Banking on a greener future

Yueqiu Zhou looks at the opportunities, challenges and strategies for commercial banks to address climate change

ICBC ranks first among China's domestic commercial banks in terms of the total amount of green investment and financing. As at the end of February 2021, the balance of green loans of ICBC was close to RMB2 trillion.

The balance of green bond investment, wealth management investment and lease financing exceeds RMB300 billion, also leading the domestic market. As at the end of March 2021, the balance of ICBC's loans granted for clean energy projects was nearly RMB500 billion, due to an increasing number of loans for the power production industry.

ICBC has strengthened business innovation and actively promotes comprehensive green financial services. For example ICBC:

- underwrote the first green building "carbon neutral bond" in China's interbank bond market.
- invested RMB8 billion in the national green industry fund to support the development of green industry through the "investment-loan linkage" mode.
- strengthened the forward-looking research on green finance, leading the world in environmental and climate risk stress testing. It released the sole "Belt and Road" green finance (investment) index in the industry.

Carbon neutrality puts forward higher requirements

For the future operation of banks in China, carbon neutrality will impact the following three areas:

Policy: In 2016, seven ministries and commissions of China incorporated the fight against climate change into green finance in the *Guidelines for Establishing the Green Financial System*. In October 2020, the Ministry of Ecology and Environment, the National Development and Reform Commission, the People's Bank of China, the China Banking and Insurance Regulatory Commission and the China Securities Regulatory Commission jointly issued the *Guidelines for Promoting Investment and Financing in Response to Climate Change*. It is expected that the standards and requirements for low carbon factors will be fully incorporated into the relevant green finance policy documents in the future.

Industry: Low-carbon transformation will bring about market opportunities and challenges. The market space of high emission industries narrowed, income decreased, while financing costs increased. Low-carbon technology is becoming more mature and the cost of low-carbon industry is decreasing rapidly. The process of low-carbon transformation will be accompanied by the renewal and upgrade of infrastructure. Carbon neutrality is expected to bring China RMB138 trillion of investment opportunities in the next 30 years, according to the research conducted by the Institute of Climate Change and Sustainable Development, Tsinghua University.

Dr Yueqiu Zhou is the chief economist of ICBC, the deputy director of the chief economist cooperation committee of the Asian Financial Cooperation Association, the dean of the modern finance institute of ICBC, and the secretary general of China Modern Finance Society. Zhou has done extensive research on reform and development of banking industry, security markets and the Chinese economy.

Market: The low-carbon demand of stakeholders has been increasingly strong. Since the outbreak of Covid-19, the ESG concept has had increased attention from more and more global investors. Institutional investors are keeping a closer eye on the disclosure of the environmental and climate-related situation of listed banks.

Need to strengthen risk assessment

The banking industry is confronted with two main climate risk changes:

1. Policy will be stricter. Under the more stringent environmental protection policies and regulatory requirements, the operating costs of enterprises are rising and the solvency is declining. Therefore, the financial industry should reduce high-carbon investment.

2. Market risk will escalate. As demand for high-carbon products and energy declines, the operation of enterprises will be restrained, which may result in credit risk.

The transition to low carbon is often accompanied by infrastructure renewals. Due to the long cycle of infrastructure projects, the risk of construction projects may expose related financial assets to risks.

The banking industry will need to accurately predict the impact of future industrial restructuring on high-carbon industries, adjust and optimise credit policies, and adapt to and support low-carbon transformation. It also must perform scenario analysis and stress testing of environmental and climate risk, especially the quantitative analysis of high-carbon industry risk.

While quantifying the environmental risk, it should implement differentiated pricing and limit management for green and brown assets and projects.

The Herald put the following questions on green finance to ICBC's Yueqiu Zhou:

Herald: What are the big trends in low-carbon investment opportunities?

Low-carbon transformation will create a huge investment demand. Carbon neutrality is expected to bring China investment opportunities worth RMB138 trillion in the next three decades with low-carbon industries developing by leaps and bounds, according to the research conducted by the Institute of Climate Change and Sustainable Development, Tsinghua University. Green and low-carbon technologies will gather pace in innovation, because industries depend on technological progress to realise green upgrades.

The ESG investment market will grow rapidly. Since the outbreak of the Covid-19 pandemic, the ESG concept has been recognised and followed by an increasing number of global investors.

