CFA Institute

Green Finance Policy Evolution in China and the Impact of Pilot Zones: Huzhou Case Study

Takeaways

1. Digital infrastructure dramatically reduced market friction
2. Systematic capacity building is foundational to success
3. Strategic use of incentives and market tools accelerated adoption
4. Use of pilots provides scalable models

Huzhou: Background

- Huzhou is located in Zhejiang Province and is only 10 km away from China's third-largest lake.
- Originally called "The City of Silk" due to its original industries:
    - Textiles
    - Mining / Building materials, and
    - Agriculture
- In 2005, the total GDP was CNY64 billion. By 2023, it rose to CNY401.51 billion.
- However, over time, this mix of primary industries would present serious structural challenges, including environmental, regulatory, and economic.

Case Study Huzhou: Challenges

- **The main drivers of these challenges were environmental.**
  - This mirrors the experience in other countries.
- **Environmental challenges included:**
  - Lead pollution from the battery industry
  - Water pollution from cement industries
  - Untreated wastewater from hotels
- **In the early 1990s and 2000s, growing public concern led to calls for environmental protection.**
- **Momentum created through growing environmental awareness allowed further regulation.**

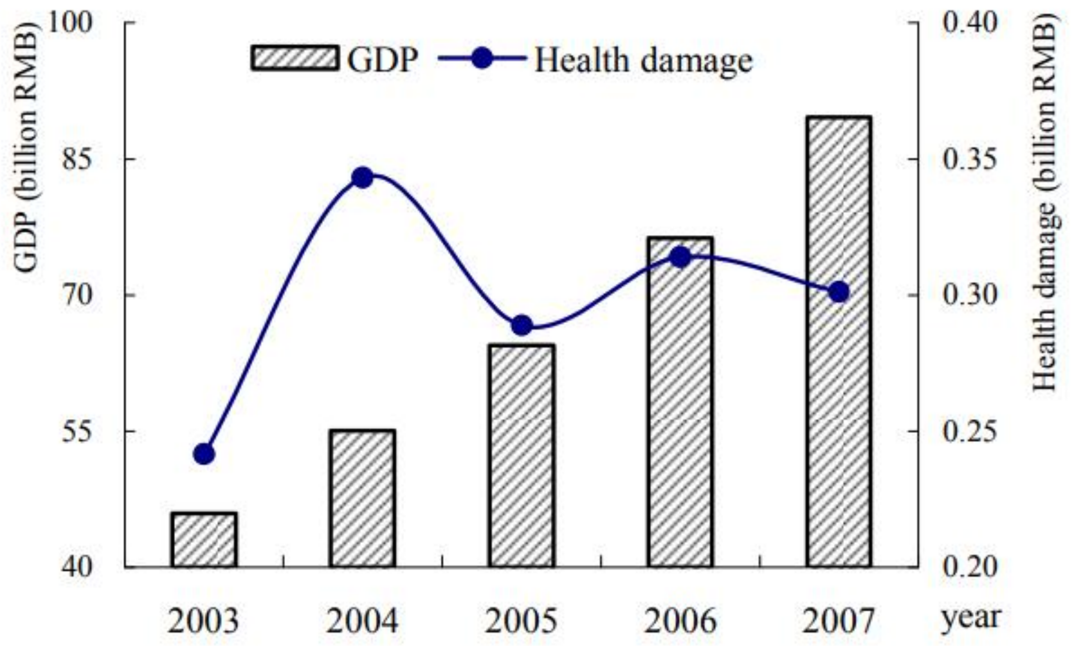


Figure 1. *the total gdp and health damage in Huzhou region,2003 to 2007*

Case Study Huzhou: Challenges

- Efforts taken by the local government significantly improved environmental quality.
- However, several mines, cement plants, and battery manufacturers closed.
    - E.g. companies involved in producing lead-acid batteries decreased from 225 to 16.
- Those that stayed open were required to upgrade their practices to become carbon neutral.

Case Study Huzhou: Challenges

- **This 15-year period before the pilot zone represented the first phase of Huzhou's economy.**
    - Increasing regulations required industries to modernize or shut down.
    - Increasing public awareness would shift focus to more sustainable business models.

- **Moving on to new phases would present a number of challenges for the local government:**
    - How to determine what was "green".
    - How to get the public to "buy-in" to sustainable development.
    - How to finance the necessary transition efforts.

Addressing Challenges: Capacity Building

- Across all of the challenges facing the local government, a lack of capacity was a common theme.
  - Because green finance covers a wide range of knowledge, including environmental science and law, practitioners need to develop a wide range of knowledge.
- Prior to the official start of the pilot zone period, the municipal government emphasized capacity building at the top levels of the government.
- Capacity building activities included attending Huzhou forums hosted by the PBOC.
  - Forums included both local and international finance leaders.
  - Encouraged the sharing of best practices by both academic scholars and industry participants.
- Building capacity within the government allowed for municipal government to develop a strong sense of understanding and support.

