SUSTAINABLE BANKING NETWORK (SBN)

# COUNTRY PROGRESS REPORT

ADDENDUM TO SBN GLOBAL PROGRESS REPORT

CHINA

Sustainable Banking Network

IFC International Finance Corporation WORLD BANK GROUP

Creating Markets, Creating Opportunities

The global SBN program is supported by the government of China through the Ministry of Finance. IFC's regional environmental and social risk management (ESRM) program is supported by the government of Switzerland through the State Secretariat for Economic Affairs (SECO).

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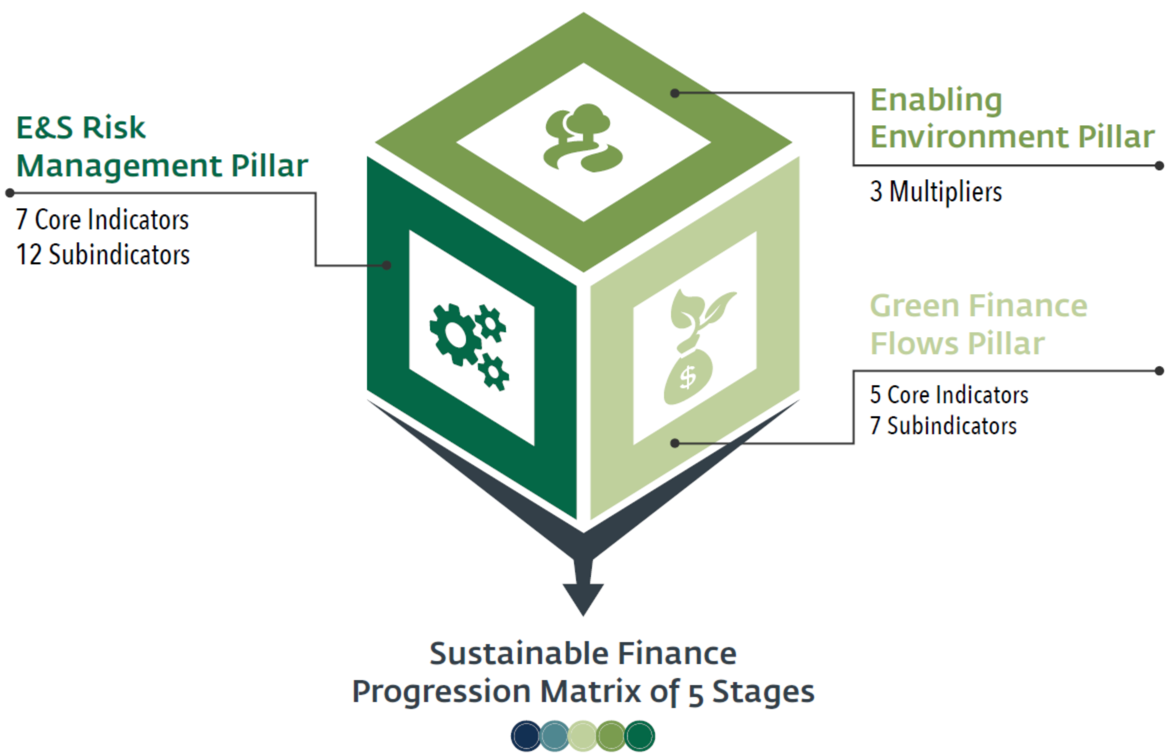
# 1. Introduction

**Market-based sustainable finance initiatives led by members of the Sustainable Banking Network (SBN) have made significant progress in directing the financial sector toward sustainability.** Established with International Finance Corporation's (IFC) support in 2012, SBN represents a community of financial sector regulators and banking associations from 34 emerging markets. SBN members now represent over US$42.6 trillion in banking assets, accounting for more than 85 percent of the total banking assets in emerging markets.

**The SBN Global Progress Report is based on a unique measurement framework, the first of its kind to assess sustainable finance initiatives across emerging markets.** The SBN Global Progress Report for the first time presents a systematic view of progress on sustainable finance among emerging economies that are represented by SBN. A rigorous measurement framework was developed and agreed on by members. The SBN Measurement Framework draws on international best practice as well as SBN members' experiences and innovations. This framework will be continuously applied to measure progress annually.



The Global Progress Report draws on the findings of **15 individual country progress reports prepared for members, including this report.** These 15 countries, with US$38.3 trillion in banking assets, account for more than 76 percent of emerging market banking assets.

