Hong Kong as a Regional Green Finance Hub
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Executive Summary

- Green finance is a broad term that refers to capital raising and financial investments flowing into projects, products and companies that support the development of a more sustainable, low-carbon and climate-resilient economy.

- Hong Kong is uniquely placed to be the regional leader in green finance. If it does not seize this opportunity, others will do so.

- Financial services accounts for 16.6% (2014) of Hong Kong’s GDP and employs 6.5% (2015) of the total workforce. It also provides business to other important sectors such as law and accountancy.

- The market for international bonds is not as developed in Hong Kong as in other leading centres. The Hong Kong government has made clear its objective to see the bond markets grow.

- Green finance presents a significant opportunity for Hong Kong to build its bond and project finance markets, providing numerous benefits from increased employment to growth in the investment management, derivative, insurance and private equity industries.

- Very large sums will be required from the international capital markets in the coming years to assist the transition from the ‘brown’ to the ‘green’ economy. At the same time, increasing awareness has led to very rapid increases in the pool of assets available for investment in green products and projects.

- China is now playing a leadership role in green finance. The PBOC in March 2015 estimated that China will need to invest over US$1.5 trillion in green projects during the 13th Five-Year plan period, only around 15% of which is likely to be provided by government.

- Particularly following the outcome of international climate negotiations in Paris in December 2015 (COP21), governments round the world are increasingly taking steps to encourage the development of green finance, including China, the UK, Japan, Singapore, Malaysia and Indonesia.

- The Financial Secretary’s Budget Speech 2016-17 made reference to green finance and stated that the government will strengthen efforts to publicise its competitive capital markets and highlight Hong Kong’s edge in developing green financial products.

- While a number of government, regulatory and market-driven initiatives have been taken in Hong Kong in this area, government leadership is required to stimulate and encourage the private sector. Government needs to adjust its own funding policies, and commit funds, to send a clear message to the financial industry locally and globally.
To this end, this Report makes a number of recommendations for action in the near future, including:

- The issue by the government and public-sector controlled issuers of benchmark ‘green bonds’.

- The establishment of a Green Finance Advisory Council or similar body to provide on-going focus and assistance.

- The hosting of a Global Conference on green finance and investment, followed by a seminar series.

- Building a pipeline of green finance professionals, through universities and professional institutions.

- Establishing a Green Labelling Scheme, covering projects and securities, thus attracting issuers and new investors to Hong Kong.

Other recommendations include encouraging asset owners (including public asset owners) and investment managers to study future risks to investments from a climate and environmental perspective; and making our equity, bond and private equity markets more attractive for ‘green’ companies and those who invest in them.

Hong Kong is in a position to be the primary centre for green finance in the region. It should act to establish and consolidate a leading position without delay.
1. SETTING THE SCENE – GLOBAL DEVELOPMENTS IN GREEN FINANCE

1.1. Introduction

Hong Kong is uniquely placed to be the regional leader in green finance. Following what was widely regarded as a successful international climate conference in December 2015 in France, there is undeniable momentum in the sector. There is a significant opportunity for Hong Kong to position itself as a leading hub for the provision of green finance and investment as billions of US dollars are required annually to fund the low-carbon assets that will be required to meet global commitments.

With a new race to the top among global financial capitals, Hong Kong also needs to manage the risk to its leadership position in the financial services industry. If it does not seize this opportunity, other financial centres will.

Green finance landscape – what are the main drivers?

At the end of 2015, France hosted and chaired the 21st Conference of the Parties (COP21) to the United Nations Framework Convention on Climate Change. The outcome of COP21 was the adoption of the Paris Agreement, signed by 195 countries, to address climate change and mitigate greenhouse gas emissions. The Paris Agreement presents a newly calibrated political ambition, requiring countries to implement their national climate plans as well as increase their ambitions over time. To achieve these goals, finance on a massive scale is required.

In February 2016, finance ministers and central bank governors of the G20 major economies committed to exploring ways to raise the US$90 trillion of investments required over the next 15 years to achieve global sustainable development and climate objectives. Along with the Paris Agreement and the Sustainable Development Goals adopted by the United Nations in September 2015, a strong signal has been sent that both public and private finance needs to be directed towards and consistent with a pathway of low-emission and climate-resilient development. This will lead to a shift in perception of risk, particularly on high-carbon investments.

