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February 2016	**April 2015**	**February 2015**	**September 2014**
USD 500,000,000 2.125% 144A/Reg S Bonds due 2021	USD 1,000,000,000 2.000% 144A/Reg S Bonds due 2022	USD 1,000,000,000 2.375% 144A/Reg S Bonds due 2025	EUR 1,000,000,000 0.875% Reg S Bonds due 2021

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Japanese corporations join the bond party

Japanese issuers are tapping the international bond market in droves, pushing volumes to a record in 2017. The market is set to get a further boost this year, as more corporations enter the fray. **Rashmi Kumar** reports.

MIZUHO FINANCIAL Group, Mitsubishi-UFJ Financial Group and Sumitomo Mitsui Financial Group. In addition to being Japan's three megabanks, something else links these huge institutions together — they were the most prolific issuers of international bonds last year.

Of the total $122bn raised in the international public bond market by Japanese issuers during the year ending March 31, 2018, about $49bn was by Japanese FIG credits. Their dominance is unlikely to wane, with ratings agency Fitch predicting that Japan's megabanks could issue as much as $50bn in securities eligible as total loss-absorbing capital by the year ending March 2019.

But investors are slowly getting more variety — thanks to corporate borrowers. DCM bankers in Japan point to AA- rated car maker Toyota Industries Corp which debuted in the dollar bond market in March with a $1bn dual-tranche issue.

"This was pretty significant, as it was a debut issue for a company that has a 90-plus-year history but is using the international debt market for the first time," says a DCM banker in Tokyo. "Not only that, we have been in discussions with multiple corporate issuers who are looking at dollars in the coming year or two."

One key reason for the rising interest from corporations for international bonds is the attractive funding cost as the bank loan market gets more expensive.

According to a senior DCM banker at Morgan Stanley in Tokyo, the relationship between Japanese banks and Japanese corporations has long been primarily based on bank borrowings rather than international capital markets.

"Historically, corporate clients have been dependent on bank borrowings to raise money," he says. "But the more the banks raise funds internationally, the more spreads go wider for bank borrowing.

"For corporates which are highly rated IG clients, it makes sense for them to raise funding independently from capital markets, so they will become less dependent on bank borrowings to diversify their funding sources."

But funding choice is not the only reason corporations are venturing to the international debt market.

Expansion boom

The need to go global is also playing a big role. Bankers say companies are busy expanding internationally, and so need dollars to pay for their M&A plans. Such firms typically keep the bond proceeds in US dollars, but if the trade is unrelated to offshore expansion, many swap the funds into yen to take advantage of arbitrage opportunities.

"Japanese credits are very stable"

Ryota Suzuki, Bank of America Merrill Lynch

Bankers point to transactions from the likes of SoftBank Group Corp, a holding company with operations in mobile and fixed line telecommunications, broadband, internet and other businesses, which raised $4.5bn from a dual-tranche bond in July 2017, following it up with a $6bn-equivalent dollar/euro combo bond.

Asahi Group Holdings, meanwhile, nabbed €1.2bn from a dual-tranche trade in September 2017. Asahi's bond proceeds were earmarked for repaying short-term loans raised for the acquisition of beer businesses in central and eastern Europe.

Despite the pick-up in action, there has never been a question around demand. Ryota Suzuki, co-head of Japan DCM at Bank of America Merrill Lynch, reckons the global investor base that can buy Japanese paper in general is getting "bigger and bigger".

"Japanese credits are very stable," he says. "Therefore, many global investors are looking to have exposure to Japanese issuers. Some Japanese banks and issuers are also starting to issue SEC registered bonds, which tap global investors."

For instance in November last year, Orix Corp, a financial services company listed in Tokyo and New York, bagged $700m from an SEC-registered offering — part of its strategy to have funding flexibility and diversification of funding sources.

Having a mix of Asian and US investors is helpful for Japanese issuers in the long run. DCM bankers agree that the Reg S dollar investor base has been expanding over the years. According to Masanori Kazama, part of Nomura's international DCM team in Tokyo, Asian investors are buying Japanese overseas issuance. He adds that issuers too have diversified in terms of tenors, adding shorter maturities — like three years — when compared to the past, and so capturing a new investor base overseas that is not able to participate in tenors of five years or longer.

But the growing Asian investor base doesn't mean US accounts are any less important.

"Even if the size [of the deal] is $500m, it makes sense to go to the US too, as the more investors come in, the more diversification you can get," says the senior Morgan Stanley DCM banker. "Asian investors also appre-

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Issued in September 2017

2.125% due September 2022
USD 1,000,000,000
Issued in September 2017

1.875% due September 2026
USD 1,100,000,000
Issued in September 2016

Sustainability Bonds

2.500% due October 2022
USD 1,000,000,000
Issued in October 2017

2.000% due October 2021
USD 500,000,000
Issued in October 2016

0.375% due October 2019
EUR 300,000,000
Issued in October 2015

FILP Agency Bonds

0.260% due January 2028
JPY 25,000,000,000
Issued in January2018

0.060% due March 2023
JPY 20,000,000,000
Issued in January 2018

0.001% due March 2021
JPY 20,000,000,000
Issued in January 2018

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ciate when US investors support the deal from a quality and liquidity perspective."

He adds that in general, he would recommend issuers to go to the US too, not just Asia, so they can tap into the global US dollar investor base. This, he says, will help borrowers price tighter and get more liquidity as more high quality investors come in.

For investors, a big draw is Japanese issuers' ratings, as a large chunk of the borrower group is in the investment grade bracket.

"For investors, Japanese issuers are high quality," says Katsumi Ishibashi, director of research, fixed income, at Fidelity International. "Banks are single-A rated and corporates single-A to triple-B — SoftBank is an exception but most are high quality credits. We have visibility over their operations and for investors, it is more a lower risk, lower return investment.

"Plus, [international investors] can get support from onshore accounts that buy US dollar bonds issued by Japanese issuers," he adds. "They are sticky investors for the bonds, supporting the bonds' stable performance, while we don't expect much spread tightening."

Bankers add that Japanese names still continue to have scarcity value among global portfolio managers, explaining why their interest for the country's bonds is rising. The biggest buyers tend to be US investors, followed by European and Japanese accounts that can invest in non-Japanese yen securities.

But the appetite of the latter group could slowly wane.

FSA clampdown

Last year, Japan's Financial Services Agency, the financial watchdog, started monitoring regional banks' investment in foreign bonds. Squeezed by the negative interest rate policy in Japan, some domestic investors had racked up their purchase of foreign currency denominated bonds in a bid to make money. But when their bond investments took a hit, the FSA stepped in.

"After the negative rate implementation in 2016, investors started to look for non-yen investments, like dollars or euros," says Kazuma Muroi, executive director at Mitsubishi UFJ Morgan Stanley Securities Co's DCM team. "But after the rate hike in dollars and euros, the majority of the investors made a loss.

"The Japanese FSA started to closely monitor the investment behaviour, especially among regional banks," he adds. "So they are becoming sensitive when it comes to investment in non-yen bonds. Their behaviour was impacted by the rates movement overseas, plus the new monitoring stance taken by Japan FSA on non-yen investments."

