

Analysis on Green Credit in China

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Abstract-Along with China's rapid economic development, environmental issues are becoming more and more prominent. According to green credit policy, economic lever effect can be created to promote the environmental protection. Meanwhile, there are many problems to be solved urgently. The China Banking Regulatory Commission (CBRC) issued *green credit guidelines* in 2012, providing green credit implementation basis for banking institutions. It will also accelerate the pace of green credit to promote sustainable development of china.

Keywords-Green credit, *Green credit guidelines*, Environmental and social risks

1. Foreword

In recent years, China has made a series of remarkable economy achievements. However, behind the rapid economic growth is the serious pollution and destruction of ecological environment. At present, the solving approaches of environmental problems in China are transforming from administrative means mainly to economic, legal and other means gradually. Compared with other instruments, economic instruments are efficient, flexible, and optimize the allocation of resources. Green credit policy is one of the important ways of economic instruments. The former State Environmental Protection Administration, the People's Bank of China and the China Banking Regulatory Commission issued *the comments on implementation of environmental policies and regulations to prevent credit risks* jointly in 2007, marking the launch of green credit in China. Since the introduction of green credit, the green credit has gotten a fast development in China, and played an important role in China's environmental protection.

2. Green credit and the Equator Principles

Green credit means that banks and other financial institutions encourage enterprises to make environment-friendly and energy-saving, emission-reduction arrangements according to credit policies. Green credit can be comprehended from three fields. First of all, support environment-friendly and energy saving projects or enterprises through appropriate of credit policy or instruments (including loan variety, period, interest rate and amount). Secondly, punish the projects or enterprises breaking the regulation and law of environmental protection or energy saving with credit stopping, credit slowing or even credit recovery. Lastly, creditors guide and supervise the borrowers against environmental risks and fulfill their social responsibilities to reduce the credit risks according to credit policies [1].

To improve the effect of green credit policy, many international banks formulate a set of guidelines and standards. The *Equator Principles* is the most famous of

them, which was made by International Finance Corporation (IFC) and the Netherlands Bank in October, 2002. The Equator Principles aims at providing bases for environmental and social risks distinguishing, assessment and management of project financing.

The contents and structure of Equator Principles are simple, including preamble, the scope of application, principles statement and disclaimer statement. The motivation, purpose and significance of the Equator Principles are introduced in the preamble. The part of application scope provides that the Equator Principles are applied to all the new projects of which the costs are more than 10 million dollars and the original projects that have important impacts on the environment or society due to expansion and reconstruction, providing financing help or financial counseling services. The core of Equator Principles is principles statement which specifies 10 regulations and principles for financial institutions adopting the Equator Principles (EPFIs, the Equator Principles financial institutions) to make investment decisions. EPFIs declare that only the qualified projects can get the loan.

3. Significance of the implementation green credit for banking institutions

3.1. Transforming economy development mode and adjusting the economy structure to achieve

the sustainable development

According to green credit, banking institutions provide different loan amount, interest rate and loan duration to enterprises based on the type, scale, environment protecting situation of enterprises. The enterprises or institutions working on pollution control facilities researching and developing, ecological environment protecting and constructing, new energy developing and utilization, circular economy producing and ecological agriculture can get the loan at a lower interest rate. While the enterprises or projects that bring pollution will get a limited loan at a higher interest rate, leading the capital flow from pollution creating industries such as iron, steel, cement, electricity, coal industry to the high-tech industry, environment protecting and energy saving industry. By the end of May 2010, the enterprises clients of Industrial and Commercial Bank of China that are qualified in environment protecting and environment-friendly have reached 68,000, involving loans of 4.7 trillion Yuan. Because of green credit, the awareness of environmental protection and social responsibility of enterprises in China has been built to make environmentally friendly decisions and behavior. In this way, transform resource-wasting and environment-damaging development mode to environment-friendly and energy-saving mode to accelerate the industrial structure adjustment.

