# Building the Capacity to Finance Green in China

Leveraging Finance for Green Policy Briefs

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# ABOUT THE AUTHOR

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# EXECUTIVE SUMMARY

China has taken a global leadership role in promoting the mainstreaming of green finance, and has moved the needle forward in a very short period of time. Yet, the full potential of green finance in China is constrained, primarily due to a lack of institutionalized effort to build capacity. Ma Jun, the former green finance point person, chief economist at the People's Bank of China (PBOC) and current chairman of the Green Finance Committee, singled out capacity as "key" to the growth of green finance, and the single biggest challenge.

Capacity building is needed in three distinct areas:

- Banks and financial institutions lack capacity and knowledge of the available tools to assess environmental costs and benefits.
- The development and innovation of green financing products requires capacity.
- Government officials at the central and local levels need to better understand the fundamentals of green finance and how to grow capacity of this sector at both levels.

While the bigger banks have begun to develop and conduct training programs, most capacity building programs still vary in quality and content. The relatively low share of green credit in their overall loan portfolios provide this evidence. In addition, training for government leaders, particularly at the local levels (provincial and below) is nonexistent.

There are over six million employees of financial intermediary firms, private and public, that could be connected to green finance. This daunting scope requires setting forth a scalable structure with intrinsic processes to ensure quality and reduce redundancies.

Unlocking the potential of green finance in China, then, depends on the execution of capacity-building fundamentals to include:

- Promoting a mix of funding sources
- Developing a standardized structure
- Collaborating with stakeholders
- Standardizing programs for quality
- Incentivizing government officials
- Measuring progress with accountable metrics
- Building consumer awareness
- Going out to observe firsthand
- Leveraging international partnerships

This paper will provide a brief overview of the current efforts in China as a baseline for green finance development, but the focus will be on practical steps to institutionalize a capacity building framework. As green finance knowledge and tools evolve, capacity building must continually adapt, so we emphasize implementation and structure over specific content.

# INTRODUCTION

China has taken a global leadership role in promoting the mainstreaming of green finance, and has moved the needle forward in a short time. During a Paulson Institute roundtable on green finance in October 2017, People's Bank of China Governor, Zhou Xiaochuan, remarked:

> "Three years ago, if you asked a banker in China whether he knew anything about green finance, very likely he would say, 'I've never heard of it.' But today, if you ask the same question, there is a much better chance for you to get a positive answer and to engage in discussion on specific green finance products."

The concept has taken hold and a regulatory scheme has taken shape; the next step will be building the capacity to implement green finance on a much larger scale.

The importance of capacity building has been singled out by the international community as a top priority. During China's 2016 presidency of the G20, green finance was included as one of the five dialogue tracks. Going into the G20, the Green Finance Study Group (GFSG) was assembled to provide practical recommendations for countries on promoting green finance. These recommendations featured the need for increased capacity building. In fact, the 2016 GFSG Synthesis Report included the need to "expand learning networks for capacity building" as one of seven priorities, and cited "inadequate analytical capabilities" as well. The 2017 GFSG Synthesis Report again identified "capacity limitations within financial institutions" as a major obstacle to the improvement of environmental risk analysis in green finance, but did note that China was the only country to make progress on GFSC recommendations.

In China, Ma Jun, the former green finance point person, chief economist at the PBOC and current chairman of the Green Finance Committee, singled out capacity as “key” to the growth of green finance and the single biggest challenge. What is needed, according to Ma, is adequate training for top and local-level officials, alongside the development of scalable methodologies and tools for analyzing environmental risks.

Capacity is needed in three distinct areas. First, many banks and financial institutions – particularly outside of headquarters, in provincial branches – lack a fundamental understanding of how to assess costs and benefits of environmental projects, and the scenario and sensitivity tools available for doing so. Evidence of this can be found in the relatively low share of green credit in their overall loan portfolios. Second, capacity building is needed to develop and innovate green financing products. For example, insurance products for green projects, asset-backed securities and carbon emissions rights collateral products need development. Insurance firms, banks, securities and asset management companies all need to do more research to bring these products to market. And third, basic training should be developed for government officials at the central and local levels to further their understanding of the importance of green finance, and to explore how the government can actively nurture this emerging sector.