"For investors, Japanese issuers are high quality. Banks are single-A rated and corporates single-A to triple-B"

Katsumi Ishibashi, Fidelity International

When it comes to the megabanks, Mizuho's portfolio of Japanese government bonds, for instance, carried a net loss of ¥7bn during the nine months ending December 2017 versus a loss of ¥160bn in its foreign bonds portfolio, according to a note from CreditSights, an independent research provider, in early February. Sumitomo Mitsui Financial Group posted a loss of ¥125bn on foreign bonds, while MUFG had gains of ¥53bn.

Bankers add, however, that investment losses among the megabanks are less of a concern than at the regional banking level. And while the FSA is cracking down on the latter's foreign bond portfolio, bankers reckon it's a step in the right direction to steer the firms away from taking on too much risk.

The FSA's clampdown aside, DCM bankers point to a more recent, and positive, development for borrowers.

More funding avenues

In addition to the traditional dollar or euro debt, Japanese firms now have an additional source of funding available — Panda bonds. Chinese and Japanese officials kicked off the race for the first Panda deal, renminbi notes sold in the Mainland by non-Chinese firms, in December 2017 when they agreed to an audit oversight over each other's markets, paving the way for Samurai and Panda issuance.

The first Panda trades emerged on the same day in January when MUFG Bank and Mizuho Bank kicked open the market. The former raised Rmb3bn from a 5.3% thee year note, while the latter bagged Rmb500m from a similar 5.3% three year.

"The Chinese regulator has started to ease rules for non-Chinese companies, including Japanese, to issue Panda bonds in the Chinese market," says Yoshihiro Inoue, executive director, international debt origination, debt capital market, Daiwa Securities. "So if there's further clarification, then potentially there will be more Japanese issuers issuing in the Chinese market, to fund in renminbi."

With the global market opening up further for Japanese issuers, bankers are confident of further progress. They do point to two potential snags, however — geopolitical issues and a political scandal in Japan. In terms of the former, a downside risk to Japan's trade outlook stems from the US's decision to impose tariffs on steel and aluminium imports. If this escalates further, it could have ramifications for the country's corporations.

On top of that, a threat internally in Japan is to prime minister Shinzo Abe, who has been embroiled in a controversial government land sale to an elementary school operator. The issue has hit Abe's popularity, but for now, bankers say international investor sentiment has not been dented. But if the situation gets more complicated and Abenomics — a term used for Abe's economic policies — comes under pressure, then there could be an impact.

But for Ishibashi at Fidelity, credit ratings are a big concern.

"Japanese government bonds are now rated A+ by S&P and A1 by Moody's and there is some medium and long-term pressure of a downgrade," he says. "That would constrain the credit rating of banks. If they get lower rated, then it will increase their costs of funding and will also affect short-term funding.

"In terms of JGB rating, a one notch downgrade is OK. But two notches will be a problem because this could affect the banks' access to short-term funding. A one notch downgrade is a risk in the next two years, while more than two notches is a three to five year risk." ▲

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USD 1,500,000,000 2.250% Guaranteed Bonds due 2020	**USD 500,000,000** 3ML+57bp Guaranteed Bonds due 2020	**USD 1,500,000,000** 2.125% Guaranteed Bonds due 2020	**USD 500,000,000** 3ML+48bp Guaranteed Bonds due 2020	**USD 1,500,000,000** 2.5% Guaranteed Bonds due 2022

May 2017	July 2017	July 2017	July 2017	July 2017
USD 1,500,000,000 2.875% Guaranteed Bonds due 2027	**USD 1,500,000,000** 2.125% Guaranteed Bonds due 2020	**USD 1,000,000,000** 3ML+39bp Guaranteed Bonds due 2020	**USD 1,250,000,000** 2.375% Guaranteed Bonds due 2022	**USD 1,250,000,000** 2.875% Guaranteed Bonds due 2027

November 2017	November 2017	November 2017
USD 1,500,000,000 2.125% Guarantee Bonds due 2020	**USD 1,500,000,000** 2.375% Guarantee Bonds due 2022	**USD 1,500,000,000** 2.750% Guarantee Bonds due 2027

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Japan's top credits assess which markets work best

It might be easy to imagine that Japan's top credits have an easy time accessing the international bond market. Compared to high yield or debut issuers, that may be so. But a strong rating and an important role in public policy bring with them certain responsibilities — not least of which is keeping funding costs down. The rise in dollar interest rates, and the volatility that is sure to result, thus represents a conundrum for these issuers. What is the right price for a dollar bond? What is the correct attitude to maturity adjustment? *GlobalCapital* asked these and other questions during a roundtable discussion that took place in Tokyo shortly before the end of the fiscal year on March 31, 2018.

Participants in the roundtable were:

Masaaki Ebisu, director, capital markets and funding division, Japan Bank for International Cooperation (JBIC)

Hideaki Ishiyama, director general, finance department, Japan Finance Organization for Municipalities (JFM)

Hiroyuki Kawae, manager, finance management section, East Nippon Expressway (E-Nexco)

Akiyo Miyakawa, director, division of financing, treasury department, Development Bank of Japan (DBJ)

Tanaka Satoko, director, capital markets division, Japan International Cooperation Agency (JICA)

Naoki Sato, director, bond section, budget division, Bureau of Finance, Tokyo Metropolitan Government (TMG)

Tatsuya Yasuda, head of international DCM, debt capital markets department, Nomura

Matthew Thomas, moderator, *GlobalCapital*

GlobalCapital: Many international investors will already be familiar with the credits around this table. But what should they know about how your funding plans are changing as volatility rises in the dollar bond market? Can you offer some context for this discussion by telling us a bit about your funding plans for next year, as well as your experiences this year?

Masaaki Ebisu, JBIC: Under the rising volatility in the market, it becomes even more important for us to identify an appropriate issuance strategy and a reasonable funding level that will balance our target and investors' appetite. In the Japanese fiscal year from April 2017 to March 2018, we issued $14.5bn of foreign bonds. Given the very favourable market conditions, we enjoyed tremendous support from investors.

Looking back at 2017, we tried to be flexible to effectively capture the appetite of a variety of investors with different needs. For example, in May, we launched $5bn in one shot — that is a sizeable deal for any issuer. We split the deal between three year, five year and 10 year tranches, and added one floating rate tranche to branch out the investor base. By having that variety of funding tools, we were able to respond to investor demand and really make the most of the differing needs of our investors.

Our funding plan for 2018 is still being discussed in the Japanese Diet at the timing of this roundtable, but the projection at the moment is for a $15bn foreign bond issuance budget.

I'm sure it is no surprise to investors that we are planning to return to the foreign bond markets in similar size this year, but for the next fiscal year in 2018, there are certain things we need to be aware of. With interest rates rising and the yield curve flattening, we may need to adjust our strategy in tapping the market so we can capture investor demand appropriately.

Hiroyuki Kawae, E-Nexco: In this fiscal year, we had a funding budget of ¥460bn, with bond issuance accounting for around ¥400bn of that. Dollar bonds are something that we issued in the current fiscal year, although it

Masaaki Ebisu
JBIC

is not public issues but rather private placements that we focus on. We're targeting domestic investors to issue those deals, so we're a little different to some of the other issuers on this panel. Regional banks are the major investors of our bonds.

