China Green Bond Market Newsletter Q3 2019

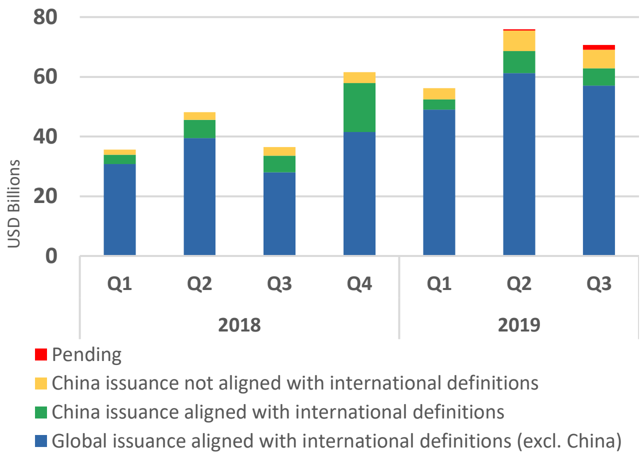
中国绿色债券市场季报 2019 第三季度

July-September 2019/2019 年 7 月- 9 月

Market overview

Green bond market increase in Q3 2019

Both global and Chinese green bonds issuance have increased significantly in Q3 compared to the same quarter of 2018, although the total amount of global green bonds that are aligned with international definitions decreased from last quarter.



Despite the surge from the same period last year, the USD14.5bn worth of green bonds dropped by 2% from Q2. Only 40% (or USD5.8bn) of the Q3 volume from Chinese issuers is in line with international green bond definitions. Another 45% is aligned with China's domestic green bond definitions only

There are 15 deals on the Pending list, all from onshore issuers. They account for USD2.1bn or 15% of Q3 volume. The largest deal on the list is China Three Gorges' CNY3.5bn (USD509.2m) bond which finances hydropower, but the information provided was not enough for us to determine if this relates to existing or new reservoirs with high density (preferably 5W/sqm or higher). BYD Company Limited ranked second on the pending list with issue amount of USD490m (CNY3.48bn) as we are seeking further clarifications on allocations.

Green bonds on Pending list

Sometimes use of proceeds details are not available or insufficient at issuance, so we cannot make an immediate assessment on the green credentials of the bond. So, the bond is marked as Pending. Further research is carried out by the end of the next quarter. If no further information becomes available or the information obtained does not show alignment, the bond is added to the excluded bond list.

Proceeds for general use remains primary reason for exclusion

By amount issued, 63% of all excluded Chinese green bonds in Q3 allocated more than 5% of proceeds to general corporate purposes or working capital, with no disclosure if they finance green assets or projects. For example, Guangzhou Metro Group allocated 60% of proceeds to finance metro construction, and the rest 40% to supplement general corporate working capital.

At a glance

Total Q3 Chinese issuance: USD14.5bn/CNY104.3bn

Onshore issuance: USD13.9bn/CNY100.2bn

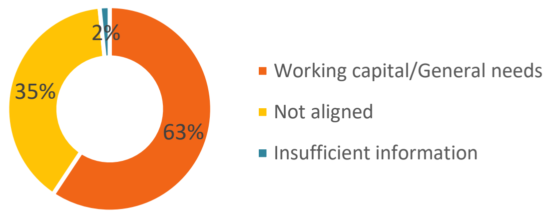
Offshore issuance: USD600m/CNY4.1bn

Issuance that meets international definitions: USD5.8bn/CNY40.3bn

Largest issuer: Industrial Bank Co., Ltd at USD2.9bn

Largest issuing sector: Low Carbon Transport

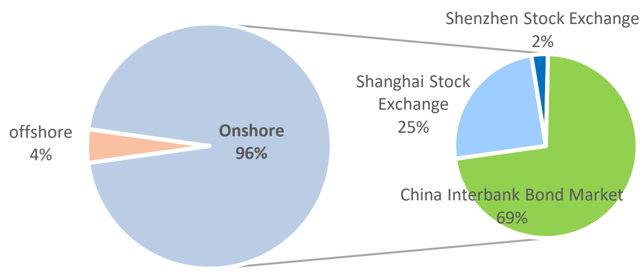
Greater levels of alignment might be achieved if Chinese issuers provide more clarity on the use of proceeds for working capital. Tightening NDRC regulations, which allow up to 50% of green bond proceeds to be allocated to working capital, and Shanghai Stock Exchange rules, which allows 30% for bonds listed on it, would help.



35% of all excluded bonds are not in line with international green definitions. For example, 'replacing the small coal powered plants with the bigger ones' is eligible in China's local context but is not considered as green by international investors. The remaining 2% fail to provide sufficient information.