Table 1. Green credit situation of China Construction Bank

Category	December 31, 2011			December 31, 2010			December 31, 2009		
	Loan	balance	Percentage of	Loan	balance	Percentage of	Loan	balance	Percentage of
	(billion Yuan)		total Loans (%)	(billion Yuan)		total Loans (%)	(billion Yuan)		total Loans (%)
Renewable energy loan	214.572		3.47	192.039		3.53	177.742		3.82
Environmental protection loan	4.498		0.07	3.767		0.07	3.355		0.07

3.2. The necessary path for banks and other financial institutions to improve efficiency and keep pace with international banks

According to the implementation of green credit policy, internal and external economic benefits can be obtained. On the one hand, expanding the credit lines of

environment-protecting and circular economy industries and decreasing the loan amount of pollution-creating, energy-wasting and overproduction industries is beneficial to reduce its environmental risks and non-performing loan ratio. Furthermore, the bank implementing green credit can expand its market share and increase profits. On the other hand, people and media

will pay more attention to banks that implement green credit, which is beneficial to enhance its brand image, obtain more business licenses and opportunities of international projects and improve the bank's operating performance.

Since the IFC and other financial institutions launched the *Equator Principles* in June 2003, 69 financial institutions have adopted the Equator Principles all around the world. Their businesses are in more than 100 countries and make a 90% project financing market share [2]. The Equator Principles Financial Institutions (EPFIs) reach a consensus on balancing the relationship between economy development and environmental protection that they refused to supply loan to projects that violate the social and environmental policies or procedures of the Equator Principles. Obviously, it has become the trend of international banks to carry out green credit. The banking in China began to completely open to foreign financial institutions on December 11, 2006, which means the more fierce competition between China's banks and foreign banks. It will be easier to get the recognition of the international community and banking for banks in China carrying out green credit and taking the environmental and social responsibilities, which is beneficial to enhance its international status and competitiveness.

3.3 Improving innovative capacity of banks

Banks and other financial institutions carrying out green credit need to innovate financial products and systems constantly to keep in line with the changing financial environment and demands of clients. On the one hand, banking institutions need to determine different loan duration; loan amount and interest rate based on the enterprise type, scale and the industry belonging to. In this way, different products are created in this procedure. On the other hand, banks should innovate process, recognition, evaluation indications and assessment approaches to ensure the implementation, evaluation and assessment of green credit.

3.4. Strengthening environmental and social risks management

Environmental risks has become risks cannot be

ignored as one of the important management objects of banks in line with the economy development and enhancing of environment protection. In the early 1990s, the United Nations Department of Financial Projects issued the *financial industry environment and sustainable development declaration*, emphasizing the significance of taking environmental factors into the standard risks assessment process and requiring that banks should take environmental factors into consideration in their operating activities. Environmental and social risks alleged in *green credit guidelines* refers to the hazards and risks brought by the clients of banks or important related parties in construction, production and operating activities that may harm the society and environment seriously, including energy consumption, pollution, land, health, safety, resettlement, ecological protection, climate change and other related environmental and social issues [3]. Through implementation of green credit, environmental and social responsibilities are put into operation and management of commercial banks. Thus, environmental and social risks are assessed and monitored dynamically, offering a valid path for the commercial banks to manage environmental and social risks.

4. Problems of green credit implementation in China

4.1. Unsound legal system and lacking of unified indicators

With the introduction of green credit policy, a number of banks have carried out green credit policy and made remarkable achievements recent years. However, the implementation of green credit for banks in China is guiding requirement instead of mandatory provision. Therefore, if banks break related regulations and operate illegally, they will be punished slightly or no penalty, which increases the possibility of violation. The *research on green credit of 14 listed banks-low costs of environmental protection violation* pointed that Chinese banks give loan to many criticized or controversial projects in terms of the implementation of green credit.

In fact, these banks are not punished correspondingly. At the same time, each bank makes green credit target, mechanism, processes and performance indicators based

on its own situation. Due to lack of uniform regulations and indicators, the effects of implementation in Chinese banks are not comparable, bringing difficulties to assess, evaluate and supervise the implementation effects of green credit. Kong long found that due to inconsistent credit operation standards; lack of quantitative information on the core indicators and selective information disclosure, there is a huge difference between the actual green credit performance of listed banks and the intended target according to the analysis of green credit information disclosure of 16 listed banks social responsibility report in 2010.