We used to issue bonds with a five year maturity, but this fiscal year we added two year bonds to our funding mix, too. In the Japanese yen market, given the monetary easing and the extremely low deposit rates, many investors are buying our bonds as a substitute for deposits.

For the next fiscal year, we will raise ¥400bn, with one or two year bonds and five year issuance amounting to ¥300bn in Japan and international markets.

Akiyo Miyakawa, DBJ: We are going to issue the equivalent of maximum ¥200bn in the dollar bond market with the use of government guarantees in the next fiscal year. But we do not just rely on government guarantees. For instance, we raised $1bn from a stand-alone deal this fiscal year. That was a sustainability bond, helping us cater to a growing investor base. We also issued some private placements without a guarantee, targeting specific investors including dollar investors.

We want to diversify our investor base and we have been issuing to that purpose for many years. The dollar bond market remains our primary market. Unless the market environment changes dramatically, it will remain our primary market in the next fiscal year.

Hideaki Ishiyama, JFM: For this fiscal year, we raised a bit less than ¥840bn. We have sold two foreign bonds every year for the last six years. We turned to the market in April with a $1bn five year bond and followed up a same-sized three year deal in August. We were able to cater to the needs of central banks with the latter deal. We tend to swap our deals and convert them into Japanese yen, so a key consideration for us is the after-swap funding cost. This is not always transparent.

Tanaka Satoko, JICA: In this fiscal year 2018, we plan to issue the same as the previous year, both in the dollar market and the onshore Japanese yen market.

We are looking to issue $500m sometime between April and June. The tenor is undecided as of now, but we prefer a longer tenor, which for us means five, seven or 10 years. That would ensure it matches the duration of our assets.

For the Japanese yen issuance, our plan is to raise a maximum of ¥80bn. We are planning to issue on a quarterly basis starting from June 2018.

Naoki Sato, TMG: We hear that international investors and markets are expected to have continuously strong demand for Japanese SSA bonds in the dollar market. On the other hand, some domestic investors are expected to have weaker demand for foreign bonds due to regulation by Japanese financial authorities as well as rising dollar funding costs.

To issue foreign bonds at the right time, careful observation of investor trends and the market is thus important.

We'll decide our funding plans based on the funding needs of TMG in addition to such market conditions mentioned earlier.

GlobalCapital: Are things getting tougher? As rates go up in the US and volatility rises in the credit markets, I wonder whether any issuers have been forced to dramatically change their plans.

Satoko, JICA: There has not been new dollar issuance by Japanese SSAs recently, and we do not have a clear vision of how the market is seeing Japan at the moment.

Nonetheless, we hear that global SSA bonds are supported by strong investor demand and are performing well despite the recent increase of market volatility both in the primary and secondary markets, and we hope that this market trend continues.

Tatsuya Yasuda
NOMURA

Tatsuya Yasuda, Nomura: When I look back to our discussion last year, I remember that a lot of issuers already anticipated that US interest rates would increase and that, given the uncertainty of the events expected and its market reactions, risks might be rising. In that sense, the market situation this year is not new to market participants — everyone is expecting US interest rates to rise, as well as other potential market risks such as Trump and fiscal policy changes. However, we are getting to the point where it is no longer simply a talking point. It is happening now, and that may force a change in strategy for issuers.

Last year's market environment was more stable than a lot of people anticipated. Although the market expects tapering, the liquidity we saw last year will not dry up immediately in 2018. However, the pace of rate hikes is likely to accelerate and investors are going to react much more noticeably later this year. Volatility will rise as a result, which in turn will change investor behavior.

This change is not going to be immediate. We will not see investors switch into other asset classes overnight. Japan is one of the strongest credit brands in the world. Nonetheless, it offers good opportunities for investors to expect spreads. There is still going to be major demand for Japanese issuers, but investors will be becoming increasingly selective with tenor, currency and timing. For issuers, flexibility is going to be more important this year.

GlobalCapital: But are issuers being flexible enough? Are you prepared to pay up, or even explore new markets, if volatility pushes up spreads?

Ebisu, JBIC: We saw a continuous tightening of spreads in 2017. When the Japanese government was downgraded in September 2015, there was naturally a widening of spreads but since then spreads have continued to move lower. Japanese credits are not experiencing any major change in investors' views. We now have a strong political leadership in Japan, which is definitely something that international investors have welcomed.

This doesn't mean that we will not have to pay some

premium to investors in this changing environment. As we have done in past issuances, what we have to do is carefully watch the market environment and strike a good balance between investors' appetite and our target funding cost. But although the cost of funding is one of our primary benchmarks, we also try to pay equal attention to how we can establish strong confidence for our name in the bond market.

Kawae, E-Nexco: We saw some spread tightening during the past year and some investors have become more reluctant as a result. We want a more stable investor base so — can we tolerate rising prices going forward? It really depends on the market. We will always try to respond to the pressure investors face in the market. When they take a particular view on what needs to happen to pricing, we will try to respond to that with a flexible approach.

Miyakawa, DBJ: This is something we think about a lot. US-based investors seem to have been showing as a stronger presence in the order books for Japanese SSA bonds in the past year. Are they going to continue to invest further in the future as US rates continue to go up? If not, we have to seek alternative investors. We cannot expect too much demand from Japanese investors either, given the context of rising hedging costs. We need to think carefully about the extent to which other investors can replace US accounts if their appetites change, and to what extent we need to adjust our pricing. This remains an ongoing question for us.

Akiyo Miyakawa
DBJ

Ishiyama, JFM: The most important point of consideration for us is the funding cost after swapping into Japanese yen, but cost is not the only factor. We also want to make sure our bonds perform well in the secondary market. That is a sensible approach for an issuer that has long-term, recurring funding needs, but it means you have no choice but to be flexible as the environment changes.

GlobalCapital: One of the problems with taking an objective view of the dollar bond market is that it is not clear whether issuers have any other options. Do you have realistic, sizeable alternatives to the dollar bond market?

Ishiyama, JFM: This is a difficult question. If foreign bonds don't meet our funding cost target, we certainly have other options. But we have to consider whether those options would also become more expensive as dollar funding costs rise. There is a chance that issuers find an alternative to dollar bonds, all adopt the same strategy in the same market, and quickly eradicate any funding cost advantage. This is something we need to watch out for.

Miyakawa, DBJ: If the funding cost in the dollar market doesn't work, one option would be the euro market. But in terms of size, it will not be sufficient on its own. Euro-yen bonds could be more compelling, but then you have the recurring question of the swap level. Considering that the main purpose of our foreign bond issuance is to spread the investor base, issuance in Tokyo's Pro-Bond market would not work for us either, since it would force us to rely even more on domestic investors.

Hiroyuki Kawae
E-NEXCO

Kawae, E-Nexco: There are other currencies we can tap. For example, the Hong Kong dollar or Australian dollar markets. But the market size is small compared to the euro or dollar markets. How much demand can we realistically secure? The other channel for us is the yen bond market, but when this doesn't work we can turn to banks for funding. There are some options for us to use as backstop when we need it.