China is playing a leadership role in green finance and shaping the policy and market landscape. In March 2015, the People’s Bank of China (PBOC) published a summary report of the Green Finance Task Force, ‘Establishing China’s green financial system’\(^1\). The report lays out the rationale why China should develop a green financial system and proposes fourteen areas for action. In many of these areas, action is already being taken and the 13th Five-Year Plan includes a number of references to green finance priorities. The report sets out fourteen recommendations, grouped under four categories. Hong Kong had already commenced its own initiatives in a number of these areas, shown in Figure 1 below, and the Green Finance Task Force report identified several areas, also shown below, which present opportunities for Hong Kong.

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\(^1\) The Task Force was co-Convened by the Research Bureau of the People’s Bank of China and the United Nations Environment Programme project Inquiry into the Design of a Sustainable Financial System (‘UNEP Inquiry’)
Figure 1: Summary of China’s Green Finance Task Force report recommendations

<table>
<thead>
<tr>
<th>Institutional development</th>
<th>Fiscal/financial policy support</th>
<th>Financial infrastructure</th>
<th>Legal infrastructure</th>
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<td>Building green banking system</td>
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- **Hong Kong already taking action**
- **Yellow** Top priority opportunity for Hong Kong
- **Green** Action being taken and further opportunity for Hong Kong
1.2. Green finance and the investment need

What is green finance?

Green finance is a broad term that refers to capital raising and financial investments flowing into projects, products and companies that support the development of a more sustainable, low-carbon and climate-resilient economy.

While green finance includes climate finance, it is not limited to it and refers to a wider range of environmental and sustainability objectives, including clean energy; pollution control; green buildings, transportation and infrastructure; energy efficiency; sustainable resource management; and environmental services, such as waste management and sustainable forestry.

Whereas green finance was previously a niche activity, it is now becoming a mainstream part of the financial services world.

Understanding the scale of the investment need

Asia

Asia requires massive investment to ensure that regional development follows a low-carbon and green trajectory. This is also integrally linked to addressing Asia’s daunting infrastructure and energy challenges. For example, it is estimated that regional investment of US$3.6 trillion over the years ahead will be required to equip Asia with the power capacity it needs for 2030. Two thirds of that sum will go towards renewable generation technologies such as wind, solar and hydro-electric2. Furthermore, the Asian Development Bank (ADB) projects infrastructure needs, specifically in energy and transportation, to be US$750 billion per year from 2010 to 2020, all of which needs to be ‘climate-change proof’3. The ADB also estimates that climate adaptation costs for Asia Pacific are in the order of US$40 billion per year between now and 20504.

Some Asian countries have already begun to put their green finance initiatives into action. For example:

- In Japan, the government has set up a clean energy fund to target projects with the potential to become business models used by regional communities to promote and profit from renewable sources of energy. Furthermore, in 2015, Japan’s Government Pension Investment Fund, the largest pool of retirement savings in the world, became a signatory to the United Nations-supported Principles for Responsible Investment making a public commitment to embedding environmental, social and governance (ESG) considerations within investment processes.

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3 http://www.adbi.org/research.infrastructure.regional.cooperation/
• In Singapore, the building authority has launched a pilot green financing scheme, enabling building owners to receive bank loans to retrofit their building to a greener standard.

• In Indonesia, the financial regulatory authority, OJK, has developed a ‘Roadmap for Sustainable Finance in Indonesia’, a guidance framework for the developing the sector through till 2019. The framework focuses on regulatory incentives, capacity and awareness building, and the development of specific products.

• In Malaysia, a state-backed asset manager launched the Malaysian ESG Opportunity Fund, an ESG equities growth fund using the FTSE4Good Bursa Malaysia Index as its reference benchmark.

