

ESTABLISHING CHINA'S GREEN FINANCIAL SYSTEM

Detailed Recommendations 8: Establish a Green Rating System



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Detailed recommendations 8: Establish a Green Rating System

Establishing green rating and green credit information systems is a fundamental task at the heart of green finance. Once the green rating of projects and companies is put into place and applied to the credit information system, it becomes possible to evaluate environmental (positive, negative) externalities in a science-based manner and provide justifications for fiscal subsidies or fines, bank interest rate discounts or increasing credit and bond financing costs. Specifically, companies and projects rated as green enterprises and projects are able to acquire financing cost advantages of relevant grades in bank loans, bond financing and interest rate discounts according to their green rating results, so as to achieve the objectives of encouraging green investments and restricting polluting investments.

(I) The case for creating green rating systems

In July 2007, the PBoC and the State Environmental Protection Administration of China (SEPA) jointly promulgated *Opinions on Implementing Environmental Protection Policies and Rules and Preventing Credit Risks*, which requires banks to regulate the credit issuance to companies that fail to meet their energy conservation and emission abatement obligations. In November of the same year, the CBRC enacted the *Guiding Opinions on Credit Issuance for Energy Conservation and Emission Reduction* to steer the implementation of green credit activities. In February 2008, the Ministry of Environmental Protection and the CIRC, the CSRC and the CBRC jointly promulgated new policies on green insurance, green securities and green credit, which have brought green finance to public attention.

However, banks and third-party rating agencies did not establish systematic green rating systems, which are the prerequisite for conducting consistent, comparable and effective evaluation of green factors including the pollution and ecological impacts of rated entities or projects and the sustainable utilization of resources. Absence of green rating systems is unfavourable to implementing credit risk evaluation for the financing of green projects on a large scale and achieving China's objectives for pollution abatement, ecological protection and sustainable utilization of resources. We believe that it is imperative to create green rating systems within China's banking system, third-party rating agencies and credit information system.

(II) Overall approach for creating China's green rating system

1. Essence of green rating

A green rating is underpinned by the consideration of three major factors, including the impact of environmental pollution, the impact to the ecological system and the sustainable utilization of natural resources. Among them, the impact of environmental pollution includes the impact or

abatement of pollution in such areas as water, air, soil and food production as an essential human need; the impact to the ecological system includes the impacts to the ecological chain, including species protection and climate change. For instance, the construction of reservoirs, roads and railways may block wildlife migration and carbon emissions may cause climate change, induce changes in the natural environment and thus cause the extinction of species. The sustainable utilization of natural resources encompasses the effective use of non-renewable resources water, petroleum and natural gas.

The scope of a green rating should be determined in accordance with the Green Credit Guidelines of the CBRC and the green bond policies of the PBoC and the CBRC. A green rating should include the monitoring and evaluation results and indicators of environmental protection authorities as ad hoc evaluation basis and the results of green rating should be applied in credit interest rate discount, green bond review and approval, fiscal subsidies, administrative penalties and tax preferences.

2. Steps for implementing a green rating

First, introduce a green factor or weight into the existing rating system and create a double rating system. Currently, the traditional rating system involves entities and projects to be rated. Rated entities include sovereign states, local governments and enterprises; rated projects include traditional debt financing projects and green industry projects that may involve green concepts.

Given the time and effort required for re-engineering the existing rating systems, for conventional debt financing projects, the rating results of the existing rating systems can be followed with the additional consideration of green factors or green weighting. This will generate the green rating results in parallel and create a double rating. In addition, fiscal subsidies, interest rate discounts or environmental penalties can be provided according to the green rating results.

Second, conduct a dedicated green rating for green industry projects. According to the definition on green projects made by the Ministry of Environmental Protection, the CBRC and the CSRC, efforts should be made to create credit rating systems including rating criteria, methods and applications for green projects, and provide dedicated credit rating for debt financing such as green credit and green bonds of green projects. Green credit classification and indicators formulated by the CBRC (see Annex I) can be used as a starting point for future extended applications to the green classification and rating of multiple financial instruments including green credit, green bonds and green securities.

3. Green rating entities

Green rating can be carried out by at the least the following three types of institutions:

(1) Banks

Banks (including green banks and the green finance divisions of commercial banks) should develop and employ green rating as the basis for project evaluation and risk pricing. Regarding the

establishment of an internal green credit rating system of banks, the Environmental Finance Division of the China Industrial Bank (CIB) and the China Development Bank have already developed experiences that can be further improved and rolled out.

(2) Rating agencies

Rating agencies provide the rating of green bonds and evaluate the environmental impacts of other corporate bonds. Third-party evaluation institutions should make an analysis according to the risk factors and processes of green finance, identify a reasonable scope of implementation, develop rating standards and methods, and explore reasonable pricing standards and business models. The first batch of rating agencies may include Dagong Global Credit Rating Co. and China Cheng Xin International Credit Rating Co. Ltd. (CCXI) before further roll out.

Considering the extensive application of conventional rating and the preliminary stage of green rating, we suggest that rating agencies provide ‘double rating’ as piloting and transition, i.e. to provide the market with green rating of the same issuer in addition to conventional rating. Public communication and promotion of green rating should be carried out to increase its market acceptability and complete the transition towards the inclusion of environmental impact assessments in all rating results.

After the inclusion of green rating factors into conventional rating programs, rating agencies may increase existing pricing standards. The inclusion of green rating factors will pose more demanding requirements on polluting and energy intensive companies and recognize the projects with clean production, new energy, low pollution and high energy efficiency. Relevant pricing standards may reflect an increased value of rating information after the inclusion of green factors.