Sato, TMG: TMG focuses mainly on the dollar market. We have been issuing dollar-denominated bonds for seven straight years now and have issued in 144A/Reg.S format since FY2016.

Since FY2015, our new dollar issues have been listed on the Tokyo Pro-Bond market as well as the London Stock Exchange. We've been aiming to invigorate the Pro-Bond market, which we think is still at a developing stage. But other markets such as the euro market might be an alternative to the offshore dollar market.

Satoko, JICA: For us, the offshore dollar market itself is an alternative funding means as our main operation currency is Japanese yen. We are not looking at other currencies as of now. Regarding Tokyo Pro-Bond, we understand it is gradually growing with more issuers listing their bonds.

GlobalCapital: How attractive is the euro market right now? Can you outline your euro issuance plans and the benefits you see from tapping the euro-denominated bond market instead of dollars?

Yasuda, Nomura: The euro bond market certainly offers diversification opportunities for issuers, but from a funding cost point of view it has rarely stood out. The dollar bond market has offered cheaper funding for Japanese issuers for a long time, with only occasional blips. But in terms of providing a support channel during periods of increasing dollar volatility, the euro continues to be there. It is not taking centre stage, but it is still an important option for issuers.

Satoko, JICA: We understand that euro market issues have performed extremely well since the beginning of 2018, and it appears attractive in our eyes as well. In addition, issuing in the euro market is particularly appealing to us as it would allow us to easily approach ESG focused investors in the region.

Nonetheless, we have not yet issued euro bonds because it is not our operating currency. We also have to consider the cost of hedging euro proceeds if we were to issue in the euro market.

For FY 2018, we are not planning to issue in the euro

market but it is on our table for consideration in the future.

Miyakawa, DBJ: The one advantage the euro bond market has over dollars is the depth of the socially responsible investor (SRI) base. We issued our first green bond and first sustainability bond in euros and, of course, that was a major consideration for us when picking the currency of issuance.

Sato, TMG: TMG swaps all the funds raised in foreign currencies to Japanese yen through a cross currency swap and uses them to cover our expenditure budget. Funding costs really matter to us. At the moment, dollar-denominated bonds are better than euro-denominated bonds from a funding cost perspective, but euro-denominated bonds could be cost beneficial in the future, depending on market conditions.

GlobalCapital: The credits around this table are among the best in the country, but that also means investors may feel comfortable using them as a government proxy. What are you telling investors about the Japanese economy? How confident should they be about an economic recovery in Japan?

Yasuda, Nomura: Japan's economy has not fared very well for almost three decades now. There are still structural problems, given the demographics and the decreasing population, which the current government is struggling with. On the other hand, the Japanese political situation is very stable at the moment, and the government is shifting to more focus on economic growth. Such political stability has made global investors feel conformable.

Japan is a developed and mature country, and a high GDP growth rate is not necessary and perhaps even not achievable. Given the political stability and its consistent policy operation, Japan would be highly valued by international investors.

Miyakawa, DBJ: This is something we echo. We always make clear to international investors that the stable government in Japan makes a solution to the country's problems so much more realistic. The government of Shinzo Abe is firmly committed to economic reforms and the benefits of those reforms are slowly starting to be seen. Although the Bank of Japan has still not hit its 2% inflation target, economic growth is improving.

Satoko, JICA: The relationship we have with the government is very robust and inherent in our operations. As a matter of fact, our dollar-denominated bonds are all government-guaranteed, and we believe we were able to access broader investor base thanks to the guarantee.

With regard to the impact of the changes in Japan's economy, the monetary easing policy has had a significant impact not so much on the borrowing levels but on the facilitation of issuing bonds in the onshore market.

Sato, TMG: If Japan's credit rating is downgraded due to changes in the Japanese economy, TMG's credit rating could also be downgraded and lead our funding costs to increase. But such a scenario is unlikely to happen under the current economic conditions in Japan.

We understand that under Abenomics, Japan has been seeing an economic recovery, including improving earnings and employment. In Tokyo, tax revenue had increased by about 3% year-on-year in FY2016, reaching over ¥5.3trn.

Ishiyama, JFM: The bulk of our business is making loans to local governments, so the health of those governments is crucial for international investors trying to understand our credit. The fiscal management of local governments is sustained by budgets that are closely linked with the central government, so we are also very dependent on the health of the wider economy. The Abe administration has given the economy a shot in the arm, which is something we welcome very much.

GlobalCapital: One interesting trend has been the rising use of short tenor bonds, especially by higher rated issuers that can reap maximum benefits from selling short-dated deals. What's your view of tapping this market over the next 12 months?

Hideaki Ishiyama
JFM

Ishiyama, JFM: In September last year, we sold our first three year bond. It was very attractive cost-wise. In view of the monetary environment, two and three year bonds are looking very cost-efficient for issuers at the moment.

The investor base was actually very different to our usual benchmark dollar bonds, which was an interesting result for us. That means it isn't just attractive from a cost perspective — it also allowed some diversification benefits. It is definitely something we will consider more in the future. It gives us extra options.

Miyakawa, DBJ: Since the maturities of our assets are relatively long, we prefer to keep longer tenors on the funding side as well. Five and 10 year US dollar bonds are our preferred maturities and that is likely to continue. The exception to this is in Japanese yen-denominated bonds, where we often sell three year bonds. Because of these deals, as well as the asset-liability mismatch, we are unlikely to move to shorter tenors in the dollar bond market in the foreseeable future.

Kawae, E-Nexco: We don't have much flexibility with it comes to tenors. The net proceeds will be used for highway construction and as such the tenor of ours bonds are designed to cover the construction periods plus a few years as a risk buffer. This does not mean we cannot issue short tenor bonds. We sold a two year bond this fiscal year and will issue a one or two year bond next fiscal year due to the completion of Chiba prefecture's project in the Tokyo Gaikan Expressway during the first quarter.

Ebisu, JBIC: The asset-debt maturity gap is a major factor we have to manage, too. We have financing needs of around $10bn, so we definitely want to offer as many options to investors as we can. We fund in three, five and 10 years. The three year deals are popular with central banks and asset managers, which adds some investor base diversification for us. Three-year bond are a new strategic funding product for JBIC to diversify and maximize investor appetite, even more so when we also use floating rate notes. We will try to effectively use three-year bonds, carefully watching the volatility and investor appetite in the market. ▲

Japan's bond investors shake things up

Japanese investors' desperation to boost their yields is helping them shed an ultra-conservative image that has long defined them. The move is overdue but as more international borrowers turn to the yen markets for funding, the increasing flexibility of the buy-side is helping to usher in new structures and international standards. **Rashmi Kumar** reports.

GONE ARE the days when global central banks acted in concert.

More than two years after Bank of Japan introduced its negative interest rate policy, juicy returns still remain largely elusive in the country's domestic debt market. But the US Federal Reserve is going in the opposite direction. As rates rise in the US, and remain suppressed in Japan, what are yen-based investors supposed to be?

