



Current Situation and Development Direction of Green Finance in Hong Kong

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Current situation of green finance in Hong Kong

Thanks to the continuous promotion of the government, Hong Kong's green bond market has shown remarkable performance in recent years and new developments have taken place in the green loan market.

1. Hong Kong green bond market develops rapidly

Since the beginning of this year, development of Hong Kong's green bond market has accelerated significantly. Firstly, issuance of green bonds increased significantly. Compared with issuance of US\$2.3 billion in 2017, about 16 green bonds with a total of US\$2.3 billion were issued in Hong Kong in the first half of this year, three times as much as last year. Secondly, the issuers tend to be diversified, including local institutions, Mainland enterprises and international organizations. Mainland enterprises are the main participants in Hong Kong's green bond market. The proportion and scale of green bonds issued offshore by Mainland enterprises increased significantly from 18% (US\$6.6 billion) in 2017 to 40% (US\$5.25 billion) in the first half of this year, and the issuers shifted from large commercial banks and policy banks to leading enterprises. Thirdly, the denominated currencies are more abundant, including currencies such as Hong Kong dollar and Renminbi.

2. The government has increased its support for green finance

In January this year, the Hong Kong Quality Assurance Agency launched the Green Finance Certification Scheme with reference to a number of international and national standards, improving the recognition of green financing. In February, The Government mentioned in its 2018-19 Budget that it would launch a green bond issuance program with a borrowing ceiling of HKD 100 billion. In June, the Green Bond Grant Scheme (GBGS) was launched to subsidize qualified green bond issuers in using the Certification Scheme. In September, the Hong Kong Green Finance Association was launched, and the Securities and Futures Commission published a Strategic Framework for Green Finance to ensure the credibility of green products sold in Hong Kong and to develop diversified green investment opportunities by providing disclosure guidelines that meet international standards.

3. Progress in Hong Kong's green loan market

In March this year, New World Development Co., Ltd. announced the launch of a "green financial framework". In accordance with this framework, the Group will invest in eligible sustainable development projects through green bonds or loans. At present, the New World Group has approved the framework for the first green loan to invest in a large-scale commercial reconstruction project. In fact, the growth of green

loans in Hong Kong financial institutions has accelerated in recent years. Growth in green loans of some Chinese banks in Hong Kong has been faster than that of traditional loans. The proportion of green loans to total assets is about 3% - 5%. As the government guides the development of green finance, the relative scale of green loans in Hong Kong is expected to increase rapidly in the future.

Opportunities for Hong Kong to develop green finance

Huge green financing demand of the Mainland and the Belt and Road initiative, as well as the connectivity mechanism, will provide new opportunities for Hong Kong to develop green finance, helping Hong Kong become an international green financial center.

1. Help connect green capital flows between the Mainland and the world

Recently, the Mainland has emphasized the development of green industry. It is estimated that annual investment of the green industry in the Mainland during the 13th Five-Year plan is about 3-4 trillion yuan. To support the development of green finance, the People's Bank of China has expanded the scope of qualified collateral for medium-term lending facility to include green bonds and green loans. As an international financial center and offshore RMB business hub, Hong Kong can serve as a bridge to match the green investment and financing needs of the Mainland and the world. In recent years, Hong Kong has become an important financing channel for Mainland enterprises. In 2017, China's US dollar bond issuance exceeded US\$220 billion, most of which were issued in Hong Kong. As of June this year, the outstanding balance of Hong Kong banks' Mainland loans amounted to HK\$4.4 trillion. Therefore, Hong Kong can help with green fundraising of Mainland enterprises and promote the green transformation of the Mainland economy by enlarging green financing markets.

2. Provide services for green construction of the Belt and Road

At present, 15 United Nations agencies have signed an agreement on Belt and Road with related Chinese institutions, aiming to create the sustainable development agenda for 2030 and develop the green Belt and Road. The OECD estimates that the world would need to invest US\$6.9 trillion per year between 2016 and 2030 in green, low-carbon and climate-resistant infrastructure. Of which US\$1.5 trillion will be invested in countries along the Belt and Road. Thus, by leveraging its sound legal system, mature capital market and robust infrastructure, Hong Kong can extend green financial services from the Mainland to the Belt and Road countries, providing services such as green fundraising, green project compliance review and green certification to international issuers.