**China**

China’s environmental crisis is increasingly apparent, with the Green Finance Task Force report stating that ‘China’s environmental carrying capacity is at its upper limit; with levels of pollution in many areas that can no longer be ignored or tolerated. For example, air quality is satisfactory in only 8 out of 74 major cities, and just 25% of drinking water reaches national quality standards’. To address these issues the report advises that China ‘urgently needs to transition toward a green and sustainable growth model’.

Elements of China’s transition towards green, sustainable growth were outlined as part of China’s pledge to COP21. China stated that by 2030 it aims to:

• Achieve the peaking of carbon dioxide emissions around 2030;
• Lower carbon dioxide emissions per unit of GDP by 60% to 65% from the 2005 level; and
• Increase the share of non-fossil fuels in primary energy consumption to around 20%.

The Green Finance Task Force report estimated that ‘achieving national environmental goals during the 13th Five-Year Plan period will require an annual investment of at least 2 trillion RMB (US$305 billion)’. However, only 15% of the required investment can be provided by the government\(^5\) - representing a funding gap of US$260 billion each year to be met by the private sector. Figure 2 below shows how this 2 trillion RMB breaks down by sector and by source of funding (public and private).

\(^5\) Yi Gang, Deputy Governor of the PBOC, quoted in *ChinaAsia Daily*, 9 October 2015
Figure 2: Investment required to meet China’s environmental goals in the 13th Five-Year Plan period

Source: Green Finance Task Force
2. HONG KONG’S POSITION IN THE EVOLVING GREEN FINANCE LANDSCAPE

2.1. Hong Kong as a major hub for green finance – what are the benefits?

Financial services is a main pillar of Hong Kong’s service-based economy. In 2014 it accounted for 16.6% of GDP and it provides business for other important sectors such as law and accountancy. The maintenance of Hong Kong’s leading position in the industry and its continuing growth are key to Hong Kong’s future. 6.5% of the total working population of Hong Kong was employed in the financing and insurance sector in 2015 (equating to almost a quarter of a million people) and the percentage has been rising over the past few years.

The primary function of the financial services industry is to facilitate the movement of capital towards meeting the needs of society. Very large sums will be required from the international capital markets over the coming decades to provide funding for the transition from the ‘brown’ to the ‘green’ economy. China alone is expected to need to raise over US$1.3 trillion from the private sector over the next five years to meet the requirements of the 13th Five Year Plan. Other economies in Asia will similarly need to raise very substantial sums.

At the same time, increasing awareness and interest in environmental protection has led to very rapid increases in the pool of assets available for investment in green products. Institutional investors controlling almost US$25 trillion of assets signed a Global Investor Statement on Climate Change that sets out the importance of funding for related initiatives and highlights the contribution signatories ‘can make to increasing low-carbon and climate-resilient investments’\(^6\). Strong investor appetite for investments that mitigate climate change risks is also highlighted by the growth in sustainable and responsible investment assets, estimated to have increased from US$13.3 trillion in 2012 to US$21.4 trillion in 2014\(^7\).

At the same time, investors are increasingly choosing to avoid carbon intensive investments. In the past few years, the types of investors choosing to divest from fossil fuels has evolved from pension funds (notably CalPERS) and sovereign wealth funds, to mainstream investment banks. In March 2016 JPMorgan joined a growing list of financial institutions including Bank of America, Citigroup, Morgan Stanley and Wells Fargo that have pledged to stop or scale back support for coal projects.

The Green Bond market has grown rapidly in the last few years. It is estimated that US$42 billion was raised in 2015\(^8\). New issues are becoming very frequent – in the first two months of 2016, issues totalling US$12 billion were announced, by issuers as diverse as ICBC, Apple, Shanghai Pudong Development Bank, the Province of Ontario and Export-Import Bank of Korea. While this market remains a small part of the global bond market as a whole, it is significant in the context of Hong Kong’s existing bond market and likely to become more so.

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The market for international bonds, both primary and secondary, is not as developed in Hong Kong as in other centres. According to data from the Bank of International Settlements (BIS), Hong Kong’s outstanding international debt instruments totalled US$208 billion (US$175 billion issued by the financial services sector) as at June 2015, which compares to the United Kingdom at US$3,219 billion and the USA at US$2,247 billion.