**Country-specific progress reports were prepared for 15 SBN members with sustainable finance initiatives.** These reports contain a thorough analysis of the country's policy or principles in relation to the environmental and social (E&S) risk management and to the green finance flows, as well as a contextual analysis of the local policy landscape and the enabling environment. Country reports detail each country's good practice and highlight areas of focus in order to support and encourage members to further accelerate sustainable finance.

**All SBN member countries are advancing sustainable finance at differing stages of development.**
Countries are mapped to five different stages of their development, from initiating to mature.

## SBN Progression Matrix with Assessment Results, based on progress up to and as of June 2017


* Pakistan launched its policy in October 2017, after the cut off date of June 2017 for the report

# 2. Executive Summary

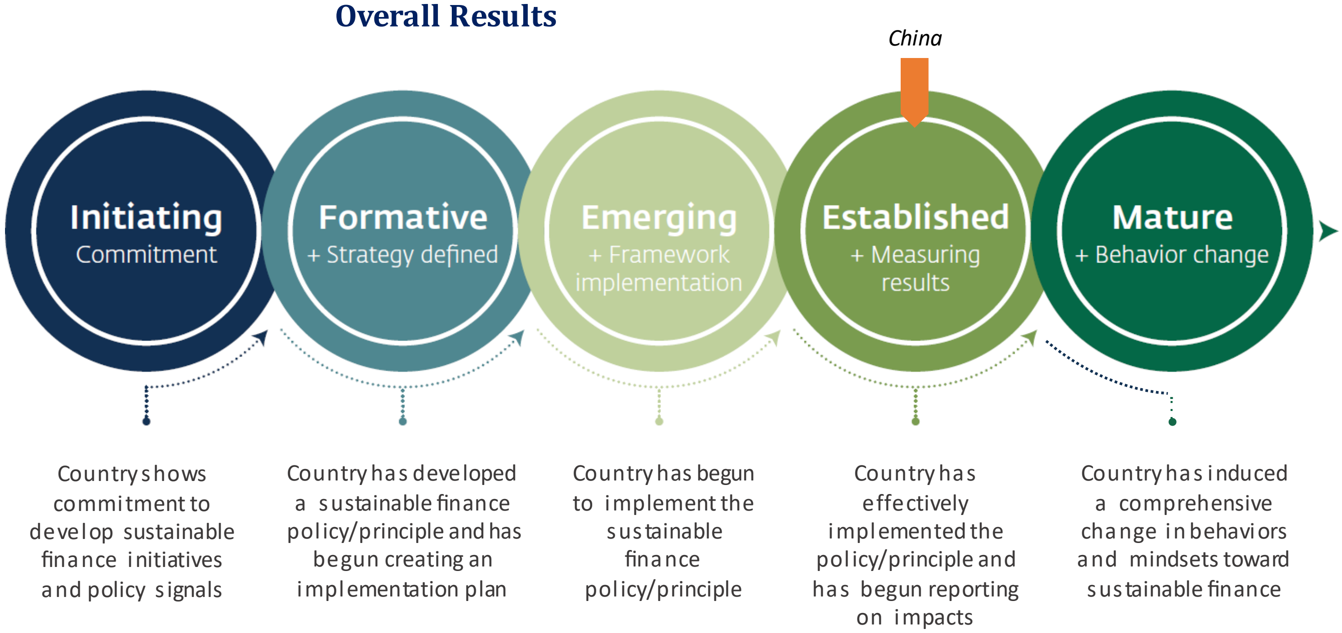
China is recognized by its peers in the Sustainable Banking Network (SBN) as a leader in the area of sustainable finance, with a comprehensive sustainable banking policy framework in place, including a monitoring and evaluation system. At the global level, the country ensured that "green finance" was included in the G20 agenda, with the aim of promoting global consensus on green finance. Overall, China's strong political governance and banking system, coupled with growing national commitments to develop a more sustainable economy, have been conducive to designing an ambitious regulatory framework regarding environmental and social (E&S) risk management, as well as increasing financial flows to green sectors.

The beginning of China's green finance journey can be traced back to 2007, when it introduced the **Green Credit Policy**, which laid down the foundation for sustainable banking in the country. To provide more guidance on implementation, the China Banking Regulatory Commission (CBRC) issued the Green Credit Guidelines in 2012, followed by a system to monitor and evaluate (M&E) green credit in 2014. In 2016, the People's Bank of China (PBC) led the launch of **Guidelines for Establishing the Green Financial System**. The policy framework has expanded to all financial markets (including insurance and capital markets), thus allowing China to further strengthen its leadership status.