4.2. Lack of appropriate incentive and restraint system

The implementation of green credit and getting the expected effect need concerted efforts and cooperation of many institutions and departments. However, the banks and government lack adequate incentives to carry out green credit and the environmental protection department cannot fulfill its obligations in accordance with the law due to the unsound legal system, making the implementation effect of green credit discounted greatly. Enterprises of high energy consumption and polluting, excess capacity industries, as the high pollution sources, are usually the major clients of banks and other financial institutions. To improve its own interest, the bank tends to relax the operation standards, not implementing the green credit policy strictly. Besides, the government performance evaluation tends to focus on the growth of the GDP, ignoring the environmental effect. While iron and steel, cement, mining and other industries are generally the main source of local government revenue. To keep the growth of local economy, the government intervenes the credit behaviors of banks frequently. Due to the existence of local protectionism; the green credit policy cannot be executed legally. On June 5, 2012, the Earth Day, 8 environmental protection groups released the report, *China banking environment record (2011)*, evaluating the environmental and social responsibility performance of the 16 listed banks of China in 2010. Everbright bank ranked bottom among the 16 banks participating in the assessment of 2010. The report said that, the information of environmental information, setting up the environmental department, the loan exit of

high energy consumption and pollution industries, joining in the international environmental protection guidelines and internal environmental performance in everbright bank was not disclosed.

4.3. Imperfect information communication mechanism

Enterprises environmental credit information plays a key role in carrying out the green credit and achieves the expected effect. While the information communication mechanisms among banks, environmental protection department and enterprises in China are not perfect enough to support the implementation of green credit. First of all, the information communication mechanism between environmental protection department and banks is unsound. Enterprises environmental information fails to be conveyed into enterprises credit information system completely or environmental protection department cannot supply the relevant information for the credit applications of banks clients timely, bringing a negative impact on carrying out the green credit.

Furthermore, the information sharing between banks and the environmental protection department is not balanced. The environmental protection department provides information to the banks unilaterally, but the banks don't feed their credit information back to the environmental protection department. In the *report of five cities in two provinces, where the green credit has reached*, the Green Financial Institution director of the Hebei University of Economics and Business, Professor Wang Xiaojiang, pointed out that the information transmission channel between banks and environmental protection department was a single line and emphasized that the third-party service organizations should be cultivate to sort, process and analyze the environmental technology information, making it readable for financial institutions.

5. Policies and proposals on green credit implementation

The China Banking Regulatory Commission issued the *green credit guidelines* on February 24, 2012 in order to promote the implementation of green credit policy further for the banking institutions in China, adjust the

credit structure reasonably and improve the environmental and social responsibility performances of banks and other enterprises. The *green credit guidelines* is divided into seven sections, including general principles, green credit organization and management, green credit regulations and capacity-building, green credit process management, internal control and information disclosure, supervision and inspection and supplementary provisions. To some extent, the *green credit guidelines* provides basis and guidelines for Chinese banking institutions to carry out green credit. A number of local governments have released some relevant policies to ensure the implementation and evaluation of green credit. Banks in China make green credit goals, processes and assessment indicators based on the *green credit guidelines*, speeding up the pace of green credit.

5.1. Establishing effective incentive and restraint mechanisms

Effective incentive and constraint systems are required to carry out the green credit effectively. Concerning banks, government can give preferential taxation or subsidy to banks carrying out green credit or preferential interest rate is supplied for banks loan from central bank. For enterprise, they should be required to operate according to the environmental protection law strictly, making enterprises incentive enough to take environment-protecting actions and fulfill their environmental and the social responsibility. In term of local government, the government performance evaluation indicators relying on the GDP mainly should be adjusted, adding environment factors into consideration. Strengthen the supervision and inspection of environmental protection department, giving appropriate punishment to institutions slacking law enforcement or examine the environmental protection department to reward or punish according the performances of banks and environmental protection department. Thus, mutual supervision and restriction between banks and environmental protection department can be enhanced to improve the effect of green credit.