The Hong Kong government has made clear its objective to see the bond markets grow. This was demonstrated by the ‘Government Bond Programme’ which has the stated objective to ‘increase the breadth and depth of the local bond market’; under this program the government launched a US$1 billion Sukuk bond to promote Hong Kong’s Islamic finance platform.

Hong Kong has so far been a relatively insignificant participant in the green bond market. For example, despite being listed in Hong Kong, ICBC chose at the end of 2015 to issue its RMB-denominated green bond out of London. Project finance has also declined in Hong Kong compared to competitor jurisdictions and professional advisers in this area have focused their operations in other centres.

The green bond market will receive enormous impetus from China’s green finance requirements, much of which will need to be raised in international markets. Because of Hong Kong’s special relationship with China and its role as the principal market for offshore RMB, Hong Kong is in a unique position to capture related opportunities. If it does not do so, other centres will, and thereby enhance their China-related and RMB businesses at the expense of Hong Kong.

Green finance presents a significant opportunity for Hong Kong. Potential benefits are commercial, reputational and environmental. A flourishing green finance business in Hong Kong would offer a number of advantages:

- It would create employment opportunities. As investors, bankers, professional advisers and traders increasingly participate in the market they are expected to recruit locally as well as relocate experts from other centres.

- It would attract capital and the concomitant new business and derivative products, creating profits for Hong Kong taxpayers.

- It would provide support for Hong Kong’s own projects and environment-related activities, providing a locally-based source of finance.

- It would provide impetus to the insurance/re-insurance sector as it seeks to meet the demand to de-risk new technologies and as regulation increasingly requires pollution risk to be transferred to the insurance sector.

- It would attract entrepreneurs in green industries, both established companies and new entrants, to raise capital and seek listings in Hong Kong.
As demand for green investment products continues to grow, it would facilitate further growth of Hong Kong’s investment management industry.

Building a vibrant green finance industry will enhance Hong Kong’s reputation as a leading international financial centre and offshore RMB centre.

Hong Kong is uniquely placed to be the regional green finance leader. Its successful financial services industry has the track record, reputation and scale, 'with a world-class business infrastructure, sound regulatory environment and unique access to market opportunities’\(^9\). These characteristics provide the basis for innovation and leadership in green finance.

2.2. Hong Kong – current position on green finance

There has been some ad hoc progress in developing green finance in Hong Kong. While certain steps have been taken by a range of actors, overall this has been piecemeal, un-coordinated and largely driven by market opportunities as opposed to direct policy or regulatory direction.

Market-driven developments

First green bond issuance
In June 2015, the first labelled green bond by a Chinese company – wind energy firm Xinjiang Goldwind Science & Technology – was issued in Hong Kong. The US$300 million green bond (with a three-year tenor) provides an excellent example of investor demand. It received orders of US$1.4 billion and was nearly five times over-subscribed.

Hang Seng Corporate Sustainability Index Series
Launched in 2010, the Hang Seng Corporate Sustainability Index Series is the first index series of its kind to focus exclusively on the environment, social and governance (ESG) performance of Hong Kong and Mainland China stocks. Constituent selection is based on a process of independent assessment.

Investor network
For more than a decade, Hong Kong has been home to the Association for Sustainable & Responsible Investment in Asia (ASrIA) and the Asia Investor Group on Climate Change (AIGCC – an initiative set up and run by ASrIA). In 2015, ASrIA joined forces with the United Nations-supported Principles for Responsible Investment (PRI), making Hong Kong the Asian headquarters of the PRI.

Regulatory developments

Hong Kong Exchange – ESG reporting
In January 2016, following consultation with the industry, Hong Kong Exchanges and Clearing Limited (HKEX) strengthened its ESG Guide in the listing rules. It requires issuers to

\(^9\) FSDC Research Paper No.01, p4
state in their annual or ESG reports whether they have complied with the ‘comply or explain’ provisions set out in the ESG Guide. Listed companies are required to report, on a ‘comply or explain’ basis, general disclosures and a series of defined key performance indicators (KPIs) in the environmental category.