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**-Governor Zhou Xiaochun, People's Bank of China-**

# OVERVIEW OF CURRENT EFFORTS

For banks and financial institutions, measuring environmental impact has added a new dimension to the risks that they confront, and they are now proceeding in getting their employees up to speed on new tools. As always in China, the numbers are staggering. There are over six million employees of financial intermediary firms, private and public, that could be connected to green finance. Training at this scale requires setting out a framework for scaling programs with intrinsic processes to ensure quality and reduce redundancies.

At least two Chinese NGOs have emerged as leaders in domestic capacity building. The International Institute of Green Finance (IIGF) at the Central University of Finance and Economics was established in September 2016. The IIGF is China's first institution committed to promoting the development of green finance with a program for capacity building. Meanwhile, upon departing the PBOC, Ma Jun became the chairman of the Green Finance Committee of the China Society for Finance and Banking, and he plans to launch capacity building programs.

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Capacity building is strongest in China's largest banks and at the headquarters of those banks. Many of these same institutions, however, still recognize a lack of knowledge and skills and have developed formal and informal training programs. According to a survey done by PricewaterhouseCoopers, the China Development Bank and Industrial and Commercial Banks of China participate in external training programs provided by international organizations. The Bank of China provides formal internal training programs focused on identifying areas of high risk. China Construction Bank provides training on the Equator Principles. China Merchants Bank works with international banks to bring in their experts to discuss best practices. Additionally, HSBC provides perhaps the most comprehensive range of initiatives including onboarding their senior executives, an internal risk management program, and a climate business learning program.

On the product innovation side, Industrial Bank of China (CIB) developed an IT system to capture environmental risk for each client, which is accessible to all departments of the bank. Training on environmental issues is also provided to the staff on the sustainability teams at both headquarters and at local branches. This has helped CIB achieve the top rankings on "outreach and training" and "internal environmental policies" among Chinese banks, as reported by a consortium of local NGOs.

Multilaterals have also engaged in capacity building in China. A new European Union (EU) project with China's National Development and Reform Commission (NDRC) features a strategic dialogue on carbon markets, research and capacity building. ICF consulting and SinoCarbon Innovation & Investment, a leading low-carbon service provider in China, won the bid to implement this initiative. As a part of its Partnership for Market Readiness (PMR) program, the World Bank launched capacity building projects in six provinces: Inner Mongolia, Chongqing, Shandong, Shanxi, Liaoning and Heilongjiang provinces. Since its founding in 2012, the Sustainable Banking Network (SBN) has enabled emerging markets around the globe to share methods, information and definitions for green finance. China has been a leader in the group, with the China Regulatory Banking Commission (CBRC) earning praise for its capacity building at the bank and ministry levels.

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These initiatives have helped China gain prominence as the only G20 member nation to have made significant progress on each of the seven green finance priorities outlined in the 2016 G20 GFSG Synthesis Report. Despite advancing on these fronts, however, there remain gaps in China’s green finance capacity.

First, there is a shortage of green finance consultants. SinoCarbon is one of the few that has emerged and has established a subsidiary to provide training. The company has provided several capacity building programs funded by the World Bank, Asian Development Bank, European Commission and foreign governments. Their programs have focused on policy overview and technical training, including simulation trading. Second, the quality of training varies greatly across the board with bigger banks leading the pack. Within these banks, training is usually strongest at headquarters and less so in the provinces where many of the actual financing determinations are being made. As it stands now, this disconnect between training and decision making is preventing a truly full-scale expansion of green finance. Lastly, where training has not been promoted or incentivized by the government, it remains variable in content and quality.

# RECOMMENDATIONS

The most significant challenge facing any capacity building initiative is securing the top-level political will to demonstrate to trainees that these programs are to be taken seriously. China has made clear the political priority of green finance; success now lies in execution.

