is not recommended banks do this single-handedly. Instead, having several institutions or industry players collaboratively create this market helps drive market momentum. Banks will need to create a dialogue with regulators to identify where additional regulatory guidance may be useful. They can begin to do this by issuing green financial products to see where regulations are sufficient and where they could be clearer (Exhibit 4).

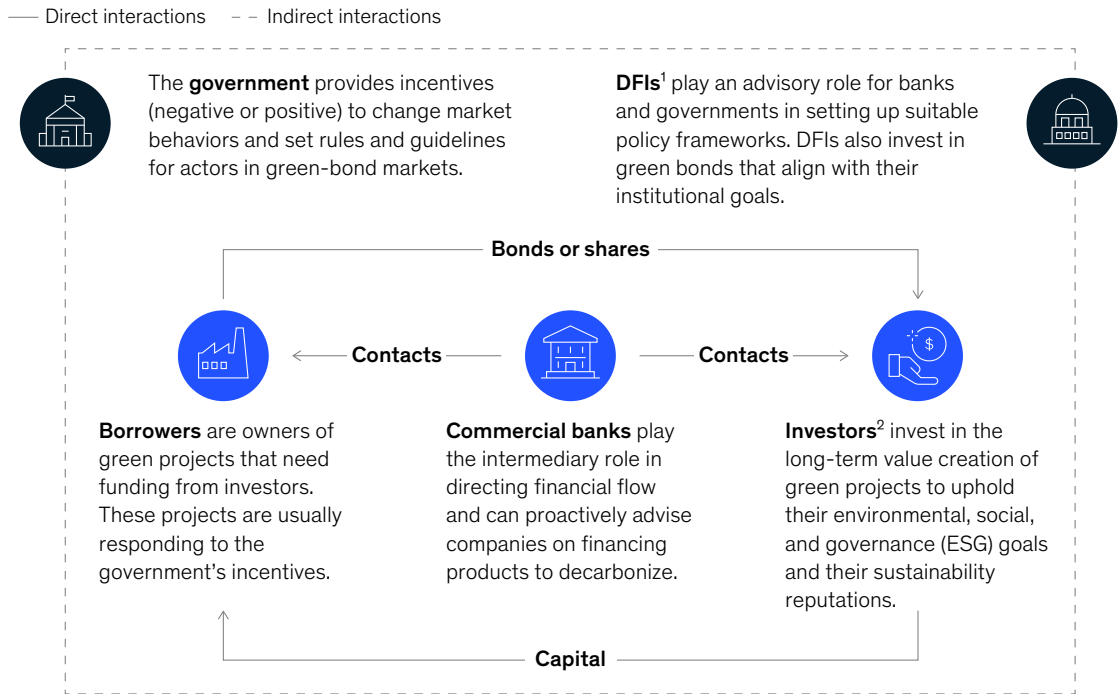
4. Creating the green-bond market

Borrowers and investors are hoping to leverage green financing—or are, at least, increasingly attracted to it. Yet local Vietnamese commercial banks are only in the early stages of developing green-bond products and projects. Vietnam-

⁵ “On promoting green credit growth and environmental-social risks management in credit granting activities,” State Bank of Vietnam, March 24, 2015; “National Green Growth Strategy for 2021–2030, vision towards 2050,” Socialist Republic of Vietnam, October 19, 2021.
⁶ “Decision No: 896/QĐ-TTg,” National Strategy for Climate Change, July 26, 2022.

Exhibit 4

Vietnamese institutions interact to form a green-bond market.



¹ Development finance institutions.
² Including institutional investors, sustainable development goals (SDG) funds, private foundations, high-net-worth individuals, and development agencies.
 Source: McKinsey analysis

based banks now have an opportunity to take full ownership of their role. Today, the number of green financial instruments and the level of sophistication is low; a recent survey suggests 40 percent of Vietnamese banks had no green investment projects in their portfolio.⁷ Yet it is still possible to move quickly to grasp this opportunity.

In Indonesia, for example, the Financial Services Authority issued regulations for the issuance and terms of green bonds in 2017 and 2018.⁸ There was sufficient demand within the market for green financial products, which prompted banks to act. With the help of the International Finance Corporation (IFC), within months, Bank OCBC NISP became the country's first commercial bank to issue green bonds.⁹ IFC provided know-how and the proper funding to help OCBC NISP make the first move.¹⁰ This helped kick-start the local market.