The answer is as familiar as it is simple: they need to rely on the laws of supply and demand. Razor-thin margins in the Japanese yen bond market have made a raft of international borrowers wake up and take notice. They see cheap funding opportunities in the yen market, even if they have to pay well above what Japanese credits are paying. That is not just good news for issuers, but also for yield-starved Japanese investors.

Most international borrowers are also taking advantage of a favourable cross-currency swap rate between yen and dollars. Swap conditions have improved dramatically in the past year between yen-dollar and yen-euro, say DCM bankers based in Tokyo, pushing numerous global borrowers to sell yen-denominated notes, either in Japan through the Samurai or Pro-Bond markets, or internationally in the global yen or euroyen formats.

Economics start to work in yen

"For five year bonds, the swap rate is more than 50bp," Tokyo-based Kazuma Muroi, an executive director in Mitsubishi UFJ Morgan Stanley Securities Co's debt capital markets division, tells *GlobalCapital* at the end of March "Compared to one year ago, when it was at around 70bp, we are seeing a 20bp improvement for international issuers swapping into dollars from yen.

"Until recently, the dollar market was really strong, so there was no way we could compete," he adds. "After we started seeing some market volatility triggered by recent interest rate movements globally, spreads on dollar bonds started to widen quickly. At the same time, the yen market remained stable. So for some issuers, including some AA rated names, the economics started to work in yen."

"We still have investors that cannot buy Chinese names, but we are seeing a development"

Yoshihiro Inoue
Daiwa Securities

As a result, the rising opportunities for funding arbirtrage is not just good news for issuers and investors, but also for local bankers, who are pitching a raft of credits to come to the onshore market. This will give a much-needed boost to issuance. In the fiscal year ending March 31, 2018, a total of 77 yen-denominated deals were sold by foreign issuers, worth the equivalent of $18.5bn between them, according to Dealogic. During the same period the previous year, 96 trades were priced worth around $22bn. For the year to March 2016, 121 deals worth about $26bn were recorded.

Akihiro Igarashi, head of international debt syndicate at Nomura, says international yen bond volumes were slightly down last year because cross-currency swap rates were still expensive for international issuers. That turned off some of the more reliable sources of yen issuance, including banks in Australia and the Nordic countries.

But as the dollar market gets more expensive, the scales appear to be tipping once again in favour of more yen issuance.

"The elevated credit spreads in dollars and elevated new issue premiums would make the Japanese market workable from the pricing perspective," says Kaneyoshi Muramatsu, director, head of international JPY debt syndicate at Mizuho Securities Co. "Up until February, we thought the international yen market volume would be similar or may be less than last year, but with the recent volatility we're feeling that the total volume could be slightly larger than last year."

That is good news for bankers. But as more global borrowers seek out Japanese yen, is there enough investor demand to go around?

Bigger buy-side

There are plenty of different avenues through which firms can sell yen-denominated bonds. Samurai bonds and Pro-Bonds promise access to the domestic investor, although the latter market is barred from retail investors. The euroyen and global yen markets allow a wider distribution to global yen accounts, as a result often leading to a speedier execution.

The Samurai market has become the obvious yen funding source for high-grade or well-known issuers. The Republic of Indonesia raised ¥100bn ($935m) last May, French banking group BPCE bagged ¥58.1bn from a social Samurai — the first for Japan — and the Turkish sovereign sold a ¥60bn issuance. More are deals in the offing, too, with the

SPONSORED STATEMENT

JFM: A reliable presence in the global debt market

Japan Finance Organization for Municipalities (JFM) has been remarkably consistent in its issuance strategy over the last few years, turning to the dollar bond market in April and after the summer holidays in both 2016 and 2017. The issuer's $2bn international fund raising across two bonds last year further cemented its reputation as a borrower of quality, with both deals getting oversubscribed more than twice. JFM now only issues without a government guarantee offshore. Here Hideaki Ishiyama, general director of finance in JFM's finance department, shares his views on JFM's issuance programme and activities.

Q: JFM sold a $1bn five year bond in last April, but opted for a $1bn three year in September. Why did you choose three years as a tenor on your most recent issuance?

The transaction was the first three year dollar benchmark transaction, not only for JFM but for any non-government guaranteed issuer in Japan's SSA space. So one of our goals for the transaction was establishing and refining our credit curve in the shorter end.

We expected to get strong demand for three year notes from investors in the context of the Federal Funds Rate hiking process, as well as the juicy spread over US Treasuries thanks to a relative wider swap spread in the three part of the curve. We then looked at our redemption schedule and considered the deal from an asset-liability management perspective — there was no problem with JFM issuing a three year.

As a result of these considerations, we started marketing the three year bond offering on August 30. We got strong demand, eventually building a $2.3bn final order book. That allowed us to price at 99.74 for a yield of 2.090%, equivalent to mid-swaps plus 47bp.

The final order book was geographically diverse, with 38% allocated to US, 35% to Europe, the Middle East and Africa and 27% to Asia. In terms of investor types, central banks took 38%, followed by asset managers with 37%, banks with 14% and insurers, pension funds and others with the remaining 11%. We were delighted with the issue, which clearly underlined the strong support from existence and new investors for our credit.

Q: What are your funding plans for the this fiscal year, starting from April 2018?

Our funding plan for this fiscal year comprises $17.9bn of fundraising, including $10.3bn of domestic issuance and $2.4bn of offshore issuance without a government guarantee. We also set $1bn of open issuance, which allows us the flexibility to select the market, tenor, and other details subject to market conditions during the period. The remainder is budgeted for government guaranteed domestic bonds and bank loans.

In the domestic market, JFM plans to raise $5.7bn through domestic public offerings with regular issuances of five, 10, 20 and 30 years.

In the offshore market, on the other hand, we are going to achieve the budget with offering of benchmark transactions, private placements and Uridashi transactions.

Q: How do you choose the best issuance currency when turning offshore?

In principle, we select the currency denomination of our bond issuance based on investor demand, market conditions and funding cost.

The US dollar and the euro are our primary currency denominations due to the potential wide range of investors and the market environment. We issued our first euro-denominated benchmark in September 2014, reflecting good market condition and funding diversification. But in recent years, we have been issuing only US dollar notes since the achievable funding levels after swapping back into yen are more favorable for us compared to what we could achieve in euros.

We will consider private placements of bonds denominated in other currencies reflecting investor demand, market conditions and funding costs. In the past, we have issued bonds denominated in Australian dollars and New Zealand dollars.

Q: What should investors be focusing on when considering your funding plan?

Since September 2012, we have issued two benchmark bonds during each fiscal year and, as mentioned, we set a $2.4bn budget for offshore funding this fiscal year. So we are continuing to access the international capital market as a frequent issuer.

Hideaki Ishiyama, general director of finance in JFM's finance department

As for the domestic public offering, we plan to issue 10 year notes every month, 20 years twice a quarter and five year and 30 year bonds twice a year. There are few issuers which supply public bonds every month in the Japanese domestic market, so we think our 10 year bonds offer a good opportunity for investors to buy Japanese yen bonds in the primary market.

Q: Why do you continue to issue overseas when demand for your paper is so strong at home?

