Green Bond Market: Hong Kong's Unique Role

by External Department

Global green finance has grown exponentially over the past few years, with strong demand for green funding coming from Mainland China, and for green investment opportunities from international investors. Hong Kong as a leading international financial centre has been the gateway between Mainland China and the rest of the world, and is uniquely positioned to connect these two markets to capture the opportunities from green finance.

Unmet Demand and Supply

In recent years, green finance has emerged and gained importance amid the global commitments to build a green and sustainable world economy. According to a dedicated study group established by the Group of Twenty (G20), the Green Finance Study Group, "green finance can be understood as financing of investments that provide environmental benefits in the broader context of environmentally sustainable development". Apart from bringing environmental benefits, green finance also helps promote technological innovation and facilitate growth of green industries, while creating potential business opportunities for the financial sector.

Global demand for green funding is enormous. The Organisation for Economic Co-operation and Development (OECD) estimates that on average, US$6.9 trillion a year would be needed for green infrastructure investment from 2016 to 2030[1]. Meeting this funding need requires the mobilisation of private capital which, in turn, creates opportunities for the green bond market. In 2017, global green bond issuance totalled US$161 billion.

Indeed, Mainland China has become the second largest green bond issuer in the world, with issuance totalling US$23 billion[2] in 2017, or nearly 15% of the world's total, and over 20 times higher than the 2015[3] figure (Chart 1). Driven by underlying demand for green funding, developing green finance is featured as a national strategy in President Xi Jinping's report to the 19th National Congress[4]. Despite the progress so far, it is estimated that Mainland China will need an annual green investment of RMB3–4 trillion (US$480–640 billion)[5], and hence domestic investment alone will not be sufficient.

1 Source: OECD, Investing in Climate, Investing in Growth, June 2017.

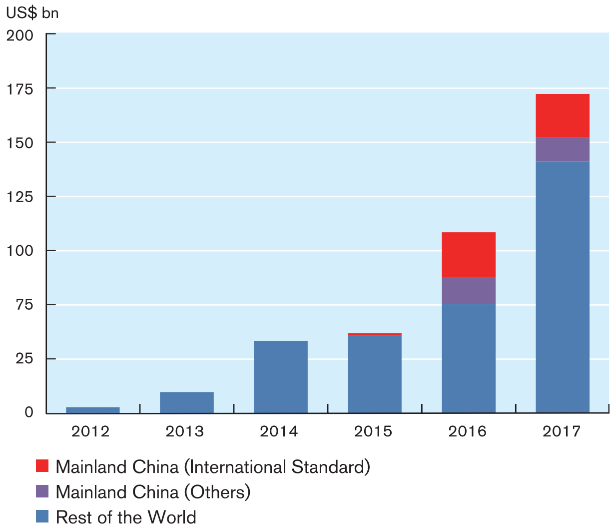
2 The figure covers only green bonds that are aligned with both local and international standards. Including green bonds that are not aligned with international standard, total green bond issuance in Mainland China reached US$37.1 billion (RMB248.6 billion).

3 Source: Climate Bonds Initiative, *China Green Bond Market Annual Report 2017*, February 2018.

4 Source: Para IX, *President Xi Jinping's Report delivered at the 19th National Congress of the Communist Party of China*, 18 October 2017.

5 Source: The International Institute of Green Finance and the United Nations Environment Programme, *Establishing China's Green Financial System: Progress Report 2017.*

CHART 1
International Green Bond Issuance (2012 – 2017)



Source: Cilmate Bond Initiative.

At the same time, international investors' interest in green finance has been growing. Since its introduction in 2006, the United Nations Principles for Responsible Investing has attracted support from over 1,900 signatories, representing nearly US$90 trillion in assets under management by March 2018.[6] An industry study showed that between 2012 and 2017, aggregate assets under management of environmental, social and governance-themed Exchange Traded Funds grew by 340%, to over US$11 billion[7]. A recent industry survey has also shown that 68% of international investors plan to increase their allocation to low-carbon related assets[8].

Matching the Mainland's demand with the international supply of green capital has the potential to create a win-win outcome. However, green financial flow between Mainland China and the rest of the world has so far been generally held back by issues regarding infrastructure, market practice, as well as legal and regulatory regimes. In fact, Hong Kong can play a role in facilitating this flow.

International Financial Centre and Gateway to Mainland China

Hong Kong is an international financial centre and a leading bond hub in Asia, ranking third in terms of issuance in Asia (ex-Japan), after Mainland China and Korea[9]. In the first six months of 2018, there were at least 23 green bond issuances in Hong Kong, with an aggregate size of nearly US$7 billion. The issuers included multilateral development banks and the private sectors from Hong Kong, Mainland China and abroad.