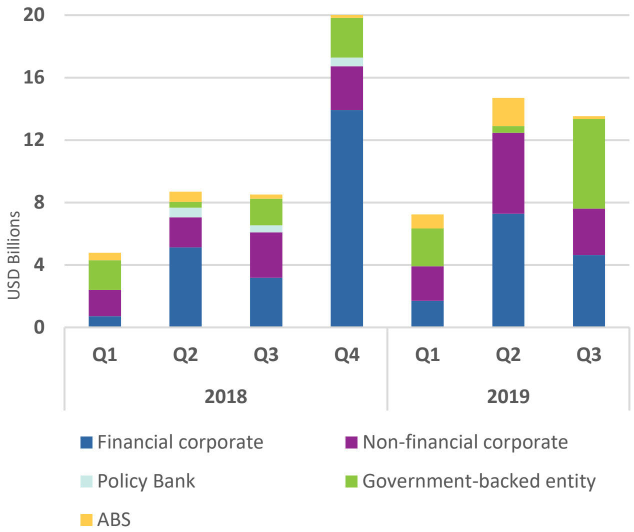
Most Chinese green bonds are issued domestically

In Q3 2019, 96% of Chinese issuance was issued domestically (onshore). Specifically, 69% were placed on the China Interbank Bond Market, followed by listings on Shanghai Stock Exchange with USD3.6bn (CNY25.8bn), or 25% of the Q3 total.



Hong Kong Stock Exchange (HKEX) was the offshore venue for CGN Power Company International's USD600m bond listing.

Government-backed entities step up issuance



Government-backed entities had the strongest quarter on record, reaching USD4.8bn in issuance. However, the vast majority of this (75%) refers to deals that are not aligned with Climate Bonds definitions.

Financial corporates remain prolific issuers with USD4.6bn issuance, despite not being at the top this quarter. Within this issuer type, USD3.7bn of issuance *conforms* with CBI definitions. The three deals that did were issued by Industrial Bank, China Zheshang Bank and Hangzhou United Rural Commercial Bank. The largest was by far Industrial Bank's, for an amount of CNY20bn (USD2.9bn).

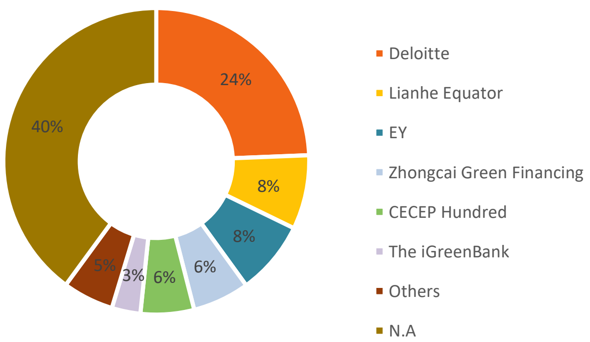
Non-financial corporates dropped to 3rd place. This is composed of 24 deals from 19 issuers, with only 17% aligned to our definitions. Aligned deals were from issuers from different industries. For example: CGN Power International (energy) and China Jushi (manufacturing).

Two aligned **ABS** were issued by Wuhan Rail Transit Construction and Guizhou Anshun Automobile Trucking Company.

60% of issuance carries an external review

Deloitte had a strong quarter, achieving 24% market share among deals with an external review, solely due to providing an assurance for the CNY20bn(USD2.9bn) Industrial Bank deal. Lianhe Equator followed in 2nd place with USD1.1bn. EY ranked at the 3rd , having reviewed two deals: the bonds from China Zheshang Bank and Qilu Bank.

The rest were Chinese providers. Zhongcai Green Financing and CECEP make up the top 5. The share of green bonds without an external review was quite high in Q3 at 40%.



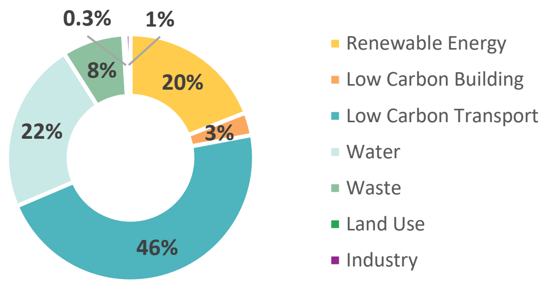
Low Carbon Transport increases its dominance

As the largest sector for bonds aligned with Climate Bonds definitions, Transport's share rose to 46% of issuance volume in Q3. Water (22%) and Renewable Energy (20%) followed.

Transport: The prevalence of commercial banks among transport-related issuance grew to over 50%, driven by Industrial Bank and China Zheshang Bank. Dedicated regional railway and urban transit issuers included Sichuan Railway Investment and Wuhan Rail Transit Construction, the latter issuing Q3's only green ABS. Beijing Infrastructure Investment, and Anshun Automobile Trucking issued the other two aligned bonds.

