

Development of Green Finance in Hong Kong

Financial services are a principal component of Hong Kong's service-based economy, providing business and employment opportunities in many other sectors. As such, maintenance of the city's position as one of the leading financial centers in the world is crucial to Hong Kong's future and its continued role in the broader financial markets. At the same time, increasing awareness and interest in environmental protection has led to rapid increases in the investment in "green products"¹.

For instance, global green bond issuance expanded drastically from 2012 to 2016 at a compound annual growth rate of 250%, from approximately US\$2.1 billion in 2012 to approximately US\$81.6 billion in 2016², and the total gross issue amount of green bond again doubled to approximately US\$161 billion in 2017³. Green bond issuance in 2018 was expected to continue this trend. The surge in demand reflects the attractiveness of green bonds as an environmentally friendly long-term financing option with longer maturities than conventional bank loans.

Anchored by a sound legal and regulatory system, as well as well-developed capital markets, Hong Kong is well positioned to be a leader in the development of green finance, allowing international investors to arrange financing for their green projects through the established local capital market.

Benefits at local and regional scale of establishing green finance in Hong Kong

Hong Kong stands to gain significantly from successful efforts to promote the city as a Green Finance center, with potential commercial, reputational, infrastructural and environmental benefits:

- a) Green finance supports the development of green projects and can lead to sustainable development; the development of green finance on the back of Hong Kong's robust market infrastructure can transform Hong Kong's regional economy into a diversified and innovative one.
- b) Green finance would attract more capital and encourage new business and derivative products which can benefit Hong Kong as a whole.

- c) Green finance would attract entrepreneurs in green industries, both established companies and new companies, to raise capital and seek listings in Hong Kong as well as allowing investors, bankers and other professional advisers to participate in this particular category of investment product. This may drive recruitment of additional experts and specialists both locally and from other countries, both of which provide strong stimulation to Hong Kong's labor market.
- d) Green finance would facilitate further growth in the local and regional investment management industry as the demand for green investment products continues to grow.
- e) The increasing number of renewable energy projects as well as environment-related projects, both locally and regionally, has resulted in strong demand for project finance.

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According to the Hong Kong Financial Services Development Council (FSDC), in terms of local policy development, it is expected that a range of environmental and low-carbon policies from the government will be implemented in the near future, as the government plans to pursue a new carbon intensity reduction target to be achieved by 2030. The need to develop renewable sources of energy, expand waste-to-energy facilities, and reduce or eliminate coal-fired electricity generation will be at the front and center of this initiative for years to come. The opportunities and recommendations with respect to green finance as delineated by the FSDC cover the following:

¹ United Nations Environment Programme defines "green financing" as financing measures to increase level of financial flows (from banking, micro-credit, insurance and investment) from public, private and not-for-profit sectors to sustainable development priorities.

² RBC Capital Markets. Green Bonds: Green is the New Black, April 2017.

³ Hong Kong Monetary Authority Quarterly Bulletin. Green Bond Market: Hong Kong's Unique Role, September 2018.

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- a) **Positioning Hong Kong as a hub for raising green capital.** Hong Kong should position itself as a source of green finance amid the funding opportunities arising from the Belt and Road initiative. Hong Kong, given its superior financial infrastructure, has advantages over many countries in the region in capturing the funding needs for green infrastructure development on the Mainland.
- b) **Broadening the offer of green financial products.** Increasing environmental awareness has encouraged more demand and enhanced the popularity of green investment by investors across different categories. Hong Kong government, working together with the financial industry, should introduce more green financial products in order to capture these business opportunities.
- c) **Developing green guidelines or standards to enhance market credibility and transparency.** Increased demand and popularity of green investments will drive the need for centralized guidelines and standards. The government should prevent what it is called “Green-Washing”⁴ by implementing clear and precise green finance guidelines to ensure market credibility and enhance demand for these products. The establishment of consistent market mechanisms that adhere to internationally acceptable concepts, rules, principles, requirements and procedures in Hong Kong will encourage green investors to consider Hong Kong when making such investment.

⁴ According to the Securities and Futures Commission of Hong Kong, “green-washing” means that certain asset managers’ claims to be investing sustainably and market themselves as “green” or “sustainable” but do not fully integrate these factors into the investment process.

Launch of Green Bond Grant Scheme

To address the increasing demand in this new category of investment products, and to meet the challenge presented by other jurisdictions in the race to become the next generation financial hub of the world, Hong Kong rolled out the “Green Bond Grant Scheme” on 15 June 2018⁵, valid for three years, to subsidize the extra financing cost incurred by external review required to label bonds as green bonds for eligible issuers. Both first time and repeat issuers of green bonds of any tenor issued and listed in Hong Kong, and denominated in any currency at a minimum issue size of HK\$500 million are welcome to apply for subsidies, and the grant can cover the full cost of external review required for a green label, subject to a cap at HK\$800,000 per issuance.

This subsidy compares favorably to other markets. For example Singapore has a grant scheme to subsidize the extra costs incurred for green labelling. However, to qualify for the grant, the issuance size needs to be at a minimum of S\$200 million (approximately HK\$1,148 million), and the grant is capped at S\$100,000 (approximately HK\$574,000) per bond. Hong Kong’s lower threshold and higher grant amount demonstrate Hong Kong’s intention to promote green finance and to attract mainland and international green investors and issuers to Hong Kong.

Government green bond program in Hong Kong

As part of Hong Kong government’s initiative to boost the development of green finance in the city, the government plans to launch a green bond issuance program with a borrowing ceiling of HK\$100 billion⁶. The funds raised will be credited to the Capital Works Reserve Fund⁷ to provide funding for green public works projects. Renewable energy projects, energy efficiency projects and green/low carbon building projects are all potential projects underpinning the government’s green bond issuance initiative. For the initial tranches of the program, the government is targeting institutional investors with bond tenors of three to five years – with the arrangement to be reviewed when the government amasses more experience⁸. This inaugural government green bond is set to be the world’s largest sovereign green bond issuance program, which shows Hong Kong’s ambition in building the momentum on green finance and its intention to set a role model for potential issuers.

Next step

Hong Kong’s recent policy changes such as the Green Bond Grant Scheme and the sovereign green bond signify the government’s support for green finance, and are in line with President Xi Jinping’s plan to speed up reform for developing an ecological civilization to combat climate change⁹. While it is hard to anticipate how successful this attempt to establish Hong Kong as a global hub for green finance will be, the outlook for this development is highly positive and indications are that the market is optimistic about Hong Kong increasing its profile in the international bond market by leveraging on the potential growth in number of Chinese companies issuing green bonds in the city.

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⁵ <https://www.info.gov.hk/gia/general/201806/06/P2018060600853.htm>

⁶ https://www.news.gov.hk/eng/2018/06/20180615/20180615_163706_163.html?type=ticker

⁷ The Capital Works Reserve Fund was established with effect from April 1, 1982 for the purpose of financing public works programme and the acquisition of land.

⁸ https://www.legco.gov.hk/yr17-18/english/subleg/brief/sc14_brf.pdf

⁹ http://www.xinhuanet.com/english/download/Xi_Jinping's_report_at_19th_CPC_National_Congress.pdf

