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British Consulate-General Hong Kong

Overview of Green Finance Trends

Summary

Finance is critical to tackling global climate change and environmental challenges. Mainland China has shown clear policy commitment to tackling climate change and is actively looking for green financial innovation to help finance its low carbon transition, including in partnership with Hong Kong. Hong Kong is a top 3 global financial centre with a large pool of financial expertise and infrastructure. There is huge potential for Hong Kong to contribute to the transformation of China's green financial system and play a role in climate finance. We see 3 areas of focus that could seed Hong Kong seize the potential: (1) Dialogue on green financing between the Hong Kong SAR government and stakeholders to define strategy and expertise; (2) enhance links with mainland China stakeholders to define opportunities; and (3) capacity building among investors and businesses to develop opportunities using existing platforms. The UK has developed as a global green financial centre. We see opportunities for Hong Kong to develop as a green financial hub, with potential for partnership with UK expertise and institutions.

Background

Climate change is happening and affecting global sustainable growth. Finance is critical in tackling this global challenge. According to the International Energy Agency, the world must invest at least an additional US$1 trillion per year into clean energy by 2050 (currently $250 billion per year) if we are to limit global warming to 2oC and avoid the worst impacts of climate change. Policy commitment and financial innovation in both the public and private sectors are required to fill this huge financial gap.

There have been a number of encouraging commitments made among governments, investors and financial institutions in recent months:

- Call for an ambitious global deal by investors - 348 world's leading institutional investors representing US$24 trillion in assets called on governments to develop an ambitious global climate deal and policy measures to encourage capital deployment at scale to finance low carbon transition.

- Green Climate Fund – Countries have pledged over US$10 billion to the UN's Green Climate Fund. As some first steps to capitalise it, governments, investors and financial institutions are committed to mobilize more than US$200 billion by the end of 2015, including issuance of green bonds worth

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US$30 billion by commercial banks; greening the investments of major pension funds upto US$31 billion by 2020 and doubling investments of insurance industry to US$82 billion by the end of 2015.

- Putting a price on carbon – a group of over 80 leaders from national and regional governments, and over 1000 businesses and investors, representing 52% of global GDP, signalled their support for pricing carbon. A new Carbon Pricing Leadership Coalition was formed.

- Carbon disclosure and decarbonisation of assets - A new Portfolio Decarbonization Coalition was formed and committed to decarbonize US$100 billion and to measure and disclose the carbon footprint of at least US$500 billion in assets under management. The Coalition was co-founded by the UNEP Finance Initiative, Swedish national pension, Europe's largest asset manager Amundi and Carbon Disclosure Project.

- G20 Commitments on energy – The G20 Principles on Energy Collaboration and the Action Plan for Voluntary Collaboration on Energy Efficiency were agreed, including financing work on energy efficiency.

Recent development in mainland China and Hong Kong

China is facing tremendous challenges resulted from climate change and environmental degradation. In particular, the Pearl River Delta region is one of the top 10 urban areas in terms of vulnerability to climate risk. Finance is crucial in both mitigating and adapting to the risks and impacts. The People's Bank of China (PBoC) estimates that China needs RMB 2 trillion (approximately £200 billion) per year by 2030 to green the economy.

The PBoC, together with United Nations Environment Programme Inquiry into the Design of a Sustainable Financial System, recently established the Green Finance Working Group comprising 40 persons in 14 sub groups across government, industry, NGOs and international advisors. The Working Group focuses on developing policy proposals to improve the efficiency of banking, institutional investment, capital markets and insurance to direct investment towards viable green projects. The Group presented their proposals in four areas in November 2014: green bonds, green insurance, legal responsibility of financial institutions, and environmental information disclosure.

The Chief Economist of the Research Bureau of PBoC, Dr. Ma Jun, is the co-chair of the Working Group has been instrumental in the development of green finance in China. A few months before the release of the Green Finance Working Group and its proposals last November, he called for a new transformational system for green finance to tackle China's environmental and climate change challenges. His earlier thoughts providing substantial basis for the proposals of the Green Finance Working Group include:

1. The creation of a 'UK style Green Investment Bank' (GIB) and green bonds could be used to fund the bank.
2. Green bond - Tax breaks for green bonds, to differentiate them from regular bonds and promote green bonds market (China ranks the first in issuance of climate-themed bonds globally, including

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explicitly labelled as green and unlabelled and in Hong Kong, there is a number of international banks active in green bond markets).