Carbon financial products will continue to innovate. In the EU carbon market, carbon financial products mainly comprise carbon futures, carbon funds, carbon asset pledge financing, carbon asset repo financing, carbon quota custody, and green structured deposits. Of these, carbon futures account for 90 per cent of the trading volume and 95 per cent of the trading amount in the market. Other carbon financial products only take a tiny market share, yet present broad prospects for development.

Herald: How has ICBC built capability and thinking in terms of green finance across the bank?

While striving to achieve our own green operation, we have also made good use of many innovative products and services, such as green loans, green bonds, industrial funds, green wealth management, and green leasing, to increase our support for eco-friendly industries, customers and projects. We have also carried out forward-looking research and international exchanges on green finance and improved the quality of environmental information disclosure. We endeavour to achieve the close integration of economic, social and ecological benefits, thus becoming a pioneer in and a leader of sustainable development among financial institutions.

We have long been committed to promoting the transformation of the Chinese economy and society towards green and low-carbon operations. The national goal of "peaking carbon emissions and achieving carbon neutrality" is a mission that must be accomplished at ICBC. ICBC head office has established a green finance committee, which is tasked to co-ordinate and urge all business lines and institutions across the ICBC Group to develop green finance.

We have controlled financing directed to carbon-intensive industries and actively transformed our investment and financing structure towards green operation.

We have fully supported the construction of pilot zones for the green finance reform in China. We therefore lead other market players in these places by the scale of green loans granted.

Herald: What have been the biggest challenges for ICBC as it scales up on green finance and support for low-carbon development?

The goal of carbon neutrality poses challenges on the Chinese banking industry:

Banks that hold a large proportion of carbon-intensive financial assets will face a relatively high level of transformation-related risks.

While transiting to low-carbon operation, carbon-intensive companies may incur higher costs, generate less profits, or even suffer losses due to technological upgrading, energy conservation and emission reduction, and other measures, which may expose banks to credit risks. Regulatory authorities will put forward more demanding requirements for the banking industry concerning the low-carbon transformation. To promote financial institutions towards low-carbon transformation, regulatory agencies will roll out innovative incentive and restraint policies. Financial institutions will be encouraged to channel more assets into low-carbon fields, and will see their climate change response capabilities, efforts and contributions evaluated by regulators. In other words, carbon reduction performance will be incorporated into the evaluation and appraisal of commercial banks.

It is also time for the banking industry to consider nailing down its own carbon neutral targets and measures. To do so, financial institutions need to measure their carbon footprint and take effective measures to reduce and neutralise their carbon emissions.

Herald: How different has the uptake of green finance been in different markets around the world?

So far, at least a dozen countries and regions around the world have issued policy frameworks and action plans for green and sustainable finance. Developing green finance has become a global consensus, but levels of development in different places of the world are varying to some extent.

The US, the EU, the UK, Japan, New Zealand, and Hong Kong have all unveiled relevant policies or ESG guidelines that stipulate contents under mandatory information disclosure. Major financial institutions all over the world follow the ESG standards set out by mainstream rating agencies such as MSCI, Standard & Poor's, Moody's, and Fitch, when it comes to environmental information disclosure.

But there are still inconsistencies in the requirements put forth by governments or regulators of various countries and regions.

Green finance has been enshrined into China's national strategy. It is an explicit requirement to "develop green finance and attain green development".

This year, Governor of the People's Bank of China, Yi Gang, said that China's green finance has been built on five pillars: standard system, information disclosure, incentives and constraints, product innovation, and international cooperation. China has seen its green finance policies and systems coming at the forefront of the world.

Herald: Does ICBC's focus on promoting green finance mean that there are some projects you decide not to fund? If so, how is that decision made?

We keep intensifying investment and financing in environmentally sensitive areas, embed green credit requirements into the full process of credit business, and incorporate environmental and social risk factors into the customer risk evaluation system and the customer credit rating monitoring and analysis flow, in a bid to comprehensively strengthen the environmental and social risk management.

Investment and financing activities are divided into twelve categories on four levels depending on their exposures to environmental and social risks, so that differentiated investment and financing policies can be implemented to manage them.

We are proactively withdrawing from the financing projects of enterprises with higher environmental and social risks.

At ICBC, corporate customer ratings are used as an important basis for making credit risk management decisions.

The classification of customers takes into account many aspects of factors including environmental protection behaviour, safety production standards, and green credit type. Environmental factors are fully considered in the monthly monitoring and analysis of customer credit ratings.

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When a major environmental or safety incident occurs or customers overstep the limits corresponding to their green credit classification, the customer will be re-evaluated within one month.