Addressing Challenges: Development of Policy Frameworks, Incentives, and Products

- In 2017, Huzhou began to identify and define green activities. At this time, there was no national catalogue.
- First, they constructed their own labeling tool for SMEs and biodiversity, focusing on the textile industry.
- Many of Huzhou's standards are focused on market-based solutions.
- Huzhou's policy incentives can be grouped into three traditional categories: fiscal, monetary, and regulatory.
- Huzhou's communication with the PBOC helped their catalogue's legitimacy.

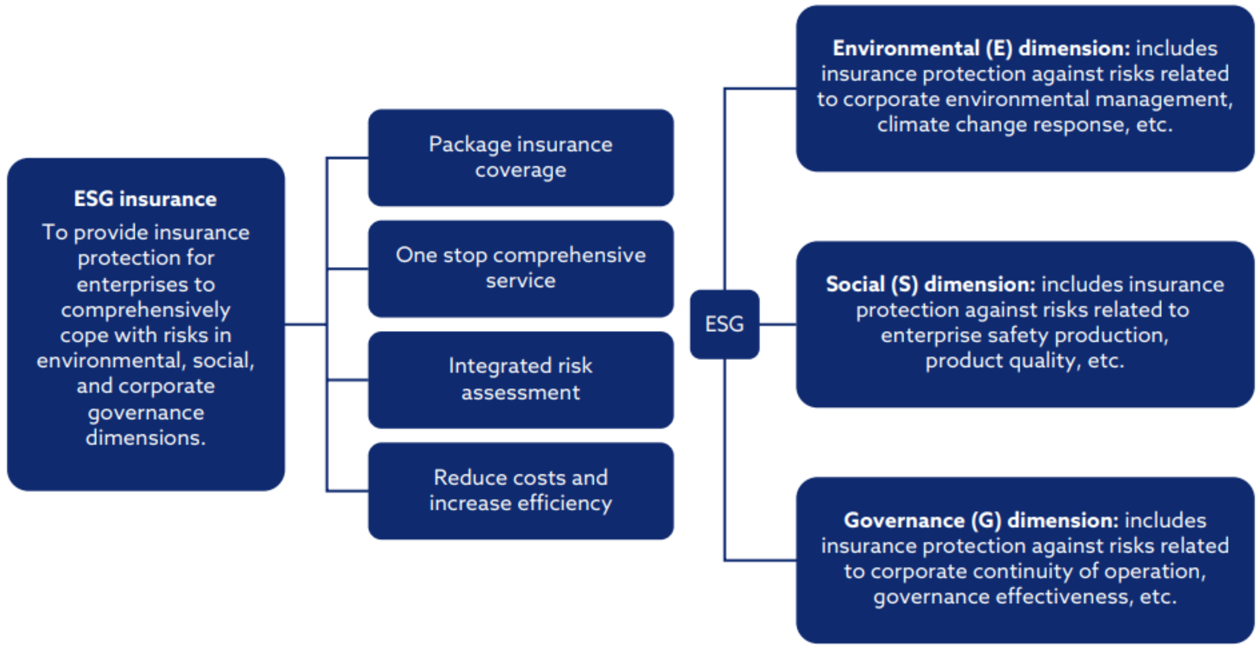
Exhibit 1. Current Policy Incentives in Huzhou (nonexhaustive)

Green Inclusive Loan	For green inclusive loans in the current year, interest subsidies of up to 12% of the China Loan Prime Rate (LPR) will be provided to FIs based on their green finance performance, with a maximum interest subsidy of RMB150,000 per enterprise.
Green Bank	Banks that are approved as the first batch of green finance demonstration banks within the pilot zone and achieve significant results in areas such as "carbon-neutral" banking, green loans, and transition finance will receive a one-time reward of up to RMB300,000.
Green Bonds (e.g., carbon-neutrality bonds, transition bonds, sustainability-linked bonds)	Eligible enterprises and financial institutions issuing green bonds, carbon-neutral bonds, transition bonds, sustainability-linked bonds, and other debt financing instruments and asset securitization products (collectively referred to as "green bonds") can receive a subsidy of RMB100,000 for each successful issuance.
	For green bonds issued in alignment with the China–EU Common Ground Taxonomy, the subsidy per bond issuance will be increased to RMB150,000.
Green; Environmental, Social, and Governance (ESG); and Transition Insurance	For enterprises that purchase environmental pollution liability insurance, a subsidy of 30% of the insurance premium will be provided, with the cap of RMB30,000 per enterprise.
	For enterprises that purchase ESG insurance (discussed later in this section), a subsidy of 50% of the insurance premium will be provided, with the cap of RMB50,000 per enterprise.
Government Procurement	In government procurement of services related to banking or insurance, the performance of FIs in green finance will be used as one of the criteria in the bidding process.
Standard Setting	For FIs, research institutions, or local financial organizations, participation in the formulation of national or industry-level green financial standards will be rewarded with RMB250,000 at a maximum for each set of standards. Participation at the provincial level will be rewarded with RMB150,000 at a maximum. The lead drafting entity in formulation of standards on the municipal level will be rewarded RMB100,000 for each set.