3. Environmental risks disclosure (Shanghai Stock Exchange has issued carbon disclosure guidelines and recommended the Securities Regulator to make it mandatory and tighter requirements are seen in Hong Kong: legislation requiring narrative environmental information in Directors' annual reports came in last year and Hong Kong Stock Exchange has plan to step up to 'comply or explain' ESG disclosure for listed companies in 2015. The HK SAR government recently launched a voluntary carbon disclosure repository).
4. A system for measuring companies' environmental costs and "natural capital liabilities".
5. Green insurance
6. Accelerate the completion of a national carbon market, expected to be the largest in the world when it comes into operation in 2016 (Among seven carbon trading pilots in mainland China, two (Guangdong and Shenzhen) are geographically close to Hong Kong and two (Shenzhen and Shanghai) are keen and started engagement in Hong Kong. Shenzhen government announced last week the approval for foreign investors to participate in Shenzhen carbon market whereas Hong Kong government's policy research unit has recently made announcement to include carbon markets as one of their interest areas. Further long-term potential for Hong Kong-mainland China collaboration is presented by the Hong Kong-Shanghai Stock Connect and potential Hong KongShenzhen Connect).
7. Establish a China Green Institutional Investor Network (The idea is in line with the international Institutional Investors Group on Climate Change whose sister organization is the Asia Investors Group on Climate Change based in Hong Kong where financial professionals are not in shortage).
8. Green consumer education for green products including green financial products.

Opportunities for Hong Kong

Hong Kong is a top 3 global financial centre with the second biggest stock exchange in the Asia Pacific region and a favoured destination for mainland Chinese companies to list publicly. This means that it is well placed to take advantage of the huge demand for green finance in the region, contribute to China's low carbon transition and help direct green finance to tackle the global climate change challenge. We see potential for Hong Kong to develop itself to be Asia's green financial hub using its expertise and mature infrastructure. Specific areas presenting opportunities include:

1. Using finance to improve energy efficiency within the three energy intensive sectors (buildings, industry and transport) in Hong Kong and South China. The Hong Kong SAR government has provided various financial incentives in all these three sectors in the past. We see opportunities to scale them up to benefit further both Hong Kong and the Pearl River Delta (PRD) region.

2. Based on the current HK-Guangdong Collaboration Framework, we see an opportunity to adopt UK

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Green Investment Bank (GIB) model to upscale in partnership with Guangdong government the Cleaner Production Programme (currently the HKSARG's flagship programme subsidising energy efficiency of Hong Kong-owned factories in PRD). A PRD GIB could be a pilot for a future national GIB.

3. Explore the models of the existing UK Energy Efficiency Investment Fund and the planned UK China Energy Efficiency Investment Fund and provide appropriate policy framework to help tackle the energy efficiency financing needs both in Hong Kong and mainland China.

4. Explore opportunities for more Hong Kong players to be involved in climate bonds market in both China and South East Asia.

5. Explore opportunities in China carbon markets and financial system reform for example capacity building, enhancing market credibility and transparency as well as developing trading products.

6. Explore opportunities in the Qianhai Shenzhen –Hong Kong Modern Service Industry Cooperation Zone, for example piloting green financing products.

7. Promote a sustainable stock exchange, including more stringent disclosure requirements.

8. Further enhance green capacity among financial professionals and educate investors, riding on Hong Kong's unique role in a number of existing regional platforms/network such as Asian Financial Forum (climate finance is part of 2015 programme).

Trends in the UK

The UK financial services sector and Government, partnering with their counterparts worldwide, have worked together to develop policy frameworks and innovative financing models to unlock the private finance. In June 2014, London hosted the first meeting of the **Global Innovation Lab for Climate Finance,** which was created to design and pilot innovative finance instruments to drive private investment into climate change action. In addition to providing its financial expertise, the UK has recently pledged to fund 12% of the UN's Green Climate Fund which raises funding from developed countries to help developing countries.