Indonesia's top eight banks in 2018 launched the Indonesia Sustainable Finance Initiative¹¹; Citibank, HSBC, Dubai Islamic Bank, and Standard Chartered then issued green bonds; and by 2021, half of the banking industry had pledged to boost funding for green projects. Members of the early-movers group now make up four of the five market leaders in green bonds in Indonesia.

Taking action: Next steps for Vietnamese banks

Vietnamese banks have a chance to take a decisive position in the green-bond market. It requires they not only clearly define their level of ambition but also address the areas of their business that will establish them as market leaders. Depending on their level of ambition, the country's banks can behave in one of three ways:

⁷ *Potential of Green Bond in Viet Nam*, Global Green Growth Institute (GGGI), September 2020.
⁸ "Roadmap for Sustainable Finance in Indonesia," OJK Financial Services Authority, December 2014.
⁹ "IFC Invests in Bank OCBC NISP for Pioneering Green Bond," International Finance Corporation, August 1, 2018.
¹⁰ Sarah Yuniarni, "IFC Invests \$150m in Bank OCBC NISP's Green Bond," *Jakarta Globe*, August 1, 2018.
¹¹ "Successful Launch Of 'Indonesia Sustainable Finance Initiative,'" Emerging Markets Sustainability Dialogues, June 5, 2018.

- *Follow the trend after the fact* by setting up the capabilities to operate and meet minimum mandatory regulatory requirements. This minimum-viable-engagement approach maintains regulatory compliance but otherwise does not win much of the available market.
- *Play in the market* by proactively adopting new standards and leading practices on climate risk. Banks can develop specific products and services based on their clients' green-financing needs, setting substantive business targets for green products.
- *Lead in the market* instead of following peers and looking to win a large proportion of the market opportunity for transition finance and green bonds. This requires proactively reallocating capital guided by science-based environmental targets, sizing the potential of specific markets and business opportunities in focused sectors (for instance, renewable developments, green manufacturing assets, and electric-vehicle infrastructure), and providing dedicated products and support to customers within those markets.

Irrespective of the path chosen, Vietnamese banks can learn from a recent example of how a bank in a mature European market addressed six areas of its business to seize the ESG banking opportunity in its home country. For any bank seeking to achieve best practices and become a market leader in ESG financing, all these actions will need to be addressed. To start, banks in Vietnam can consider the first few actions as initial steps:

1. Consider all the potential ESG business opportunities, from transition financing to corporate ESG products. A bank must decide which specific green-banking offers will be most relevant for its clients.
2. Realign portfolios to hit specific emissions reduction targets while also measuring their levels of financed emissions.
3. Review overall risk management processes, including risk identification, materiality assessments, and stress testing.
4. Revise the credit operating model and especially the credit risk management approach, including scoring banks' counterparties on their climate risk.
5. Highlight the bank's green commitment through new types of disclosures and business reporting, such as incorporating Task Force on Climate-Related Financial Disclosures (TCFD) recommendations around the release of climate-related financial information.
6. Underpin the changes with data foundations and systems, such as credit scoring models. These may require either external data providers for ESG dimensions or an internal data source. There are additional adjustments—from training staff in new tools and products to anchoring the board to new sustainable goals and undertaking external branding—but these can be considered enablers rather than core shifts to the business.

Vietnamese banks have a chance to take a decisive position in the green-bond market.

Some pioneering Vietnamese banks have already taken early steps. From 2018 to 2021, one large bank's green-credit business grew by more than 60 percent as the bank integrated environmental and social risk considerations into its credit approval system. At the same time, it began to issue a sustainable development report as part of its standard annual report. It is now planning to issue green bonds and is building processes and frameworks to support this goal. Another Vietnamese bank has invested in internal capability building, training staff across multiple segments of

its business on market fluency around renewable energy, specifically wind and solar power, so staff can issue products related to those markets.

Financing the planet's transition to net zero is creating a booming financing opportunity for banks worldwide, and Southeast Asia is no exception. With demand only expected to grow, Vietnamese banks can participate in the climate transition and choose to claim a share of the market—or risk being left behind.

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