Hong Kong is also the preferred location for international investors to tap into the Mainland bond market, and for Mainland issuers looking to raise debt financing. Two recent developments have further reinforced Hong Kong's appeal:

I. Bond Connect: Since its launch in July 2017, the Bond Connect has quickly become the preferred channel for international investors looking to invest in the China Interbank Bond Market. The Bond Connect offers many benefits, such as allowing international investors to use the Hong Kong trading and clearing platform, as well as their existing legal framework, counterparty arrangements and internal practices. Between January and July 2018, RMB537 billion worth of Chinese bonds were traded through the Bond Connect[10].

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[6] Source: *Principles for Responsible Investment Annual Report 2018.*

[7] Source: JP Morgan, *Sustainable Investing is Moving Mainstream*, 20 April 2018.

[8] Source: HSBC, *Growing Investor Appetite for Green Assets Puts Pressure on Companies to Explain Their Climate Strategies*, 12 September 2017.

[9] G3 (the US dollar, the euro and the Japanese yen) and local currency issuance. Source: Asian Development Bank.

[10] Source: Bond Connect Company Limited.

II. Increasing issuance of offshore bonds by Mainland issuers: In 2017, Mainland entities issued more than US$220 billion worth of foreign currency bonds[11], a majority of which were issued in Hong Kong. In addition, many Mainland issuers have issued renminbi "dim sum" bonds in Hong Kong. At the end of 2017, outstanding "dim sum" bonds totalled over RMB200 billion[12]. Indeed, Mainland issuers have been attracted to Hong Kong because of its deep financial market and the issuers' familiarity with Hong Kong's regulatory and operating environment. The number of bond issuances by Mainland issuers in Hong Kong is expected to grow further, given the increasing offshore funding needs of Mainland enterprises seeking to expand abroad, for example, under the Belt and Road Initiative.

The Trusted Interlocutor

Hong Kong's gateway role is particularly important in the green bond market as international investors may face challenges in making green investment in Mainland China due to differences in green standards and insufficient understanding in the ongoing green compliance requirements by Mainland issuers. Hong Kong is well-positioned to bridge this gap:

- Many internationally renowned green reviewers have a presence in Hong Kong to provide coverage of onshore or offshore green bonds issued by Mainland issuers. By setting up operations in Hong Kong, these reviewers can combine on-the-ground knowledge of the Mainland market with their robust and internationally recognised green assessment approach, thereby facilitating a more efficient assessment process, while giving confidence to international green bond investors.

- With the support of the Government, the Hong Kong Quality Assurance Agency (HKQAA) has developed the Green Certification Scheme, with reference to a number of widely recognised international and Mainland standards[13]. The scheme leverages on the HKQAA's experience gained from its existing certification services, as well as its familiarity with the Mainland market. The scheme enhances the credibility of the Hong Kong green bond market and facilitates its further development.

Robust Government Support

The Chief Executive of the Hong Kong Special Administrative Region has declared green finance a priority area, and the Financial Secretary announced in the 2018-19 Budget a series of supportive measures, including:

- A Pilot Bond Grant Scheme to subsidise bond issuance in Hong Kong covering green bonds;

- A Green Bond Grant Scheme to subsidise the use of the HKQAA Green Certification Scheme;

- A HK$100 billion Government Green Bond Programme to create a demonstration effect to attract Mainland and international green issuers and investors to Hong Kong; and

- Enhancement of the Qualifying Debt Instrument scheme to provide a tax concession for bond investment in Hong Kong.

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[11] Source: Asian Development Bank. Figure only includes bonds denominated in G3 currencies, which should make up the majority of Mainland's foreign currency bond issuance.

[12] Source: HKMA.

[13] The standards that the HKQAA has referred to in developing its scheme include:

- Clean Development Mechanism under the United Nations Framework Convention on Climate Change;
- Green Bond Principles of the International Capital Market Association;
- The People's Bank of China Announcement No. 39 [2015] and its Annex - Green Bond Endorsed Project Catalogue; and
- ISO 26000:2010 Guidance on Social Responsibility, among others.

In June 2018, the HKMA co-hosted the Green and Social Bond Principles Conference with the International Capital Market Association and a joint seminar with the Research Bureau of the People's Bank of China, attracting some 1,300 participants, including industry professionals and policymakers. The events showcased Hong Kong's credentials as a premier green finance centre and raised awareness of green finance among financial services practitioners.

Looking ahead

There are enormous potential for Hong Kong's green bond market and the HKMA will continue to work with the Government and industry to support its further development.