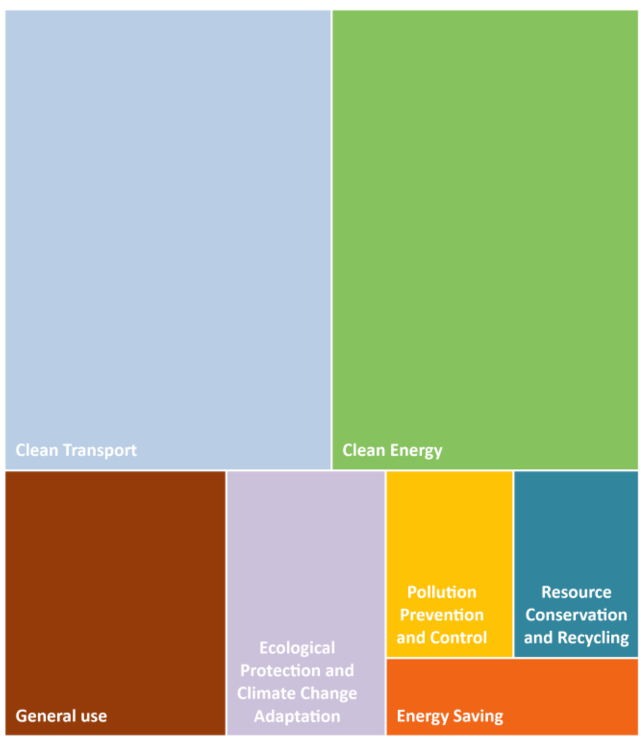
Water: Q3 was a relatively strong period for the water sector with USD1.3bn from five deals. Most of this (82%) came from Industrial Bank's deal, with 36% of proceeds financing water projects. State-owned Tongling Construction and Fuzhou Water Affairs were the 2nd and 3rd largest, respectively.

Energy: Energy-related issuance was weaker than usual at USD1.2bn. Unlike most other sectors, it was dominated by a non-financial corporate (CGN Power International), which issued a USD600m deal in July to finance wind power. As in transport, Industrial Bank and China Zheshang Bank were the two largest financial corporates.



According to China's local green bond definitions, the top three categories are Clean Transport , Clean Energy and and Ecological Protection and Climate Change Adaptation.

Use of proceeds (China's local definition)



Climate Bonds discussion: Sustainable waste management

Background

The consultation paper of Waste criteria of Climate Bonds Standards indicates that the waste sector has the potential to contribute a 10-15% reduction in global greenhouse gas emissions. Opportunities in prevention, reuse, recycling, and energy recovery can achieve significant mitigation by reducing landfill emissions, reducing emissions linked to resource extraction and production using virgin materials, and providing an alternative energy source that substitutes fossil fuels.

The enforcement of waste sorting regulations in China

Starting from early 2019, a couple of cities in China have launched pilot programs to create "waste-free cities", aiming to eliminate environmental impact caused by municipal waste and to use resources more efficiently. Cities including Shanghai, Beijing, Guangzhou, Shenzhen and Hangzhou have enacted or revised regulations on waste classification and have enhanced the guidance on residents' behaviour, strengthened enforcement powers and improved classification in the whole process.

For example, Shanghai's regulation requires residents to sort municipal waste into four categories - dry garbage, wet garbage (kitchen waste), recyclables and hazardous waste. Individuals who fail to do so may face fines.

Waste infrastructure financing in China – challenges and opportunities

According to World Bank research, China's solid waste infrastructure is struggling to cope with unprecedented levels of waste generation. With the tightening of waste sorting and management regulations, the demand for investment in waste management facilities is expected to increase.

China's government is seeking to address the situation through measures such as increasing public investment, introducing "marketization" reforms, and encouraging private sector participation.

Green bond financing for waste infrastructure

57 Chinese entities that have issued green bonds fully or partially financing waste assets. The total proceeds allocated to the theme has reached USD12bn, accounting for 13% of China's overall green bond market that are aligned with international definitions.

The largest issuer segment are financial corporates, representing 68% of the total. The largest non-financial corporate issuers include dedicated WEEE recycling companies such as Zhejiang Huayou Cobalt Co., Ltd, and comprehensive waste and water management corporates such as Tus-Holding, Capital Environment Holdings and China Energy Conservation and Environmental Protection Group.

Future trends

Green bonds provide a channel for waste management facilities financing by introducing both public and private investment. In China, there are 46 cities currently involved in a waste management pilot program, according to the Ministry of Housing and Urban-Rural Development. By 2022, every city at the prefecture level and above should have at least one district where all household garbage is classified. Therefore, we expect to see a surge in waste management and recycling facilities financing.