3. Strengthen green connectivity with the Mainland

With financial openness of the Mainland deepening, the future green links between Hong Kong and the Mainland can focus on two aspects: (1) Broaden the depth of both Hong Kong and Mainland's green bond markets through Bond Connect. By the end of 2017, the outstanding amount of Mainland green bonds market was 433.4 billion yuan, the largest green bond market in the world. At the same time, Bond Connect has increased the demand for Chinese bonds by international investors. As of August 2018, foreign institutions had increased their holdings of Chinese bonds for 18 consecutive months, amounting to 1.75 trillion yuan, and 2.4% of the total amount of Chinese bonds. Hong Kong can facilitate overseas investors to enter the Mainland

green bond market via Bond Connect, while broadening the depth of its own green bond market; (2) Help the Mainland to integrate into the international green financial market. At present, there are still differences between the Mainland's green financial markets and international standards in terms of infrastructure, market practices, and regulation. Hong Kong can play an intermediary role for China's integration into the international green bond market.

Development direction of green finance in Hong Kong

Although Hong Kong's green bond market has achieved some progress, efforts should be made in policy, regulation, investment and financing, and product innovation to provide a better market environment for the issuance and trading of green financial products. Considering the latest Strategic Framework for Green Finance announced by the SFC and the experience of developed countries and some emerging markets in developing green finance, Hong Kong can start from the following aspects to promote faster development of green finance.

1. Improve the framework of green finance system

Development of green finance requires the government to establish a green financial system framework including clear green standards, specific development guidelines, and comprehensive laws and regulations. At present, about 20 countries and regions have launched a green finance development roadmap. In the future, Hong Kong can further improve the framework of green financial system. For example, on the basis of the Green Financial Certification Scheme, a green fund labeling scheme can be considered to improve the transparency of the green standard system. At the same time, clear guidelines on green investment and financing should be drawn up to enhance market confidence in green finance.

2. Give financial policy incentives

Although the government has provided some financial support such as the GBGS for green bond issuance, it is not yet enough. Referring to the experience of the UK, Germany and other European countries, the government can boost the development of green finance through fiscal policies, such as tax deductions for companies issuing green bonds, or cost and pricing incentives for green lending. At the same time, funds investing in green financial products could be exempted from profit tax.

3. Innovate green investment products and mechanisms

With a relatively developed financial market, Hong Kong can create a diversified green financial products platform by innovating green financial products and mechanisms.

Firstly, reform the public listing process for green sector companies. Hong Kong is well established as a center for the listing and trading of equity securities and derivatives of companies in China and elsewhere. The regulators can consider reforming the listing process to make Hong Kong the listing venue of choice for earlier stage green companies. Meanwhile, green index and green derivatives can enrich green financial products.

Secondly, asset management institutions can incorporate ESG factors into their decisions, to innovate

in green investment mechanisms and to support green financing needs. At present, nearly 84% of asset management companies in the world integrate ESG principles into their investment policies. The United States, Japan and other countries have also taken ESG factors into account in their major pension funds and pension plans. Hong Kong has sizable assets and wealth management business (up to HK\$24.3 trillion at the end of 2017) but lags behind in sustainable investment. In the future, Hong Kong insurance companies can develop green investment linked products and investing premium incomes in green funds, green bonds and other green assets. Fund companies can increase ESG investment ratios in their portfolios or even set up special green funds.

Thirdly, commercial banks can consider green asset securitization to facilitate their access to the green field. For example, banks can issue green asset-backed bonds and green mortgage securitization products to expand the market for green credit.

4. Set up green investment bank, attracting private capital

Government finance and other public funds can only meet 10% - 15% of the investment needs of green projects, so private capital is required for the development of green finance. Due to high risks and small scale of green projects, financial institutions are generally reluctant to invest in green projects. Referring to the experience of the UK, an independent Green Investment Bank (GIB) can be established through government funds to attract private capital and invest in various types of green projects.

Currently, there are two major GIBs in Asia, the Green Finance Organization in Japan and the GreenTech in Malaysia. Therefore, the Hong Kong SAR government can also consider setting up a GIB to expand the scale of the green financial market.

5. Improve enterprise information disclosure system

Due to the lack of professionals and relevant experience in investing in green financial products, assessing risks and returns on green financial products will increase investment costs of asset management institutions by about 15%. Improving the enterprise environmental information disclosure system can help asset managers rationally price products and increase investors' confidence.

In 2017, the Task Force on Climate-related Financial Disclosures (TCFD) under the Financial Stability Board of the Group 20 set feasible standards for enterprises to disclose environmental information. In response to TCFD's recommendation, UK, France, Canada and Australia have launched mandatory measures for information disclosure. The Mainland also requires listed companies to disclose environmental information compulsorily by 2020. This requirement also applies to issuers of A/H shares on the Hong Kong Stock Exchange.

Therefore, Hong Kong regulators need to update the ESG disclosure rules to enhance the consistency and comparability of environmental information provided by the listed companies to drive more green investment demand.