Notable features of the current regulatory framework include the following:

- Reporting obligations for banks against predefined key performance indicators (KPIs) on E&S risks (including climate risk) and green finance flows since 2015.
- A rapid maturing of the green bond market, which started almost from scratch in 2015, before becoming the world's largest in 2016, coupled with the rapid adoption of best practice, such as third-party verification.
- Guidelines on green bond issuance and green definitions, which initially covered the interbank market (90 percent of China's bond market) and progressively extended to listed companies and the entire financial system.

## Overall Results



## Good Practice

- The government's strong leadership and the influence of regulatory authorities have together facilitated the emergence of a regulatory framework that applies not only to the banking industry, but is now expanding across the entire financial system.

- Banks face stringent reporting obligations on their green credit operations and E&S risks, across all their financial activities. China Banking Regulatory Commission (CBRC) has designed rigorous reporting tools and key performance indicators. It is responsible for collecting data and evaluating the implementation of this comprehensive policy package.

- The booming green bond market in China has mobilized various stakeholders to create a commercially viable market, which has led to a positive experience of green finance, with high standards and a healthy, market-based ecosystem.

## Areas for Improvement

- Regulatory authorities have been the main drivers of the development of sustainable banking in China to date. To generate positive impacts and spillovers, the banking industry could be more proactive in driving improvements of the current policy landscape. The People's Bank of China (PBC) has identified lack of financial incentives for the banking industry as an area for improvement.

- While reporting obligations rely on a structured mechanism, the impact of the CBRC's policy package cannot easily be assessed because of lack of data transparency and public disclosure.

- Actions aimed at capitalizing on the implementation experience could be accelerated, in order to help the entire financial system go green. Green definitions and green bond issuance guidelines could be harmonized.

CONTEXT:

# 3. Enabling Environment

## Country Profile

China's economic growth has come at the expense of its environment and public health. The pressure on the environment remains significant, despite slower gross domestic product (GDP) growth in recent years. The country is now facing an environmental crisis, as statistics indicate that 75 percent of water resources and 19 percent of arable land are contaminated, coupled with growing social tensions. China seeks new means of growth, by capitalizing on the green economy.

Facing growing domestic public concerns, in 2015 the Chinese government published an overarching national strategy on ecological civilization, focusing on the transition to a green economy and environmental protection. Certain energy intensive industries are closely monitored, with noncompliance severely punished. As part of the enforcement of environmental law, environmental data are becoming more transparent, with the emissions and violation records of major polluters now published online. China has also committed to, and signed, the Paris Agreement on Climate Change. As part of its first National Determined Contribution (NDC), China has committed to lowering its $CO^2$ emissions per unit of GDP by 60 percent to 65 percent (from 2005 levels). It has also committed to increasing the share of non-fossil fuels in primary energy consumption to around 20 percent.

Large state-owned banks dominate China's banking sector. They play a key role in financing the state sector and the investment-driven economic growth model. However, the private sector and households use alternative financial intermediaries, which adds complexity to the country's financial sector. The stock market is growing at a fast pace.

## Background and Strategy of the Sustainable Finance Framework

In 2007, the **Green Credit Policy** was the first policy statement jointly issued by CBRC, PBC and the Ministry of Environmental Protection, setting out the objective of directing banking finance flows toward green projects and away from polluting and energy intensive projects.

The CBRC has performed a crucial role in developing and enforcing a comprehensive policy package imposed upon all banks and all their activities, with the issuance of the **Green Credit Guidelines** in 2012, the **Green Credit Statistics System** in 2014, and the **Green Credit Implementation Key Performance Indicators** and **Energy Efficiency Lending Guidance**, both in 2015.

As the banking regulator, the CBRC has imposed green credit operations and reporting obligations upon banks by developing reporting tools and relevant indicators. To date, the impact of the CBRC's policy package cannot be assessed with accuracy, because the data collected from banks are not made publicly available. Likewise, the monitoring of implementation does not include penalties in cases of noncompliance.