Eligible green assets according to the Climate Bonds Taxonomy

	Waste management asset type
Preparation	Facilities and assets with high recovery rates of reusable or recyclable material; Collection of waste that is going to landfill
Reuse	Facilities refurbishing or repairing products or cleaning components or products for reuse in their original function
Recycling	Facilities for recycling or metals, plastics, glass (except aggregate) and paper
Biological treatment facilities	Facilities for the production of biogas from organic waste; Facilities for the production of compost from organic waste
Waste to energy	Facilities for solid waste treatment with production of electricity or heat as a by-product
Closed landfill	Projects to add gas capture to existing, closed landfill facilities
Radioactive waste	Nuclear waste treatment; Nuclear waste disposal

News and events

China's Foreign Minister states that China will continue to build a green *Belt and Road*

China State Councilor and Foreign Minister Wang Yi said that "climate change is a common challenge faced by all countries" in a speech at the UN Climate Action Summit in New York on 23 September. He noted, that, cooperating to address climate change is related to the future of mankind, and that China will continue to build a green *Belt and Road* and bring more power to international cooperation on climate change.

Hong Kong Green Finance Association (HKGFA) will form Green Finance Alliance with cities in the Greater Bay Area

The Guangdong-Hong Kong-Macao Greater Bay Area Development Plan provides a huge opportunity for the development of green finance. HKGFA announced in September that it plans to establish the "Green Finance Alliance" to promote green and sustainable development in the Greater Bay Area with Guangzhou Green Finance Committee, Shenzhen Green Finance Committee and Macau Association of Banks. This platform will host research projects and incubate green investment projects in four key areas: greening the supply chain in Guangzhou, major waste treatment facilities in Shenzhen, standardised water risk analysis and green building initiatives, leveraging the vast green investment demand in Guangdong and green finance capacities in Hong Kong and Macau.

The Bank for International Settlements (BIS) recommends that central banks consider green bonds as reserve assets

BIS found that about 65% of the green bonds issued so far this year are "investment grade" and potentially in line with the requirements of central banks for reserve assets. The authors said that, overall, "we found that sustainability goals can be incorporated into the (central bank) reserve management framework without giving up security and returns."

Policy update

State Council supports Shenzhen's *Pilot Demonstration Zone of Socialism with Chinese Characteristics*

The State Council of the People's Republic of China announced the *Opinion on Supporting Shenzhen's Pilot Demonstration Zone of Socialism with Chinese Characteristics*. The opinion emphasizes the need to accelerate the establishment of a low-carbon economic system by creating a new pattern of urban green development.

The opinion suggests Shenzhen is to accelerate the establishment of an economic system for green and low carbon development, build a market-oriented green technology innovation system, develop green industries, promote green consumption and the development of green finance. It is also expected to implement dual control actions on energy consumption and intensity and take the leading role in building a water-saving city.

Investment quota limit for QFII and RQFII has been cancelled

On 10 September, the State Administration of Foreign Exchange announced to cancel of investment quota limit for Qualified Foreign Institutional Investors (QFII) and RMB Qualified Foreign Institutional Investors (RQFII). This will largely increase the convenience of foreign investors to participate in the Chinese domestic financial market.

The Qualified Foreign Institutional Investor program was established in 2002. It provides foreign institutional investors the right to trade on the Shanghai and Shenzhen Stock Exchanges in China. And the RMB Qualified Foreign Institutional Investors was launched in 2012. Over 400 institutional investors from 31 different countries and regions have entered the Chinese market.

Jiangsu Province introduced a subsidy for green bond issuers

Jiangsu Province has introduced a subsidy of 30% on green bond interest, which is expected to decrease company financing costs. This subsidy is applicable to non-financial corporates and will be compensated to the corporate after their payment of the interest. The total amount of the subsidy should not exceed CNY2m per annum per bond.

The subsidy scheme is part of a wider set of incoming policies, including also Jiangsu Province Green Industry Enterprise Issue and Listing Award Policy Implementation Rules, Jiangsu Province Environmental Pollution Liability Insurance Premium Subsidy Policy Implementation Rules, and Jiangsu Province Green Guarantee Awards Policy Implementation Rules, These demonstrate Jiangsu Provinces commitment to green finance.

Innovation and development of Green Finance Reform in Guangzhou

The General Office of the Guangzhou Municipal People's Government announced the Guangzhou Municipal People's Government Office's opinions on Promoting Guangzhou implementation of the Innovation and Development of Green Finance Reform.

The key points cover deepening the reform and innovation of green finance, implementation of some main tasks and the leading role of green finance demonstration in Dawan District of Guangdong, Hong Kong and Macao, strengthening green financial risk prevention and improving safeguard measures.

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** Figures used in this report refer to both onshore and offshore green bonds issued by entities domiciled in mainland China, and green panda bonds unless otherwise stated. Internationally aligned green bonds are those aligned with both local and international definitions of green.*

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