Regardless of the content, the fundamentals of capacity building hold true and are the basis for the recommendations below.

**Funding:** Despite the lip service paid to capacity building, budgets for and the priority of training are typically low, and the need is vast. A strategy based on identifying multipliers leverages low budgets by promoting efficient and low-cost training methods. While the government should allocate funding for NGOs or associations to conduct research, to play a coordinator role, or to execute training programs, the majority of the training will be private sector and in-house. Thus, the government – or private sector – budgets do not need to be high. A government grant of as little as $500,000 - $1 million could be very substantive and meaningful.

**Structure**: Putting in place a basic structure to institutionalize capacity building promotes efficiency. Without a structure, multiple organizations may offer the same training, yet critical gaps will be left unaddressed. When possible, appointing – even unofficially – a lead coordinator helps reduce redundancy, ensures all issues and regions are covered, and provides standard content. Ideally, the PBOC or other agency could provide funding to a lead NGO or association that could act as a coordinator and gain a comprehensive view of the training programs offered; identifying gaps, developing standardized materials, conducting research and measuring progress. Sub-grants could then be given to fill specific needs and leverage strengths of the various organizations, but a lead coordinator would have an overall view.

**Collaborate:** Encourage collaboration and the pooling of resources in training, capacity building and other common objectives for green finance. Every bank will require professional support or training on green finance. Regulators can help lower the cost for each bank by encouraging sector-level collaboration on common issues such as training on best practices, environmental regulations and topics of common interest.

**Standardize:** Developing and disseminating standardized high-quality content, where possible, can act as a great multiplier. For green finance, it would be advisable to develop standard training modules which begin at the macro-level with international efforts and lessons learned, and then incorporate China's environmental goals, challenges and key policies into the regulatory scheme and structure. Industry best practices and common risk tools could also be highlighted. This could formulate the bulk of government training with some tailoring for local-level priorities. Of course, banks will need to incorporate different policies and proprietary tools into their in-house training modules.

**Incentivize:** There have been notable efforts to incorporate environmental metrics into the criteria for promoting local officials. Incentivizing both officials and bankers in this way clarifies the importance of capacity building. The government could also encourage capacity building by developing a unified reporting criteria for green finance that enables regulators to accurately track and assess the performance of banks.

**Measure:** As the wise adage goes, you can't improve what you can't measure. Developing reporting criteria based on a standard set of assessment tools for evaluating how training impacts the level of green credit, would quantify the benefits of capacity building. Reporting could be an official requirement by the government, or even an encouraged yet voluntary process led by the coordinating NGO. Measuring impact helps secure further buy-in and often further funding (public or private).

**Build Awareness:** One of the challenges commonly mentioned is that banks are not getting any consumer pressure for green finance. Ant Financial has developed ingenious tools that allow consumers to track how their actions are greening China. By keeping a record of consumers' purchases through their Alipay platform, Ant Financial awards points based on the downstream effects of individual purchases, such as buying a train ticket rather than paying for gas. With roughly 200 million people using the app, over 150,000 tons of carbon dioxide emissions have been avoided and over one million trees have been planted as a direct result of this financial technology innovation. Awareness campaigns have been crucial to the overall green movement, from promoting recycling to ride sharing, and could be useful in creating more consumer awareness of how their banks' activities affect the environment. This, in turn, could create the necessary consumer pressure for green finance.

**Go Out:** Seeing is believing. Getting Chinese officials out of the country for study tours has become the source of much criticism, but these are, in fact, important drivers of change. Schedules are dense and immersive, and trips are taken seriously, perhaps as a result of the scrutiny. Getting officials out of China to observe sustainability initiatives, how carbon markets are run, or how different systems function reliably, energizes people, sparks innovation, builds networks and creates real change. A simple bike ride along the lakefront in Chicago prompted a Beijing official to revamp plans for a riverfront. Rather than run the roadway along the river, he called for a new, much greener plan that included a greenspace, bike paths and parks for residents. A meeting between the U.S. Senate Appropriations Chair and a National People's Congress Committee Chairman prompted the Chairman to recommend streamlining the budget process in China. Walking the streets of Portland, Oregon prompted a Zhejiang official to consider ways his city could incorporate more pedestrian zones. There is little substitute for going out and seeing firsthand how other countries have grappled with similar challenges.