**Securities and Futures Commission – Principles of Responsible Ownership consultation**

In March 2015, the Securities and Futures Commission (SFC) launched a consultation on proposed Principles of Responsible Ownership, the purpose of which are to provide guidance to investors on how they should fulfil their ownership responsibilities in relation to their investment in a listed company. In March 2016, the SFC issued its findings from the consultation\(^\text{10}\), specifically highlighting the responsibilities of investors to engage on ESG issues stating:

‘Investors should encourage their investee companies to have policies on environmental, social and governance (ESG) issues and engage with investee companies on significant ESG issues that have the potential to impact on the companies’ goodwill, reputation and performance.’

**Policy developments**

The Hong Kong government has over the years introduced related policies, for example, the Cleaner Production Partnership Programme, and the Carbon Footprint Repository which was launched by the Environment Bureau in 2014. The Financial Secretary’s Budget Speech 2016-17 made reference to green finance and stated that the government will strengthen efforts to publicise its competitive capital markets and highlight Hong Kong’s edge in developing green financial products\(^\text{11}\). It further stated that the Airport Authority will explore the feasibility of financing through green bonds.

**2.3. Hong Kong government – taking action to stimulate the market**

Governments around the world are increasingly taking steps to encourage the development of green finance. For example, China was the first country to publish official rules on issuing green bonds. The PBOC rules are designed to kick-start a green bond market in the Mainland, and China’s Green Finance Task Force report suggests the establishment in the Mainland of a national Ecological Development Bank. In the UK, the Green Investment Bank was established to invest in, and mobilise capital towards, green projects.

Public pressure on governments has been building as attitudes to environmental issues gain prominence. Many younger people in particular, in Hong Kong and elsewhere, strongly believe that governments should prioritise environmental issues, and are likely to become more vocal in urging action. Governments, including Hong Kong, are also prioritising environmental policies under the international negotiations on climate change, and further to the Paris Agreement at COP21. China is also spearheading a global green finance push through its presidency of the G20 this year, in particular through an initiative called the G20

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\(^\text{10}\) http://www.sfc.hk/edistributionWeb/gateway/EN/consultation/conclusion?refNo=15CP2

Green Finance Study Group, which is drawing together experts to promote cooperation on a green financial system and developing the attractiveness of green finance.

In terms of local policy development in Hong Kong, we can expect a range of environmental and low-carbon policies from the government to be made in the coming years. It is already revamping the fuel mix for local electricity generation to reduce the use of coal by 2020. The government is also actively promoting energy saving across the economy, as well as green building. The government plans to set a new carbon intensity reduction target in the foreseeable future to be achieved by 2030. The government will have to consider such measures as reducing further or even eliminating coal-fired electricity generation by 2030, developing renewable sources of energy, expanding waste-to-energy facilities, promoting electric mobility etc. In addition, the government will follow the five-yearly review process set by the Paris Agreement, which means it will seek to 'up' Hong Kong’s low-carbon efforts every few years. The sectors of business that would be most affected include the energy, property development and management, transport and waste sectors.

Traditionally, Hong Kong’s financial services sector has evolved and grown by responding to market changes and the government’s role has been to facilitate. However, for Hong Kong to gain sufficient credibility as a green financial centre, government leadership is required to stimulate and encourage the private sector as well as facilitate the development of market reference products.

Hong Kong’s financial industry requires a kick-start to begin engaging in the opportunities related to the green sector. In part, this can be achieved by the Hong Kong government using resources from its own balance sheet to part fund certain green projects that currently require capital investment. By proactively committing its own funds, the government can send a clear message of confidence to the financial industry.
3. RECOMMENDATIONS

A. RECOMMENDATIONS FOR ACTION IN THE NEAR FUTURE

3.1. Recommendation One: Strategic green bond issuance

In order to demonstrate a clear precedent to issuers, investors and sponsors of Hong Kong’s ability to support a reference green bond issue, we recommend that the government issues benchmark green bonds.

This may involve departing from the government practice of not using borrowings for infrastructure projects, but a green bond would be consistent with the Government Bond Programme’s objective to promote development of the domestic bond market, particularly if longer maturities are included, and would target a nascent market before competing venues attain critical mass.

