China's green bond market

By Yao Wang and Ricco Zhang

Since the People's Bank of China (PBOC) and the National Development and Reform Commission (NDRC) published their guidelines for issuing green bonds in China at the end of 2015, along with policy endorsements from other official bodies, green bonds have become important financing tools for China's capital market to serve the real economy. China Industrial Bank and Shanghai Pudong Development Bank were the first two issuers of green bonds. Since then, many financial institutions have started to take an active role in this expanding market. According to data from Wind, as of 30 November 2016, the size of China's labelled green bond market reached RMB 195.53 billion (US$ 28.211 billion), including 46 green bonds from 26 issuers, of which four are asset-backed securities.

The development of China's green bond guidelines has relied on international experience and Chinese regulators keep regular contacts with international self-regulatory organizations, market standards providers, market participants and other regulators. In particular, China's Green Finance Committee (GFC) working under the PBOC has benefitted from the participation and input of the International Capital Market Association (ICMA) and the Climate Bonds Initiative (CBI) while developing the framework of China's green bond market. Both ICMA's Green Bond Principles (GBP) and the Climate Bonds Standards were used as references during the drafting of the Chinese green bond guidelines and the Preparation Instructions on Green Bond Endorsed Project Catalogue (2015 Edition) (GB Catalogue). A number of important Chinese institutions have also become members or observers of the GBP and partners of CBI respectively.

During 2016, China's green bond market became the largest in the world. This article looks at the factors behind its rapid development.

Official support

Green finance is now becoming a top priority for the Chinese authorities. As a major component in building the green finance system, green bonds have been included in its development strategy. On 21 September 2015, the Central Committee of the Communist Party of China (CPC Central Committee) and the State Council released its policy paper, *Systematic Scheme for Environmental Conservation Culture Structural Reform,* explaining the top-level design of China's green financial system explicitly for the first time. This scheme suggests that, in facing the challenges presented by climate change, the "new normality", the green financial system will stimulate economic growth during the 13th Five-Year-Plan period (2016-2020).

Consistency with domestic policy

In recent years, a series of reform measures in China's bond market and the more relaxed policy environment have provided a powerful driving force for the development of green bonds.

First of all, the relaxation of the regulation around bond issues has provided the conditions for the issue of all kinds of green bonds. For example, a wider range of companies are now able to issue corporate bonds, a system of private placement is allowed and project revenue bonds can be publicly issued through book building in the interbank bond market. Reform and innovation in the issue of enterprise bonds has been speeded up, simplifying the declaration procedure for enterprise bonds, increasing the efficiency of bond funds, intensifying the responsibility of the intermediaries for information disclosure and emphasizing regulatory supervision in the course of the issue and afterwards. The issuing terms for Quasi-Municipal Bonds have also been relaxed and high-quality enterprises are encouraged to issue bonds to support such key projects and areas endorsed by the authorities. More local enterprises are encouraged to raise funds using enterprise bonds. Local treasury bonds have cash management guarantees from the central and local treasury and monetary policy operating tools guarantees from the PBOC, which will benefit the issue of green municipal bonds in the future.

Second, the liberalization of the bond market in China allows easier transactions involving green bonds. For instance, approval for bond transactions in the interbank bond market is no longer a requirement and private investment funds are allowed to participate in cash bond transactions. More foreign agencies (namely other central banks, international finance corporations and sovereign wealth funds) have access to the interbank bond market. In addition, the examination and approval system will be replaced by the filing system. The restriction on the investment amounts will be relaxed and participants can choose their settlement agents themselves.

Encouragement of the use of financial bonds for infrastructure projects will also accelerate the development of the green bond market. In 2015, China Development Bank and Agricultural Development Bank of China offered a RMB 300 billion private placement to Postal Savings Bank of China as an infrastructure construction loan, which enjoys an interest subsidy at a 90% rate of the special project bond from the central finance. The speeding up of developments in asset securitization also offers development opportunities for green bonds.

Last but not least, several green bond related guidelines have been put forward by regulators, including PBOC, NDRC, Shanghai Stock Exchange, Shenzhen Stock Exchange and The National Association of Financial Market Institutional Investors, which directly give policy support to China's green bond development. Along with the development of China's green finance agenda, the GFC has been playing the key role. In the green bonds space, GFC has developed the GB Catalogue which is used to support the green bond guidelines by PBOC and Shanghai Stock Exchange. GFC is also responsible for harmonizing different Chinese green bond standards and promoting the Chinese onshore green bond market.

GFC also works closely with ICMA, GIZ and other international organizations to promote green bond development in China. Commercial institutions such as HSBC, Bank of China, Agricultural Bank of China and other institutions who are active in the international green bond market contribute to the growing interaction between the international and Chinese green bond markets.

Market foundation

The development of green bonds relies on the overall success of the Chinese bond market. Although China is an emerging market, it is already the second largest bond market worldwide, with good credit and strong liquidity, and a wide base of market and public participation. As the scale of financing through markets is expanding and interest rate liberalization is moving forward, the scale and transaction variety of the Chinese bond market is developing rapidly.

The tremendous potential of China's bond markets is the foundation for the development of green bonds. It is expected that, from 2015 to 2020, the direct financing of non-financial enterprises will increase from 17.2% to about 25%, and the value of outstanding bonds at the Chinese capital market will increase to 100% of China's GDP.[16] In 2015, China's total GDP reached RMB 67.67 trillion. If the GDP increases by 6.5% per year, China's total GDP will reach RMB 92.71 trillion in 2020, which means there is potential for more than RMB 29 trillion of issuance in China's bond market. If the ratio of green bonds increases to 1%, it means there will be RMB 290 billion of green bonds in 2020. But if the ratio of green bonds increases to 5%, it means there could be as much as RMB 1.45 trillion of green bonds in 2020.

Investor demand

Green bonds enjoy greater demand from responsible investors. Especially in the international capital market, banks, insurance companies, pension funds and some fund companies accept the principle of sustainable investment, so they have a considerable investment allocation for green projects in their asset portfolio and therefore a large demand for green bonds. In October 2015, Agricultural Bank of China issued green bonds of US$-denominated 900 million bonds and RMB-denominated 600 million bonds. The dollar bonds, including a 400 million 3-year bond and a 500 million 5-year bond, were 4.2-times oversubscribed at rates of 2.125% and 2.75% respectively. The offshore RMB bond was 8.2-times oversubscribed at a rate of 4.15%. Such successful examples show the interest that international investors have in China's green bonds and RMB-denominated green bonds.

The proceeds raised by green bonds are invested in green projects such as renewable energy, and energy efficiency improvements etc. Most of the projects enjoy subsidies from central and local government. Further preferential policies for green bonds are expected, such as lower investment thresholds and more favourable tax rates. These preferential policies can lower the financing cost to some extent, leading issuers and investors to invest more in projects for environmental protection, low-carbon development and sustainable development. Green bonds also have stricter information disclosure responsibilities and more transparent use of the proceeds, so investors can invest in environmental projects at a lower risk, at the same time satisfying their sense of social responsibility.

Conclusion

In conclusion, as green finance has become a significant part of the national strategy, the development of China's green bond market has been encouraged by the Chinese authorities. Meanwhile, a series of policy reform measures have promoted the development of the bond market, which in turn creates many opportunities for the green bond market. More issuance of green bonds in China and China's green bond popularity among responsible investors in the international capital market has expanded the investor base for green bonds. Further development of the green bond market will rely on continuing stable policies, a favourable market environment, cooperation with the international market and a growing number of green investors.

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16. By Xiaochuan Zhou, the Governor of PBOC.