Sources: Compiled by the author from publicly disclosed policy documents obtained from the Huzhou Municipal Government Office: https://www.huzhou.gov.cn/col/col1229213986/index.html.

Addressing Challenges: Development of Policy Frameworks, Incentives, and Products

- Financial institutions have taken the initiative in developing innovative green financial products, offering more than 180 varieties:
  - loans
  - bonds
  - insurance and guarantees
- These products also cover a wide range of themes, such as carbon efficiency, carbon price, electric vehicles (EVs), and green buildings.
- ESG insurance was created to address business needs.
- Rural banks have needed to be particularly innovative, as they lack access to PBOC lines of credit.



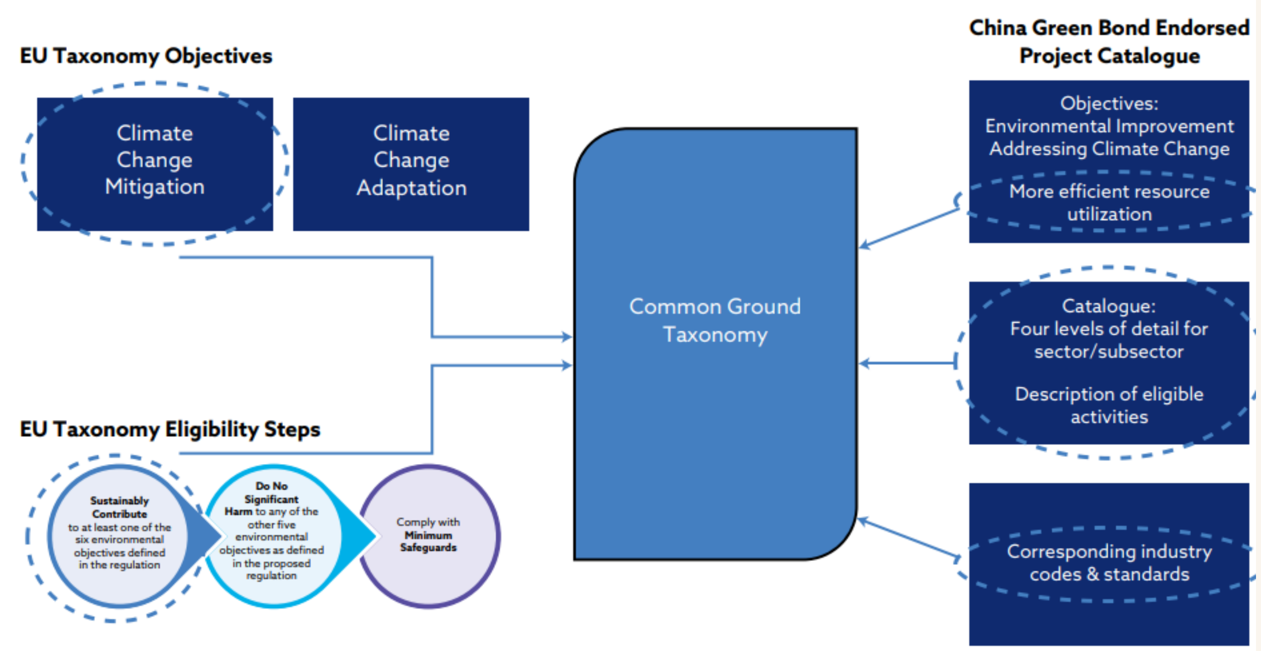
Source: National Financial Regulatory Administration (NFRA), Huzhou Branch.

Development of Digital Platforms

- While several incentives and products had been developed, the green finance process remained labor-intensive.
- Another challenge was also the number of SMEs.
- To improve speed and efficiency a digital information system was developed.
- Other developments include a green finance database, an ESG evaluation model and a carbon-accounting system.
- The digital system has decreased loan matching time and lowered information burdens.

Determining Local Context

- Climate change discourse during the 1980s and early 1990s in China followed a similar trajectory.
- Following the formation of the National Climate Change Coordinating Group, climate change in China began to be seen as a developmental issue in addition to a scientific one.
- China prioritized the inclusion of “common but differentiated responsibilities”.
- This principle states that developing economies must balance environmental protection with economic growth.
- The influence of these principles can still be seen in China’s green finance approach today, particularly in the Common Ground Taxonomy.



Note: Minor differences at high levels can lead to more significant differences at the granular level.
Source: International Platform on Sustainable Finance (IPSF) Taxonomy Working Group (2021, p. 24).

Final Takeaways

- Developing a green finance system properly requires a number of important steps.

  1. Buy-in and leadership from the top are needed to ensure sufficient resources are allocated.
     - Top leadership is needed to create a strong communication channel with higher levels of the government.

  2. Capacity building is a key early priority.
     - Requires both local and international knowledge to create best practices.

  3. Friction in the green finance system needs to be reduced.
     - Fintech can assist with data collection and matching.

  4. A diverse range of financial products must be developed.
     - Markets must become self-sustaining without the need for incentives.

Thank you