While Hong Kong can articulate a desire to become a regional centre for green bond issuance, issuers and their advisors are likely to steer issuance towards venues where there is a proven ability to issue these instruments successfully at market prices. Given the still modest number of green bonds listed by Asian issuers in other markets the size and number of issues required to demonstrate Hong Kong’s competency in this market should be relatively modest. Furthermore, it would send a clear statement of intent regarding the government’s commitment to Hong Kong emerging as Asia’s pre-eminent green bond market, build confidence in local technical capabilities and showcase Hong Kong’s strong and liquid private sector bond market.

Proceeds could be ear-marked for deployment towards a range of projects, including Building Environmental Assessment Method (BEAM Plus)-compliant public housing and an extension of the Mass Transit Railway.

In addition to issuing its own bonds, we recommend that the Hong Kong government seek to influence development banks in the region, such as the Asian Development Bank and the Asian Infrastructure Investment Bank in the Mainland, to issue green bonds in Hong Kong.

To facilitate the formation of capital to support bond issues in Hong Kong, it would be important for the government to devise tax policies that encourage the development of the bond market in Hong Kong. For example, the Hong Kong Inland Revenue Department’s position on ‘interest income’ for Hong Kong issued bonds under the current profits tax exemption for offshore funds is that interest income is ‘income from incidental transactions’ (rather than income from ‘specified transactions’) and would only be exempt from Hong Kong profits tax to the extent it does not exceed 5% of the total trading receipts of the offshore fund. This position discourages asset managers from managing unauthorised bond funds in Hong Kong, since a significant portion of the total income derived by a bond fund is ‘interest income’.
In addition, to encourage corporates to issue bonds in Hong Kong, the current tax concessions relating to Qualifying Debt Instruments should be more widely publicised.

3.2. **Recommendation Two: Continuing coordination on green finance activities**

To ensure ongoing momentum, we recommend that specific responsibilities for coordinating green finance be established. Similar actions have been taken in other markets.

For example:

- **China**: In 2014, the Green Finance Task Force was initiated by the PBOC’s Research Bureau to bring together local experts from the government, private sector, academia, think tanks as well as those overseas.

- **UK**: In January 2016, the City of London Corporation launched the Green Finance Initiative (GFI) - a long-planned effort to create a market around financial products dedicated to funding sustainable infrastructure projects.

- **G20**: Under China’s presidency of the G20, the Green Finance Study Group was established to identify institutional and market barriers to green finance and, based on country experiences and best practices, analyse options to mobilise private green investment.

We recommend that action be taken to ensure the on-going coordination of green finance activities. This may, for example, take the form of establishing a Green Finance Advisory Council with responsibility for advising the government on policies and actions to promote and support the green finance industry in Hong Kong. Members would be appointed by the Finance Secretary and membership would be on a voluntary and unpaid basis. The Council could be a temporary body with a fixed term.

In addition, we recommend that the Financial Services and Treasury Bureau should feed information into the newly announced Inter-departmental Committee on Climate Change (IDCCC) as a mechanism to continue reporting on green finance developments.

3.3. **Recommendation Three: Supporting growth of a green investor base**

Hong Kong’s financial industry faces certain capacity and expertise constraints, in particular relating to industry understanding on the risk-return characteristics that green sector investment opportunities present. We recommend that specific steps are taken to support the growth of a green institutional investor base. This need has also been specifically highlighted by China’s Green Finance Task Force report.

The goal of this recommendation is to inform and excite stakeholders about the market’s potential and improve understanding of the green sector, thereby encouraging demand for related investment products. It will also help in developing the supporting infrastructure – such as industry skills and expertise, an investor network and growth of service providers in the market – all required to deliver a green finance industry.
We recommend that the government consider the following:

1. **Hosting a regional conference on green finance and investment.** A conference – with wide scale appeal to market participants in Hong Kong and across the world – would demonstrate government commitment to the investment industry and attract specialists in the field from other financial centres across the world. Bringing in subject-matter experts, content and dialogue could be focused on educating the financial industry, understanding investment returns and promoting business opportunities. The conference could be organised, for example, by the Hong Kong Trade and Development Council (HKTDC).