We certainly enjoy extremely tight funding costs at home — for example, our latest 10 year issue priced at 16bp over JGBs. But in order to help our diversification of funding sources and widen our investor base, we maintain an overseas funding budget for the regular issuance of benchmark bonds. That is something we plan to continue for as long as international investors want a regular and committed supply of JFM paper.

Philippines and Mexico understood to be considering Samurais.

In the global yen market, deals have come from the likes of US multinational technology company Corning and retail behemoth Walmart, to name just a few.

Bankers point out that last year marked a turning point for yen bonds, with the gradual implementation of the pot method when selling notes. The pot method effectively means issuers and lead managers are able to see which investors are placing orders into the book and at what price in real time.

This is a change from the typical retention system used during bookbuilding, where each underwriter builds its own book of investor orders without sharing the details with others in the syndicate. The underwriter then takes charge of its own allocation and delivers the bonds to clients.

The pot system has improved transparency. Perhaps surprisingly, investors are embracing the change. Bankers say the trend of using the pot system started with some of the global yen or euroyen transactions issued by US corporations. But then the technique moved into the Samurai market too. South Korea's Shinhan Bank paved the way when it used the pot system for its ¥26.3bn Samurai issuance in October 2017.

"Since then all Samurai or international yen transactions have been under the pot method," says Mizuho's Muramatsu. "It's a big development in Japan. We still need time for the pure domestic market to convert into pot or complete conversion may not happen, but at least on the international yen side, the pot method is the new norm."

Right timing

He adds that in other markets, the pot method is already common. And due to the increase in Japanese investors' participation in dollar or euro trades, they have become more comfortable with the system. "That laid the groundwork," he says.

"When some of the US issuers came to the market with global yen deals, the pot was their choice and investors accepted it. There was some hesitation to adopt pot into the Samurai format, but when Shinhan did the trade — we were one of the leads — we felt the timing was right and that investors were ready. So we introduced pot for Samurai and didn't feel any pushback from investors. And once [France's] BPCE adopted pot, investors accepted it without any problems. That accelerated the implementation of pot method into the Samurai market."

"Until recently, the dollar market was really strong, so there was no way we could compete"

Kazuma Muroi, Mitsubishi UFJ Morgan Stanley Securities Co

Kazuhide Tanaka, head of long term funding for Japan at Rabobank, says the reason for the delay and the reluctance of the Japanese market to employ the pot system was a widespread belief that the release of investor names was a breach of confidentiality.

"Of course, if you are a dealer and an underwriter, you don't want to give your investor list to anyone else," he adds. "But the pot system has been accepted very well, and it has become a very transparent and fair way to price bonds. And I think it'll continue to be employed here."

Diversified investments

Japanese investors' acceptance of the pot method is not the only change that has been notable in the yen market. Their investment behaviour has also changed. Traditionally, both borrowers and investors have opted for the Samurai format over Pro-Bonds. The Samurai market is more liquid thanks to a wider investor base. As Pro-Bonds are only available to professional investors, the number of accounts that can buy the product are limited, as is aftermarket liquidity.

But owing to the low-yield environment and often expensive basis swap conditions, investors are slowly warming up to accepting a variety of different issuance formats.

"Some accounts used to buy only in the Samurai format, especially asset managers," says Nomura's Igarashi. "But because the supply of Samurai is getting lower and supply of non-Samurai deals is rising, they have changed their internal policy and are now able to buy in the Pro-Bond format. So we are seeing a slight change and an increase of the investor base for Pro-Bonds, despite limited liquidity."

He adds that the preference for Samurai bonds will continue, but as investors get more flexible, the expectation is for more issuers to access the yen market using other formats, including Pro-Bonds.

Mizuho's Muramatsu says one of the biggest evolutions in the international yen bond market is pension fund managers — namely trust banks and asset managers — buying euroyen or global yen bonds. Up until the recent past, these investors strongly preferred the Samurai format, as the perceived liquidity in the bonds is higher and for index eligibility.

"But after they saw an increase in the number of trades in global or euro yen, and after they saw a good pick up against dollars or optical yen spreads which has been very attractive for them, they started to invest in global yen or euro yen formats," he adds.

"With the recent volatility we're feeling that the international yen market volume could be slightly larger than last year"

Kaneyoshi Muramatsu Mizuho Securities

In addition, Japanese investors' need for yield is forcing them to look at credits they wouldn't have before — in terms of ratings and duration. Bankers point to the fact that last year the Indonesian sovereign, rated Baa3/BBB-/BBB-, raised ¥100bn from a Samurai. In March this year, the Hungarian

sovereign (Baa3/BBB-/BBB-) returned to the yen market for the first time in 11 years, raising ¥30bn with a 2021 at a 0.37% coupon.

Turkey, with a Ba2/BB/BB+ rating, bagged a ¥60bn Samurai in December, while Taiwan's Foxconn Far East sold a ¥50bn trade in September and Genting Singapore, a casino operator and integrated resort developer, raised ¥20bn in October.

"Maybe five years ago, we wouldn't see an integrated resort developer or Turkey or a Taiwanese corporate coming to the yen market, but now the macro environment has urged Japanese investors to change their investment behavior, which is why we are seeing more variety," reckons Nomura's Igarashi.

Greater acceptance

For Rabobank's Tanaka, the biggest change in the past 10 years has been the acceptance of various credit instruments rather than just plain vanilla senior notes. He cites Rabobank's example, which was the first Samurai issuer to sell a subordinated tier two bond, paving the way for more to follow.

"We've also seen investors accept senior non preferred issuance," he says. "So there are different categories from the senior unsecured notes that everyone has been used to, and these different instruments have become more popular and investors have become more accepting of those instruments."

The change in their attitude was also evident when China Eastern Airlines broke new ground in March by selling a Pro-Bond backed by a standby letter of credit — the first use of SBLCs in the yen market.

It priced a triple-tranche transaction with three year tenors, comprising a ¥10bn 0.33% 2021 bond at 20bp over yen swap offer rate, and two ¥20bn 0.64% 2021s at 51bp over.

The first tranche was backed by a guarantee from Sumitomo Mitsui Financial Group, with the other two portions having SBLCs from Bank of China's Tokyo branch and ICBC Shanghai, respectively.

"We didn't expect to see such strong demand," says Yoshihiro Inoue, executive director, international debt origination, debt capital market, Daiwa Securities.

"But we saw huge numbers of Japanese accounts — both central and regional investors — participate. Regional interest was surprising. Traditionally Japanese investors try to avoid Chinese paper because they just don't understand how the country runs. We still have investors that cannot buy Chinese names, but we are seeing a huge development."

Inoue adds that be it Samurai or Pro-Bonds, there are still restrictions around the acceptance of accounting standards of other countries.

"Many countries are not allowed to issue Samurai or Pro-Bonds because of differences in accounting standards with Japan, like Thailand and India," he says. "To see strong developments in the Japanese market, the authorities need to deregulate to accept those countries' accounting standards." ▲

Despite growing interest, Samurai bond volumes have taken a hit

Source: Dealogic

Issuers dance around Kabuki bonds

DCM bankers in Japan are testing a new fundraising option for the country's issuers – a domestic offering of foreign currency denominated bonds by a Japanese entity. Dubbed Kabuki bonds after the country's classical dance-drama, the structure was pioneered by Nomura Research Institute in mid-March when it issued a A$50m ($38.4m) five year note.