More recently, the PBC has taken a larger role in establishing standards and definitions, with the issuance in late 2015 of the **Guidelines for Establishing the Green Financial System**. The same year, PBC issued green bond guidelines and a catalogue for the interbank market. In 2017, China Securities Regulatory Commission (CSRC) issued **Guidelines for Green Bond Issuance for Listed Companies** (2015) and the addition of the restrictive provision that "*green bond issuers shall not be those who are high polluters or are in industries that conflict with the national industrial planning policy*." The implementation experience of the banking industry is progressively helping the entire financial system go green, while there are plans to harmonize standards and definitions.

While political and regulatory authorities have been the main drivers of change during the last ten years, industry-led initiatives to improve the regulatory framework and trigger policy innovation have been limited. However, the launch of the **Green Finance Committee** in 2015, which includes regulators, banks, asset managers, insurers, and technical experts, marked a big step forward for China. The Green Finance Committee notably developed the Green Bond Catalogue, which defines categories of projects eligible for financing via green bonds, and has been endorsed by the PBC as well as adopted by the CSRC.

## Support from Regulators

The CBRC carries out offsite monitoring and onsite inspections to ensure implementation of the green credit policy framework. It requires banks to conduct comprehensive evaluations at least twice a year on E&S risk and green credit performance and to file self-assessment reports. The results are collected and used as an "*important basis for regulatory rating, licensing, senior management performance evaluation in accordance with relevant laws and regulations*." In addition, the Green Credit Guidelines indicate that the CBRC should provide guidance throughout the process. This guidance is provided through the Green Credit Statistics System (2014) and Implementation KPIs (2015).

Going forward, the PBC wishes to include green assets as part of their macro-prudential assessment and plans to introduce incentives, such as re-lending for assets with a high environmental benefit.

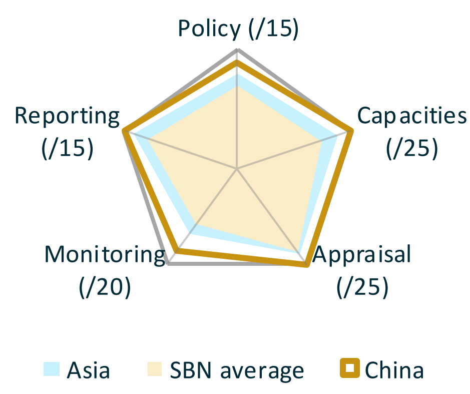
RISK:

# 4. Environmental and Social Risk Management

The current regulatory framework in China demonstrates a high level of maturity in terms of E&S risk management. The country has introduced a comprehensive set of requirements covering the building and maintenance of E&S capacity, periodic portfolio reviews, stakeholder relationships, and reporting obligations for banks.

As early as 2007, the CBRC, PBC and Ministry of Environmental Protection jointly called on banks to consider environmental impact and energy efficiency as part of their lending decisions, via the issuance of the **Green Credit Policy**. Five years later, building on successful local and international experience, the CBRC issued the **Green Credit Guidelines**, which provided operational guidance on how to implement green banking in three categories, one of which was E&S risk management. In this document, E&S risks were defined as "*potential impact and risks brought to the environment and communities by banks' clients and their primary supply chains through construction, production and operational activities*." The development of E&S risk ratings and the identification of high E&S risk clients with E&S risk ratings was also explicitly required. E&S risk reporting obligations were imposed on banks by the CBRC with the introduction of the **Green Credit Key Performance Indicators** in 2015.

The Green Credit Guidelines encourage banks to adopt best practice or international standards. To date, two banks are signatories to the Equator Principles (EPs), three banks are signatories to the UN Global Compact (UNGC), and five investment managers have signed the UN Principles for Responsible Investment (UN PRI).