(3) The Credit Information Centre of the PBoC may use the environmental impact assessments of the green rating provided to financial institutions as an important supplement to the record of defaults and environmental violations.

(III) Application of rating results

Green rating results have a broader scope of potential applications, including (1) credit departments of banks will make credit extension and risk pricing decisions based on the green rating of their respective banks and the Credit Information Centre of the PBoC; (2) fiscal authorities and partner banks may provide interest rate discounts for green loans according to the green rating; (3) fiscal authorities may provide tax exemption preferences for investors of green bonds with reference to the green rating; (4) environmental authorities may impose penalties on polluters with reference to the green rating; (5) various types of green industry funds or ecological protection funds may provide support to green enterprises with reference to the green rating; (6) NGOs, the media and consumers may evaluate the environmental performance of companies according to their green rating information and influence their conduct.

Annex 1: Classification of green credit

Classification and the balance of green credit for major Chinese bank institutions in 2013

Unit: 100 million yuan

No.	Indicator of green credit		Year-end loan balance
(I)	Projects and services of energy conservation and environmental protection		36853.5
1	Green agriculture		229.3
2	Green forestry		193.8
3	Industrial energy and water conservation and environmental protection		3180.8
4	Nature preservation, ecological restoration and disaster prevention and control		998.5
5	Circular utilization of resources		848.5
6	Waste treatment and pollution control		1834.5
7	Renewable energy and clean energy	7.1 Solar power	616.4
		7.2 Wind power	2374.1
		7.3 Biomass	161.1
		7.4 Hydropower	6366.7
		7.5 Other renewable energy and clean energy	806.2
		7.6 Smart grid	82.8
		Subtotal	10407.4
8	Rural and urban water supply	8.1 Rural drinking water safety	197.5
		8.2 Small farmland water conservancy facilities	297.9
		8.3 Urban water conservation	436.5
		Subtotal	931.9
9	Building energy conservation and green buildings	9.1 Green renovation of existing buildings	49.2
		9.2 Construction O&M of green buildings	410.9
		Subtotal	460.1
10	Green transport	10.1 Railway transport	10444.7
		10.2 Waterway regulation and ship procurement	555.8
		10.3 Urban public transport	5862.5
		10.4 Environmental protection of transport	443.9
		Subtotal	17307.0
11	Energy conservation and environmental services	11.1 Energy conservation and services	152.1
		11.2 Environmental protection services	127.5
		11.3 Water conservation services	18.8
		11.4 Circular economy (circular utilization of resources) services	63.4
		Subtotal	361.9
12	Overseas projects with international practices or international standards		99.8
(II)	Green credit for strategic emerging industries		15129.6
1	Energy conservation and environmental protection		9613.1
2	New energy		5294.5
3	New energy vehicles		222.0
(III)	Sum of green credit by major bank institutions [(I)+(II)]		51983.1

Source: 2013 Green Credit Fact Sheet of Major Bank Institutions, the CBRC, 2014

Annex 2: Environmental protection regulations

1. On December 18, 2013, the Ministry of Environmental Protection, the NDRC, the PBoC and the CBRC promulgated *Measures for the Evaluation of Corporate Environmental Credit (Trial Implementation)* under MEP [2013] No.150 Document.
2. On April 17, 2007, the Ministry of Finance and the State Administration of Environmental Protection promulgated *Interim Administrative Measures on Ad hoc Funds of Central Finance for the Abatement of Major Pollutants under the MOF Department of Economic Development* [2007] No.112 Document.
3. On June 5, 2013, the NDRC, the Ministry of Environmental Protection and the Ministry of Industry and Information Technology promulgated the 2013 No.33 *General Rules on the Formulation of Evaluation Indicator System for Clean Production (Trial Implementation)*.
4. On August 1, 2013, the State Council promulgated the *Opinions on Accelerating the Development of Energy Conservation and Environmental Industries under the State Council* [2013] No.30 Document.
5. On September 1, 2014, the Ministry of Environmental Protection promulgated the 2014 No.41 *General Outline of Technical Guidelines for the Environmental Impact Assessment of Planning*.
6. On October 30, 2012, the Ministry of Environmental Protection promulgated the 2012 No.134 *Notice on Further Enhancing the Disclosure of Environmental Protection Information*.
7. On January 20, 2014, the Ministry of Finance and the Ministry of Environmental Protection promulgated the *Notice on the Adjustment of Government Procurement to List of the 13th Term of Environmental Label Products under the MOF* [2014] No.7 Document.
8. On December 4, 2007, the Ministry of Environmental Protection promulgated *Guiding Opinions on Environmental Pollution Liability Insurance under the MEP* [2007] No.189 Document.
9. On January 21, 2013, the Ministry of Environmental Protection and the CIRC jointly promulgated *Guiding Opinions on Implementing the Pilot Programs of Compulsory Environmental Pollution Liability under the MEP* [2013] No.10 Document.

THE GREEN FINANCE TASK FORCE

The Green Finance Task Force was initiated by People's Bank of China (PBC) Research Bureau and the UNEP Inquiry into the Design of a Sustainable Financial System in 2014. The Task Force brought together leading Chinese financial policy and regulation experts together with experts from the private sector, academia and think tanks, as well as international experts.

A number of organizations have lent great support to this Task Force, chief among them are Chongyang Institute for Financial Studies of Renmin University, the Ecological Finance Research Center at the Renmin University of China, the Eco Forum Global, the International Institute for Sustainable Development, the Green Credit Special Committee of China Banking Association, and China Finance 40 Forum.

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