

Green Credit Service in China: Policy Review and Flawed Regulation

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Abstract: This article provides the review of policy evolution concerning the green credit service in China. Also, this article addresses the issue of regulatory flaws in this regard. Based on the analysis above, the proposed regulatory amendment is offered. Significance of the article is to provide the comprehensive and reliable regulatory insights of green credit service for China's financial policymakers to enhance regulatory policies' amendment in the future.

1. Introduction

For the sake of harmonizing economic growth, ecological environment protection, and facilitating the government to achieve the carbon objective, green credit service is introduced in China considering its critical financing function in the financial market instruments.¹ The green credit service provided by China's commercial banks is currently in its elementary stage,² therefore, is inevitably accompanied by certain regulatory drawbacks. That could entail a conflict between the goal of green credit service and the policy objective originally set by policy-maker.³

In view of the above background, this article firstly provides a critical review of policy evolution in this regard in the second section. The third section of this article attempts to analyze regulatory flaws concerning two aspects: the information disclosure regulation, disharmonious standards of green credit service. Based on the analysis above, the fourth section proposes regulatory amendment concerning the green credit service in the future.

2. Regulatory Evolution of Green Credit Service

2.1 Introduction of General Policy of Green Credit Service

In 2007, considering national situation of energy conservation, emission reduction, and environmental pollution control, the State Environmental Protection Administration, the People's

Bank of China and the China Banking Regulatory Commission jointly issued the Opinions on Implementing Environmental Protection Policies and Regulations to Prevent Credit Risks [2007] to propose the financial policy to enhance the transition to low-carbon economy. Although this document did not mention the term "green credit", it was the first time that China's policymaker explicitly associates the credit service of commercial banks with the environmental performance of enterprises. That policy document was therefore considered as a symbol of the official introduction of green credit service in China. In August 2016, the People's Bank of China, the Ministry of Finance, the Banking Regulatory Commission, the Ministry of Environmental Protection, and other seven ministries jointly issued the "Guidance on Establishing Green Financial System"[2016], which explicitly proposed the construction of a systematic policy to support green credit service in the national scope. Those policy documents listed above demonstrates government's tone with regard to the construction of regulatory system in the field of green credit service.

2.2 Regulatory Frameworks of Green Credit Service

To encourage commercial banks to introduce green credit service, China's government agency issued series of regulatory documents in the past decade. These regulatory documents address the green credit system, including the Guidance on Granting Credit for Energy Saving and Emission Reduction [2007], Green Credit Guidelines [2012], Energy Efficiency Credit Guidelines [2015], etc. These documents provide a comprehensive package of regulatory guidelines, management methods, and assessment policies for commercial banks to carry out green credit service in the field of green, recycling, and low-carbon. It is worth mentioning that, the important regulation involving green credit statistics and monitoring is the Green Credit Statistics System issued by CBRC [2013]. This document provides the rules of regular statistics instrument on commercial banks' credit involving traditional high-emission projects, energy-saving and environmental protection projects and ecological services, the quality of green credit assets, and other green projects.

The regulatory documents concerning the green credit assessment and evaluation include the Key Evaluation Indicators of Green Credit Implementation issued by BRCF [2014] and the Social Responsibility Indicators set in the Supervisory Guidelines on Performance Evaluation of Banking Financial Institutions issued by BRCF [2012]. Two documents above intend to facilitate major national commercial banks to deploy the self-evaluation system of green credit and construct a comprehensive mechanism with the unified standards and timely rectification.

3. Regulation Defects of Green Credit Service

3.1 Lack of Effective Information Disclosure Mechanism

China has made continuous efforts to improve the construction of environmental information disclosure system in recent years, the current environmental information disclosure mechanism has some flaws however.⁴ Those regulatory flaws include the weak enforcement of rules, the lack of unified coordination of rules, various bodies of supervision and the rule of information accuracy. Those regulatory flaws definitely impede the operative effect of green credit issuance and evaluation.

First of all, because commercial banks and environmental protection departments doesn't belong to the same sector, no information sharing platform is established available to different sectors'

regulators, resulting in information asymmetry between different departments and sector. This situation would hinder the effective implementation of green credit policies. Secondly, commercial banks lack the capability of environmental protection assessment, and the cost of collecting, assessing, processing and disclosing the environmental protection information of enterprises is comparatively high and their assessment efficiency is low in most cases. These factors definitely hinder the enthusiasm of commercial banks to implement green credit policy.

As required by the “Guidelines on Green Credit” issued by China Banking and Insurance Regulatory Commission in 2012, commercial banks should fulfill the obligation of disclosing information related to green credit service. However, due to the vague text of the relevant provisions in this document and the lack of operability in practice, banks apply the approach of voluntary or selective information disclosure concerning the green credit operation in the practice, and furthermore, most banks do not take the initiative to disclose relevant information as required.⁵

3.2 Disharmonious Standard of Green Credit Service

One of the major flaws in China’s green credit regulatory policy is the implementation standards of green credit standard are not harmonized in the national scope. In 2012, China issued the “Guidelines on Green Credit”, which addresses the issue of introducing national standard of the green credit service of commercial banks. It is undeniable that the relevant regulatory policy and documents encourage and guide commercial banks to implement green credit policy to a certain extent, but most policymaking agencies have only responded to the central policy documents without introducing the operative initiatives and implementation standards.⁶

The Green Industry Guidance Catalog (2019) emphasizes that all commercial banks and other financial institutions should comply with the rules of document mentioned above as a standard benchmark to assess green credit service, green bonds and other green projects. However, when the defined standard is not specified and operative, the manager of green credit cannot get timely and accurate feedback on the actual market situation. Different commercial banks have different standards when defining and assessing green projects. Furthermore, we cannot ignore the fact that the data standards disclosed in the social responsibility report are also different among national banks.