| Subpillars | Comments on good practice and areas for improvement |
|---|---|
| Policy | - The Green Credit Guidelines indicate the application scope. However, they are not detailed by type of activity (such as project finance, asset management or private banking), which could help FIs when applying them.<br><br>- Banks are not required to develop a climate strategy aligned with China's climate commitment or with a 2°C trajectory. Furthermore, none of the existing regulations require transition risks to be assessed or measured (such as financial exposure to policy changes or the implementation of a carbon price). |
| Capacities | - The Green Credit Guidelines highlight the need to "*recruit and train specialized staff*," including a senior manager, "*to lead and manage green credit related work*."<br><br>- Training is also expected to be enhanced, and such information must be reported (for example, "*annual green credit training and education hours for each employee*"). |
| Appraisal | - Banks are required to screen and categorize projects and, if needed, to include conditions and covenants in the transaction documentation. |
| Monitoring | - The Green Credit Guidelines do not require regular site visits for high-risk projects, but "*banks shall develop a list of clients with major E&S risks. Such clients shall be requested to develop and implement action plans for major risks involved, put in place comprehensive and effective stakeholder communication mechanism and seek risk mitigation measures*."<br><br>- Climate risk must be taken into account in lending decisions and "$CO^2$ *emission reduction equivalent per 100 million RMB investment*" is a compulsory indicator among the Green Credit Key Performance Indicators (KPIs) that banks must report against to the CBRC. |
| Reporting | - Banks must report against a comprehensive set of green credit KPIs to the CBRC. To date, data collected by the CBRC are not made available to the public, and no sanctions are imposed in cases of noncompliance. |

OPPORTUNITY:

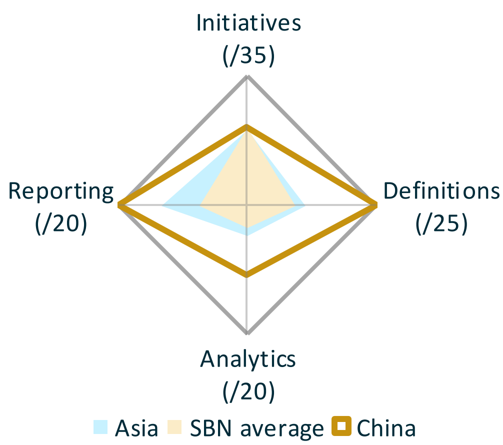
# 5. Green Finance Flows

China's regulatory framework regarding green loan origination is considered the most comprehensive one among SBN members. The introduction of **the Green Credit Statistics System** in 2014 was a groundbreaking initiative as it was one of the first attempts to define green loans in emerging markets. It represents a decisive first step to enable banks to issue green bonds more easily or manage green banking assets, such as asset-backed securities. Green credit loans have been classified into 12 categories, with subcategories to define which projects are green. A tool to calculate the environmental benefit of green credit lending was also developed.

In 2015, the PBC required bond issuers to refer to the China Green Bond Endorsed Project Catalogue, an official list of six categories, with 31 subcategories, of projects eligible for financing via green bonds. This catalogue, which was developed by the Green Finance Committee, also contains detailed explanations and definition criteria.

China has experienced a thriving green bond market, which increased from almost zero in 2015 to US$36.2 billion in 2016 to become the world's largest green bond market. Against this backdrop, the PBC and seven state ministries published the **Guidelines for Establishing the Green Financial System** in late 2015. These guidelines are important, as they notably accomplish the following:

- Clarify the definition of green finance, which has also been adopted by the CSRC for listed companies.
- Advocate for unified rules and regulations on green bond issuance (for example, third-party evaluation standards).
- Intend to create financial incentives for green investment.
- Push forward the development of green insurance.
- Seek to support local governments and promote international cooperation in green finance.



| Subpillars | Comments on good practice and areas for improvement |
|---|---|
| Initiatives | - The Green Credit Guidelines state that "*banks shall promote innovation in green credit business process, products and services under the premises of effective control of risks and sound commercial viability*."<br><br>- The Guidelines for Establishing the Green Financial System include a series of policy incentives to allow "*projects supported by green loans to apply for fiscal subsidies on interest payments*" as well as re-lending operations by the PBC. This incentive could lead to more effective implementation. |
| Definitions | - The Green Bond Catalogue endorsed by the PBC and developed by the Green Finance Committee includes six categories (and 31 subcategories) of projects eligible for green bonds.<br><br>- As set out in the Guidelines for Establishing the Green Financial System, "*green finance refers to financial services provided for economic activities that are supportive of environment improvement, climate change mitigation and more efficient resource utilization*." |
| Analytics | - A tool to report on environmental benefits was developed under the CBRC's Green Credit Statistics System. In order to make further progress, shared and transparent methodologies for measuring environmental impact could be developed. |
| Reporting | - The 2016 Guidelines for Establishing the Green Financial System issued by 7 ministries recommend "*institutional investors to make use of green verification reports in investment decision-making*" and also advocate for new "*ways to standardize the quality requirements for third-party verification*".<br><br>- Data reporting on green finance performance to the CBRC is required once a year, but the CBRC has not publicly disclosed the results yet. |