The deal was helmed by Nomura as bookrunner and Morgan Stanley as an underwriter, shows Dealogic.

"Japanese investors are buying dollar or euro bonds overseas," says Masanori Kazama, part of Nomura's international DCM team. "There is certainly demand for higher yields. We wanted to provide solutions to these needs, rather than urging investors to go overseas to buy bonds, so we provided a solution by offering non-yen denominated bonds in Japan.

"We did see a strong demand for the issue by Nomura Research Institute. So we are marketing this product based on the buy-side's needs," he adds.

It's still too early to say if the Kabuki market will expand significantly, but what is evident is that Japanese investors' investment into non-yen bonds has been rising. While dollars have been the main currency of choice, bankers say a good chunk of investment is also going into euros and Australian dollars.

"The Kabuki bond format gives more opportunities for both Japanese investors and issuers to tap into international or non-yen currencies," says Kaneyoshi Muramatsu, director, head of international JPY debt syndicate at Mizuho Securities Co.

"If issuers don't have an EMTN programme or experience in issuing international bonds, then the Kabuki format will be easier as they can issue in non-yen currencies domestically," he adds. ▲

Japan looks to tap new investor base in SRI market

Green bonds have become one of the hottest topics in finance, taking their place alongside project finance and China's Belt and Road as the necessary buzzwords on every investor's lips. But green financing is more than just a passing fad for Japan's strongest issuers. In a market defined by a famously rigid investor base, they are attempting to build a market that can be sustainable in every sense of the word. *GlobalCapital* sat down with some of Japan's leading issuers, analysts, bankers and policy bankers to discuss where green and social financing is heading.

Participants in the roundtable were:

Kazuyuki Aihara, head of ESG products, debt capital markets department, Nomura

Akiyo Miyakawa, director, division of financing, treasury department, Development Bank of Japan (DBJ)

Masaya Okuyama, director for environmental finance, Ministry of the Environment (MoE)

Naoki Sato, director, bond section, budget division, Bureau of Finance, Tokyo Metropolitan Government (TMG)

Satoko Tanaka, director, capital markets division, Japan International Cooperation Agency (JICA)

Masato Takebayashi, senior analyst, research products, Sustainalytics

Kenji Yokoyama, group chief financial officer, Nomura Research Institute (NRI)

Matthew Thomas, moderator, *GlobalCapital*

GlobalCapital: **How do the offshore and onshore markets compare in terms of opportunities for SRI issuance? Where are you concentrating your efforts?**

Satoko Tanaka, JICA: The biggest difference we see between the offshore and onshore SRI markets is the investor base. In the onshore market, as the number of SRI investors is still limited, we are making efforts to have dialogues with investors to let them know about our social bonds when we meet them on the road or by attending seminars on SRI. As for the offshore market, because the concept of SRI, or, in a more recent term, ESG, is widely accepted, our focus is to let them know about JICA, our work for the United Nations' Sustainable Development Goals (SDGs), and our mission so that we can tap into the ESG focused investor base.

Naoki Sato, TMG: We understand the market is currently much bigger offshore than onshore, but TMG has concentrated its efforts on developing the domestic market. We raised ¥10bn from institutional investors with our Tokyo Green Bonds, and also sold an Australian dollar-denominated bond worth around the same amount; that was bought by individual investors. TMG wants to make the most of domestic funds for the promotion of Japan's environmental measures, while at the same time invigorating green bond opportunities for other issuers. We were the first Japanese local government to issue green bonds, but we won't be the last.

Akiyo Miyakawa, DBJ: Since 2014, we have issued one green bond and three sustainability bond deals — all of them in the offshore market. Recently

we have seen some demand from domestic investors for DBJ to make its debut in the onshore sustainability bond market. We understand that this is a sign of the growing ESG investor base here, but since our priority is to diversify our investor base, and considering the limitation of the size of the eligible asset, we cannot immediately respond to the expectations from domestic investors at this point.

Akiyo Miyakawa
DBJ

Sustainability bonds allow us a good way to diversify our investor base when we go offshore but, in the onshore market, there is still not a distinct set of green bond investors. That doesn't mean we have ruled out a domestic deal. It is certainly something we're considering. But the offshore market is more compelling at the moment.

Kenji Yokoyama, NRI: We take the opposite stance. We prefer to remain in the onshore market. Two years ago, we made our first SRI issue. We wanted to help create the market in Japan, so along with Nomura we put the work in to do a deal. It was a natural fit for us.

We have always been a green company, but we wanted to help lay the groundwork for the development of this market so we conducted intensive investor relations activity. That ensured we had conversations with investors across the market and those meetings gave me confidence that the green bond market will increase dramatically.

The issuer base is already growing quickly, including with a deal from TMG. But there is still so much more room for more issuers to join this market. Corporations should make efforts to show the outside world they care about ESG.

As they start to do that in greater numbers, the growth of this market is inevitable.

Masaya Okuyama, MoE: There is clearly a difference between the onshore market and the offshore market. The offshore market had a head start, has expanded impressively, and is still growing year after year. Why has the onshore market in Japan not improved enough? This is something we have to reflect on ourselves.

Masato Takebayashi, Sustainalytics: ESG bonds in Japan are still at an early stage, so investors look at these bonds and still wonder how best to evaluate them. This is similar to all markets at an early stage of development: the first step is that investors put the work in to understand the product and what its advantages are. After they have made that commitment, they are much more likely to become a regular participant in the market. We're still waiting for Japanese investors to show that commitment on a wide scale.

Kazuyuki Aihara, Nomura: Green bonds require a certain level of commitment from the issuer base, for instance in adhering to Green Bond Principles. ESG investors are certainly growing, but they have not grown to the point that they can drive pricing of the deal.

This is one difference to the offshore markets. Offshore, we are starting to see some indication that ESG demand can impact pricing, although mainly in the secondary market. Onshore, that is still a long way off. In many ways, though, the choice of market is not important. The key factor is taking action. Issuers need to make a commitment to this market.

Sato, TMG: We are not aware of any statistics showing how many Japanese investors have quantitative targets for investments in ESG. However, for the Tokyo Green Bonds that TMG issued in 2017, the demand from institutional investors reached more than four times the issue size. We believe that SRI and ESG investor base has been expanding steadily. In that sense, TMG has contributed to the long-term development of the market in Japan.

GlobalCapital: The fundamental question driving any funding decision is one of incentives, whether these incentives come from cheap funding costs, diversification or anything else. But when you look only at the funding cost, green bonds do not seem to offer cheaper pricing than conventional deals, at least not in the primary market. What are the incentives for selling green bonds? Is it mainly PR value at this point?

Aihara, Nomura: Their motivation is, in part, the PR benefits. But that is surely not the only motivation. The background is that investor interest is increasing significantly. Issuers would naturally want to respond to this demand.

Masato Takebayashi,
SUSTAINALYTICS

Takebayashi, Sustainalytics: That's a difficult question. Japanese issuers are certainly aware of the PR value of issuing bonds, but

that is not the only factor. A lot of companies are becoming more conscious of their environmental impact. As an extension of that they ask: 'what more can we do?'