5.2. Strengthening enterprises management and supervision

Banks should develop its products for clients in accordance with the types, industries belonging to, and scales of enterprises respectively in carrying out green credit. In addition, classify the enterprises into different clients' types to manage referring to enterprises environmental information supplied by environmental protection department. Due to the polluting industries tending to be concentrated, operation efficiency can be enhanced through classification. The banks feed credit information of enterprises to environmental protection department and environmental protection department will supervise enterprises timely according to the information provided by banks to reduce the environmental and social risks of enterprises and banks.

5.3. Encouraging the public engagement and improving the media supervision

Public participation plays an important role in the implementation of green credit. The rapid development of information technology provides a convenient platform and approach for public participation. As an advanced team and active member of environmental protection, environmental protection NGO of China is playing an increasingly important role. The NGO spread green credit knowledge actively to increase the environmental protection awareness of public and deepen understanding of green credit. Furthermore, the environmental protection NGO learns knowledge and technology constantly from foreign organizations and improves the mutual learning and communication of domestic and international environmental protection organizations.

Media also play an important role for the green credit. The *green credit guidelines* provides that the banking institutions should undertake a comprehensive assessment of green credit at least once every two years and submit the self-assessment report to banking regulators in line with the requirement of *green credit guidelines*. The effect of green credit implementation can be disclosed rapidly through the intermediary function of different media, making it possible to reward the institutions that carrying out green credit seriously and punish the enterprises or banks breaking regulations of green credit.

5.4. Speed up the construction of information sharing mechanism

To guarantee the success of green credit and enhance the effect of green credit, the construction of information sharing mechanism between banks and environmental protection department should be emphasized to offer a powerful information platform for the urgent cooperation. The Ministry of Environmental Protection, People's Bank of China and China Banking Regulatory Commission started the evaluation project of green credit and announced to create green credit data center of China On September 27. Once the data center is completed, it will be possible to exchange data between banks and environmental protection sectors. The environmental protection department offers the enterprises environmental information to banks timely and banks feed the credit information of enterprises back to environmental protection department, improving the efficiency of green credit.

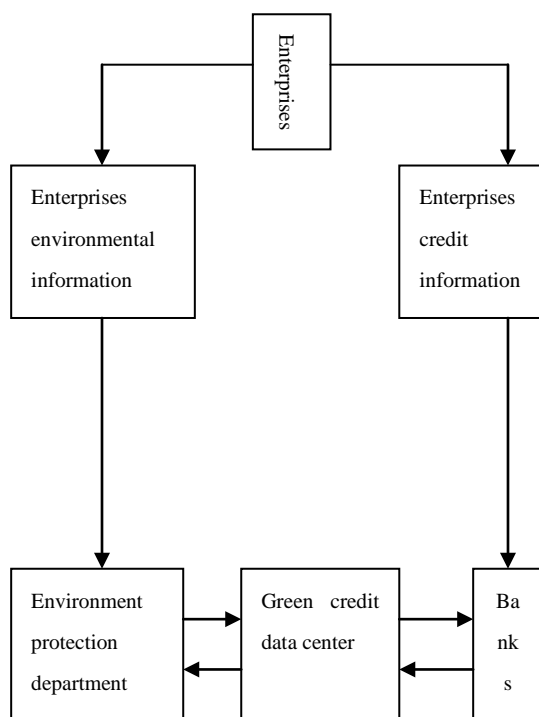


Figure 1. Information sharing mechanism

5.5. Establishing the green credit standards system, improving the legal system

First of all, the government of China should establish and adjust the green credit system and formulate operational green credit management guidelines for banks in accordance with the Equator Principles or other international standards and the situation of China to offer uniform standards of green credit execution, assessment, monitoring and examination.

Furthermore, speed up the construction of legal system. Define the legal obligations of banks clearly and perfect the accountability mechanism. Establish the environmental standards system green credit, ensuring banks and environmental protection sectors have the basis to rely on. Increase penalties for illegal enterprises, to make its marginal cost of environmental violations more than the marginal revenue.

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Vitae

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