**International Partnerships:** China has always excelled at studying international examples and adapting them with "Chinese characteristics." Alongside the previously mentioned SBN, the UN-backed Principles of Responsible Investment (PRI) is one group committed to tailoring green finance solutions to China. Having recently appointed a Beijing-based head of China operations, the PRI is focused on collaborating with groups like the IIGF and others to improve investor capacity and expand the green finance sector. There are many U.S.-based organizations eager to support China's green finance efforts, including the Paulson Institute, the Institute for International Finance (IIF) and the Securities Industry and Financial Markets Association (SIFMA). With the support of the UNEP, these organizations convene an annual green finance roundtable on the margins of the World Bank/IMF meetings in Washington, D.C. to advance the dialogue globally. The UNEP has also called for practical capacity building and is well-positioned to develop and provide training. European governments, banks and financial associations have begun their own training efforts. Expanding and coordinating these efforts would be impactful.

**The Tried and True:** There are also the tried and true methods of scaling training programs quickly. One of the cardinal rules is to employ "train the trainers" programs, of particular importance given China's nascent environmental consulting industry. In addition, building out online platforms is an efficient and green way to disseminate information quickly and at scale. Finally, convening regularly through annual conferences which feature a blend of high-level and working-level practitioners and policy makers is always effective, and its impact is amplified when done both centrally and regionally.

# CONCLUSION

As one of the world's two largest carbon emitters, China has emerged as a leader in identifying and supporting innovative solutions to meet lofty climate goals. The Chinese government estimates that it will take $800 billion over five years to finance China's ambitious climate change goals, yet they can only meet about 15% of that cost. Green finance is an imperative for China. With the political will in place, the priority becomes building capacity to finance green.

China has shown that when it is committed to success, it excels at executing the fundamentals of capacity building outlined above. One need not look far to find examples of successful capacity building models and initiatives from which to draw inspiration. China's Party Schools train on a massive scale ensuring that officials from the grassroots to the center understand China's political priorities.

As has been true in the past, now that the direction and determination of the policy agenda has been set, the next step is capacity building at the central, regional and local levels. With government support and collaboration across financial institutions, sufficient knowledge and analytical capacity can be mobilized to create a green finance sector capable of achieving China's goals for environmentally sustainable business practices and an improved environment overall.

| Capacity Building Recommendations | |
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| **FUNDING** | Encourage a mix of public and private funding, which is often low despite widespread recognition of the importance of training. This will help to extend limited budgets and adopt multipliers, such as “train the trainers” and online platforms. |
| **STRUCTURE** | Appoint an official or unofficial lead coordinator to develop standardized materials, track programs and program gaps, and disseminate information. |
| **COLLABORATE** | Pool resources and leverage existing programs across non-governmental organizations, the private sector and the international community. |
| **STANDARDIZE** | Develop standard programs to ensure quality and reduce redundancy. |
| **INCENTIVIZE** | Incorporate environmental metrics into the criteria for promoting local officials to signal the importance of capacity building. |
| **MEASURE** | Develop metrics to track progress, build in accountability and demonstrate a tangible impact, which can help secure funding. |
| **BUILD AWARENESS** | Promote greater consumer awareness to increase demand for environmental products. |
| **GO OUT** | Conduct field studies that are crucial to capacity building. There is no substitute for firsthand observation. |
| **INTERNATIONAL PARTNERSHIPS** | Continue to leverage the work of the international community, led by the UN Environmental Programme. |
| **TRIED AND TRUE** | Methods of scaling training programs quickly such as “train the trainers” programs, building out online platforms, and convening stakeholders are particularly useful. |