Green bonds are a natural next step for environmentally-conscious companies.

Green bonds need to have some relevance to the core ESG activities that issuers are doing. They cannot be seen as a completely separate product. They flow from a company's wider approach to ESG.

Yokoyama, NRI: You're right that the incentives aren't exactly clear. We turned to the green bond market because our capital expenditure needs and the nature of the product matched. We invested in a green office building since no investments in our core business were necessary [at the time of issuance]. Frankly, it is a bit of a challenge to always have green bonds linked to a specific green project.

Miyakawa, DBJ: By its nature, DBJ has been committed to ESG for a long time. We were the first financial institution in the world to create and introduce an environmentally-rated loan programme, and we became the first Japanese issuer of green bonds in 2014. Since then we have issued several sustainability bonds, with the primary objective of diversifying our investor base.

Issuing such bonds helps us to have dialogue with the investors who are not interested in our government guaranteed bonds. The investor base is clearly growing offshore, so we're very happy with what we've seen in the overseas market. It has definitely hit the targets we set out to achieve when we first started to issue sustainability bonds.

Okuyama, MoE: When we started trying to popularize green bonds in Japan, we had a lot of conversations with market participants and tried to find out exactly what issuers needed to know before they would consider issuing green bonds. The aim was to remove any obstacles to green bonds.

Masaya Okuyama
MOE

In March last year, we published our Green Bond Guidelines, which are in line with the global Green Bond Principles. These guidelines ensured that issuers could quickly understand green bonds, including the use of proceeds, the external review and the objectives. The idea was to encourage the rise of green bonds in the domestic market, since issuance is still quite sporadic onshore.

Why is issuance still not increasing? I think one of the reason is because there are additional costs associated with green bonds. The MoE will support the entities seeking the issuance of green bond by providing subsidy to mitigate the extra cost.

GlobalCapital: Would you consider offering subsidies to reduce the additional costs of selling a green bond?

Okuyama, MoE: We're trying to mitigate the costs in an indirect manner. We will create a platform that publishes the information related to green bonds, and we will support and champion issuers that present a model case for the market. The MoE will support the entities seeking the issuance of green bonds by providing a subsidy to mitigate the extra cost.

GlobalCapital: Are subsidies needed to give the domestic green bond market an early boost?

Takebayashi, Sustainalytics: The cost related to issuance is an important burden for those corporations considering green bonds, so subsidies would certainly help in that regard. But they are not the only solution. Regulators could help reduce the administrative costs of green bonds by improving the ease of registering these bonds, for example.

There are some issues that are not economic. Green bonds require a lot of co-ordination between different departments. More and more companies are creating CSR or SRI departments now, and they would naturally get involved in the decision to sell a green bond. But ultimately the decision will come from the treasury team, and the treasury team will often in turn be responding to the capital expenditure needs of another department. The need for co-ordination between these different groups is leading to serious bottlenecks at a lot of companies.

Aihara, Nomura: I agree. The benefits of a subsidy would be large, but issuers have welcomed the support the Ministry of Environment has shown already. The bigger problem seems to be creating an internal consensus when it comes to green bonds. This is an area where banks like Nomura can play a bigger role.

There are some other incentives that are worth mentioning, however. The withholding tax could be exempted for green bonds. That would be a major change.

The risk-weighting of green bonds could also be reduced, encouraging banks to more readily invest in these deals. Direct subsidies are only one tool the government could use to encourage the development of green bonds. There is so much more that can be done.

Tanaka, JICA: Yes, it is correct that we are yet to enjoy a clear price benefit by issuing social bonds. It is also unclear whether we have the liquidity benefit since our bonds are already illiquid given their small size.

That said, through issuing social bonds, we have been able to reach out to SRI investors who agree with our mission and support our work that aims to directly contribute to the UN Sustainable Development Goals, and as a result, have been able to expand our relationships. We believe this has been the biggest benefit for us so far.

Additionally, we feel that being the first and only social bond issuer in Japan helps us promote our public relations through increased media coverage related to ESG investment, leading to a positive image of our organization itself.

GlobalCapital: There's a lot of talk about standardizing green bonds, but it's not clear this is actually a worthy goal. One could imagine vastly different standards in different jurisdictions, offering flexibility to issuers and increasing the chance that one market becomes the real green bond hub. Should regulators in the green bond market also be willing to set their own standards — potentially giving them an advantage over other financial hubs? Or is standardization necessary?

Takebayashi, Sustainalytics: Green bond standardization is something that we are watching with great interest. In the principles-based approach, the general guidelines are set and issuers only need to follow the principles. This is sometimes hard to determine. The other option is a more restrictive approach, where issuers essentially have a checklist they have to meet.

Japan has so far taken the principles approach, following the lead of other markets. This means there is some room for innovation among the issuer base, but it opens up the question of how investors should evaluate environmental impact.

Which aspect of green bonds should be evaluated? What sort of details should investors pay attention to? It may be the case that a more standardized set of rules would help.

I'm curious to hear the view of the other panellists on this. Which approach should be adopted in Japan?

Aihara, Nomura: This is, indeed, a very difficult question. Japanese issuers are paying attention to the Ministry of Environment's Green Bond Guidelines, but they still need some further details. What are the eligible projects? What projects are not allowed? The guidelines are not clear on this point. There are some transitional projects, like clean coal projects for instance, that should be officially recognized in these guidelines.

Kazuyuki Aihara
NOMURA

Miyakawa, DBJ: The more detailed, list-based approach would be easier for issuers, because they would have that reassurance they were complying exactly with the rules. But in my personal view, the principles-based approach is preferable to help expand the market. It leaves a lot up to issuers, which gives them the flexibility to structure deals in a way that suits their specific situation. It also allows issuers to adapt as the demands of investors adapt, something we should be considering at a time when the ESG investor is small but growing quickly.

Kenji Yokoyama
NRI

Yokoyama, NRI: We have given consultancy services to many issuers and we have found that most of them seem to prefer the principles-based approach. It's that same point that others have made: the flexibility is a major boost. A checklist approach would probably limit green bonds to the financing of new, green-certified projects, but a principles-based approach opens the door for green bonds to also be used to refinance deals.

Okuyama, MoE: It is respected that different markets approach differently, but we prefer the principles approach. It should be discussed among markets participants what could be considered as green. It is important that the understanding of investors is deepened.

Sato, TMG: The largest challenge in issuing Tokyo Green Bonds was to obtain a second party opinion from a SRI rating agency. While TMG is restricted under the Local Government Finance Act regarding the use of proceeds from the bonds issued, TMG has carefully selected projects that are highly eligible for a use of proceeds of a green bond and spent an adequate amount of time providing explanations to our second party opinion provider.

We would give the following tips to potential issuers. First, you need to clarify with investors the significance of your bond. Second, carefully select the type of deal, whether it is a green bond, a social bond or any other type of ESG bond. Third, obtain a second party opinion from an SRI rating agency, as necessary, in order to obtain better creditworthiness in the market. We are certainly helping to grow this market. We hope more issuers join us. ▲

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