2. **Running a green finance seminar series.** The conference should be followed by a seminar series aimed at more granular education and capacity-building on specific issues (e.g. implementing the Green Bond Principles for issuers, understanding the characteristics of renewable energy projects, financing options and funding considerations). Partnerships with other training and education providers should be considered (e.g. CFA Institute, Hong Kong Venture Capital and Private Equity Association, Hong Kong Securities and Investment Institute). Seminars would be supplemented with educational briefing papers and ‘how-to-guides’ on the session content.

3. **Building a pipeline of green finance professionals.** Universities and professional institutions should be encouraged to integrate green finance professional skills into their courses, skills development and continuing professional development curricula.

4. **The necessary tax changes** should be made to allow sovereign wealth funds, pension funds (that comply with the requirements and regulations of stipulated jurisdictions), central banks and government agencies to invest in Hong Kong-issued bonds without incurring local tax charges.

5. **If the Ecological Development Bank** referred to in the Green Finance Task Force report is set up, we recommend that the government press the Mainland authorities to open a significant branch of the Bank in Hong Kong.

3.4. **Recommendation Four: Developing and implementing green fund labelling and green project accreditation schemes**

Investor preferences are changing, with increased demand for investment products that address sustainability and environmental issues expected. As a leading asset and fund management centre, developments in green finance present an exciting opportunity to enhance Hong Kong’s market position in the provision of asset management services.

We recommend that consideration be given to developing and implementing green fund labelling and green project accreditation schemes, enhancing transparency and accreditation standards so that market participants have greater confidence in green fund products and projects. It is anticipated that this will facilitate the growth of green asset
management services and attract new investors to Hong Kong, as well as help building Hong Kong’s project finance sector.

The green label can provide investors with assurance that a fund or project’s green characteristics have been clearly identified and defined, and analysed by an independent external expert (e.g. certification by third party assurers such as Hong Kong Quality Assurance Agency). We recommend that a study group is established, comprising independent experts, to explore how such schemes can be designed and implemented. The green label can also be awarded to funds investing in green bonds, supporting recommendations made in relation to developing Hong Kong’s green bond market.

As part of this initiative, Hong Kong’s current quality accreditation capabilities could be expanded to include green projects, such as for use for green bonds and funds reserved by bonds for ‘green’ loans. Hong Kong has a precedent for developing a green labelling/accreditation scheme in the building sector (i.e. BEAM Plus).

Consideration should also be given to providing financial support to the green labelling scheme or schemes, so that costs to the issuers / borrowers themselves can be eliminated or reduced.

**B. RECOMMENDATIONS FOR ACTION IN THE MEDIUM TERM**

**3.5. Recommendation Five: Public listings for green sector companies**

Hong Kong is well established as a centre for the listing and trading of equity securities and derivatives of companies in China and elsewhere. In three of the last four years, the Hong Kong Stock Exchange has seen the raising of more equity capital than any other market in the world.

Hong Kong has also provided the venue for the Initial Public Offerings of many new companies established by entrepreneurs in China and elsewhere. These have included ‘green’ companies such as the solar power manufacturers. The process of listing in Hong Kong has normally been quicker and more predictable than in the Mainland, and continues to attract many new applicants.

As entrepreneurs in China respond to the government’s green initiatives, an increase can be expected in the establishment of new technology businesses, in areas such as alternative energy and green technology. These businesses will need access to capital, but in many cases will not be able to meet the criteria for listing on HKSE.

The Growth Enterprise Market was designed to provide a platform for such companies, but has had limited success and is believed to be under review. Other options for early-stage companies such as a ‘Third Board’ have also been canvassed. Meanwhile, potential green listing applicants in the Mainland are believed to be resorting to other sources of capital, such as ‘back door’ listings.
We recommend that, in considering how the listing process in Hong Kong is reformed to allow earlier stage companies to raise capital and obtain listings, particular attention is paid to companies developing green businesses or technologies. Hong Kong should seek to be the listing venue of choice for such companies, providing a growth platform for its equity market and enhancing its reputation as a green financial centre.