Domestically, the UK government is committed to transitioning to a green economy. The **UK Green Investment Bank (UK GIB)** was created by the government with an initial £$3.8 billion of capital. UK GIB use the capital to back green projects in target sectors (offshore wind, energy efficiency, waste and bio energy), on commercial terms, to mobilize other private sector capital to accelerate the UK's transition to a greener and stronger economy. The Bank has backed 33 green infrastructure projects committing over £1.4 billion.

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Energy efficiency is widely recognized as the low hanging fruit to tackle greenhouse gas emissions. As in many other countries, the UK identified large rooms for improvement in energy efficiency, in particular in buildings and a gap in financing available to enable energy efficiency improvement work at scale (**The UK National Energy Efficiency Action Plan and Building Renovation Strategy**). The UK Energy Efficiency Investments Fund is a public-private-partnership with £50 million of investment from the UK GIB and a further £50 million of private investment to tackle the finance gap. The Fund is managed by the Sustainable Development Capital which is also managing similar funds in Singapore and Ireland with investment from their respective governments. In partnership with the Hong Kong-based First Eastern Investment Group, the fund manager also has plans to launch the UK China Energy Efficiency Investment Fund which will seek to invest up to US$200 million in energy efficiency projects.

Another innovative climate friendly financing scheme using public-private partnership approach is the **Green Deal** which aims to finance building energy efficiency improvement works without upfront capital investment made by the property owners.

London has developed as the preeminent global green financial hub, introducing innovative products into the market. Two of many examples include **emissions trading schemes (ETS)** (The UK is the pioneer of the EU ETS. The world's ETS were valued at US$30 billion in 2013 and keeps growing with more national schemes coming into operation) and **climate bonds**. The 2014 market for green bonds concluded at approximately US$40 billion (the figure varies depending on the detailed definition of green bond), which is about triple the volume issued in 2013. The top 3 types of issuers are development banks (44%), corporate (33%) and municipal governments (13%). It is projected to reach US$100 billion by 2015.

The UK ranks second to China in of climate-themed bonds, including both explicitly labelled as green and unlabelled. The total universe of climate-themed bonds stands at over US$500 billion outstanding, including an issuance of US$95 billion in 2013 (12% increase on 2012). A number of corporate green bonds were also issued including by Toyota and Unilever. The **Climate Bond Initiative** (CBI), a London-based investors-focused NGO, works together with institutional investors representing US$2.24 trillion of assets, and with financiers such as HSBC, Barclays, Skandinaviska Enskilda Banken (SEB) and more in the City of London to promote the green bond market. SEB pioneered the green bond market in partnership with the World Bank in 2008 and currently tops the CBI's green bond underwriter's league table.

The **London Stock Exchange** (LSE) also plays an important role in facilitating the flow of green capital from investors. For example, it hosts a range of FTSE4 sustainability indices, it is a member of the UN-led Sustainable Stock Exchanges Initiative and hosts numerous cleantech funds as well as the IFC's RMBdenominated green bond issued in June 2014, the first RMB green bond issued by a multilateral institution in the offshore Chinese markets. Last year, the LSE announced requirements of **carbon disclosure** for listed companies. The Carbon Disclosure Project (CDP) has been representing 767 institutional investors holding US$492 trillion in assets to obtain carbon performance data from thousands of companies to help reveal the investment risks and facilitate their investment decision. CDP recently concluded in a study report that industry leadership on climate change engagement is linked to higher financial performance.

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Comment

The UK has developed as a global centre of green finance. Hong Kong has the opportunity to develop its green finance capacity, with huge demand for climate finance in mainland China and SE Asia. There is much scope for closer collaboration between the UK and Hong Kong on green finance. We see 3 areas of focus that could seed Hong Kong seize the potential: (1) Dialogue on green financing between the Hong Kong SAR government and stakeholders to define strategy and expertise; (2) enhance links with mainland China stakeholders to define opportunities; and (3) capacity building among investors and businesses to develop opportunities using existing platforms.