China's government agencies and regulatory bodies are constantly improving the relevant regulatory systems of green credit, most provisions are, however, vague and guiding, with general and broad text, resulting the weak enforcement of most regulatory policy in this regard. As far as the supervision issue is concerned, the regulatory agencies in the green credit service introduced no specific rules to supervise the process of green credit project operation, and there are no operational rules to supervise the green credit proceedings of commercial banks, which entails the fact that the regulatory documents lack enforcement effectiveness. The current regulatory documents are released by different government bodies, those different level of governmental bodies traditionally are involved with interest game participated by namely provincial governments, financial institutions and green project operator.⁷ If the provincial commercial banks set the higher green environmental protection standards when assessing green projects, it would bring about a negative impact on the provincial economic interest.⁸ On the other hand, green projects with low-return definitely hinders the deployment of green project credit service.

4. Proposed Regulatory Amendment

4.1 Formulation of Unified Standards for Green Credit Service

Green credit service is a newly-emerging market in China's banking sector, and there is a lack of nationally unified and operative guidelines in the process of the service.⁹ In order to effectively regulate the practice of commercial banks and facilitate the sustainable development of green financial market, the banking financial regulators should organize an organ consisted of industry experts, complying with the "Equator Principles" and sophisticated international rules as a reference, to formulate effective guidelines in line with China's national market situation. Those provisions should cover green project evaluation, approval, post-monitoring, risk management for the sake of constructing a specific, standardized and transparent regulation in the field of green credit service. Specifically, with regard to "operational due diligence", the Article 15 of "Guidelines on Green Credit Service" stipulates that the third-party authentication is required when necessary, which means that it is the commercial bank to decide whether the third-party authentication is necessary when granting green loan. In this regard, it is feasible for the bank to turn to the recommendations of a Working Group on climate change related financial information disclosure and uniformly stipulate that green credit information disclosure of commercial banks shall be verified by an independent third-party to ensure the authenticity and accuracy of information. In addition, in accordance with the provisions of Article 11 of "Guidelines on Green Credits", the unified standardized template for projects' environmental risk assessment should be established. Moreover, the quantitative indicators, analysis methods for environmental revenue accounting and data collection procedures should be specified in a scientific manner. In this regard, the feasible approach is to introduce the guidelines of environmental risk management under the banking regulatory authorities, incorporating specific assessment indicators into the bank's green credit risk management mechanism.

4.2 Establishment of Effective Subsidy Policy for Green Credit Service

Compared with traditional credit service, green credit service usually encounters higher risk, low rate of return, long-run operation and other negative factors. Therefore, financial policymakers should introduce effective subsidy instruments to encourage commercial banks to deploy green credit service. Considering the efficiency of public subsidy allocation, China's traditional approach of direct subsidy should be changed, introduce operative fiscal and tax-break policies to attract private capital to flow into green industries, and at the same time, give full play to the leverage of financial instruments in view of promoting low-carbon transformation. In terms of subsidy policy overhaul, differentiated reserve requirements should be formulated to encourage commercial banks to carry out credit service involving green sectors.¹⁰ Specifically, the level of differentiated green deposit reserve ratio is substantially related to the amount of green credit in the bank's balance sheet, so as to materialize indirect subsidy instrument involving green credit service for commercial banks. In addition, in light of reshaping fiscal and tax policies, tax-break should be granted to the interest-income of commercial banks respectively deploying green credit service; last but not least, the government should set up a funding program to provide indirect subsidy such as collateral or security for green credit service.

4.3 Building Environmental Information Sharing Platform

Market failure issues such as moral hazard and adverse selection caused by the phenomenon of "information asymmetry" perplex the management of commercial banks all the time. On the one hand, they affect the implementation of green credit business,¹¹ on the other hand, they will increase the financing cost of green project enterprises, and is not conducive to the effective supervision by financial regulators. Therefore, the establishment of a scientific environmental information sharing mechanism is a critical prerequisite for the sustainable development of green credit service. As to government departments, they should take full advantage of their executive resources, exert the government's position to communicate and coordinate with public agencies involving environmental law enforcement, financial supervision and other sectors, and integrate relevant eco-information resources. Only by this means is it feasible to establish the environmental information sharing platform; for commercial banks, the information such as green loan access and auditing of corporate customers should be implanted into the green credit sharing platform. Through such sharing platform, the commercial banks could improve the procedure concerning auditing, information disclosure, monitoring and early notification of the ecological and environmental data of enterprise' project. Under this information sharing platform, the banks may improve the efficiency of green credit service, so as to prevent green credit funds from being used by enterprises for high emission and pollution projects. Specifically, the bank can timely adjust the credit level for non-green enterprises with reference of the EIA information about enterprises from the environmental department released on the platform.

5. Conclusion

Due to the lack of practical experience in green credit service, this emerging service is far from being a systematic and structured component of banking constitution and strategy. From the perspective of regulatory policy, the green credit policy with sound operability and enforcement can effectively enhance function of financial institutions in the low-carbon economic transformation. As China's progress in the energy and environmental protection industry has always been affected by the enforceable legal regulation and financial subsidy policies, the further promotion of green credit service of China's commercial banks shall adopt the approach of "integration of legal rules and market incentive tools".

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