Meanwhile, China’s Green Finance Task Force report identified Hong Kong as a suitable venue for listing the Mainland’s green companies. We should seek to take up this opportunity. We therefore further recommend that HKEx is pro-active in making efforts to increase awareness in the Mainland of its advantages as a venue for green IPOs. Such efforts could include roadshows targeted at potential green listing applicants.

3.6. **Recommendation Six: Support for private equity**

Private equity plays a major role in the funding for entrepreneurs in green fields such as alternative energy and green technology, as it does for the broader technological sector. In some jurisdictions, the growth of private equity has been encouraged by sovereign wealth funds or other government-related entities becoming investors in private equity funds, providing leadership for other investors.

We recommend that the government give consideration to steps it could take to support this industry in Hong Kong, including the provision of capital from the Exchange Fund or otherwise either to establish its own fund or to ‘seed’ funds established by others. This investment can be considered a long-term investment that will generate attractive investment returns whilst also making a strategic investment to build Hong Kong’s position in this important sector.

Investment support can also be extended at the operating company level. To the extent that many ‘green companies’ will use innovative technologies, the terms of the HK$2 billion Innovation and Technology Venture Fund announced in the 2016-17 Budget should encourage investment in early stage green technology companies.

The government has in 2015 extended the profits tax exemption for offshore funds to offshore private equity funds. However, such tax exemption does not apply where the offshore private equity funds invest in Hong Kong private companies. To encourage entrepreneurship in Hong Kong, the government should consider granting tax exemption to offshore private equity funds that invest in Hong Kong private companies as well.

3.7. **Recommendation Seven: Climate and environmental risks to investment portfolios**

We recommend that the government encourages asset owners and their investment managers to consider studying the potential risks to investment portfolios associated with climate change and environmental issues. This may also include aligning investment processes and policies with best practices on environmental, social and governance (ESG) management and disclosure. This recommendation is aligned with international
developments on climate-related financial disclosure – in particular, the industry-led Task Force on Climate-related Financial Disclosures launched by the Financial Stability Board in December 2015.

In particular, Hong Kong’s public asset owners set the tone for domestic asset owners and we recommend that government encourage the Hong Kong Monetary Authority (HKMA) to study future risks to the investment portfolio through an ESG lens, in alignment with the above. HKMA could publish figures indicating how much of the Exchange Fund is currently invested in ‘green’ products and adopt a policy of gradually increasing this amount.

3.8. **Recommendation Eight: Providing supporting services for emissions trading**

Emissions trading is a policy tool to reduce emissions. China has been piloting several carbon emissions trading projects over the past few years and the Chinese authorities have announced that they plan to start a national emissions trading system in 2017. While details are still to be released, it is expected that China will gradually develop what is likely to be the world’s largest emissions trading system.

There could be an opportunity when the time is right for Hong Kong’s financial and professional services sectors to play a role to support the development of this system. Separately, it is expected that the government will also need to formulate its own policy on emissions trading in due course.
4. CONCLUSION

Hong Kong is in a position to be the leading centre for green finance in the region. It should act to establish and consolidate this position without delay, as companies around the world consider the options for raising the vast amounts of capital required, investors seek markets for their 'green' funds, and competitor jurisdictions also seek to establish themselves as green finance centres.

Green finance presents Hong Kong with an opportunity and a threat: by committing to this now, Hong Kong can build an expertise in a major new stream of finance whilst also aligning itself with a high priority Mainland initiative. However, if Hong Kong does not seize the opportunity, others will.

As a first step, we suggest that our Recommendations 1 to 4 above should be acted on in the near future.
About the Financial Services Development Council, Hong Kong

Established in January 2013, the Financial Services Development Council (FSDC), Hong Kong is a high-level and cross-sector platform to engage the industry and formulate proposals to promote the further development of Hong Kong’s financial services industry and map out the strategic direction for development. The FSDC will advise the Hong Kong SAR Government on areas related to diversifying the financial services industry, enhancing Hong Kong’s position and functions as an international financial centre of our country and in the region, and further consolidate our competitiveness through leveraging the Mainland to become more global.

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