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Credit where it's due (1)

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Since groundbreaking green finance laws were launched in China three years ago, the country's banks have made admirable efforts to clean up lending practices. But, says Adina Matisoff, transparency remains weak.

> **"China Construction Bank exceeded its own expectations by cutting lending to companies in the cement, steel and other energy-intensive and polluting industries by 120% on the figure planned for 2008."**

Three years ago this July, the Chinese government introduced unprecedented financial regulations as a means to harness the power of China's commercial banks to curb the country's severe environmental degradation. The Green Credit Policy, created by the China Banking Regulatory Commission (CBRC), The People's Bank of China and State Environmental Protection Administration (now the Ministry of Environmental Protection or MEP), was a bold idea to prohibit lending to dirty companies; and one that few governments internationally have had the power or will to pull off.

With this tool, Chinese banks have made strides in the development of their environmental policies and have started to see the green results of their implementation measures. And yet poor transparency of lending policies and practices at Chinese banks is holding the sector back from meeting the environmental-protection demands of government and society.

In 2008, I co-authored a report for Friends of the Earth and BankTrack, the international network of NGOs monitoring the operations of the private financial sector, examining the state of environmental policy and practice in China's banking industry. We noted that the Green Credit Policy was "an entirely new way of addressing environmental degradation in China" that was "proving to be the most powerful factor spurring and influencing sustainable finance in China today".

Since that time, Chinese NGOs have taken up the issue of sustainable banking in China, adjudicating the first-ever "Green Banking Innovation Award" as part of the *Economic Observer* magazine's annual banking awards in 2008 and 2009. In March this year, Green Watershed and eight other groups collectively issued the first Chinese NGO benchmarks of the Chinese banking sector. Their "Chinese Banking Sector Environmental Record (NGO

Analysis)" examines the environmental performance of 14 Chinese banks listed on Chinese stock markets in 2008 (complete 2009 data is still unavailable).

Yu Xiaogang, the report's lead author, explains that the study takes into consideration "national conditions" as well as the fact that the concept of sustainable banking is relatively novel in China. The report highlights the growth of green finance education within the banks, which, Yu notes, is key to creating a corporate culture of sustainability among lenders and clients. For example, Industrial Bank brought in a green finance trainer from WWF before adopting the Equator Principles (EPs), a voluntary standard for project finance modelled on the International Finance Corporation's (IFC's) environmental and social policies. And Industrial and Commercial Bank of China conducted research on the EPs in cooperation with the CBRC and MEP. However, many of the banks polled for the study did not disclose what, if any, learning activities they had carried out on green finance, making it difficult to tell how deeply awareness of the subject has penetrated staff and client networks.

The report gives recognition to banks that have stepped up lending to energy-saving projects, such as a biomass power generation project in Shandong, east China, financed by Industrial Bank, and a waste heat generation project in Hunan, south China, which was backed by Bank of Beijing and named as one of the country's top ten green credit projects by the *21st Century Business Herald*. The NGOs also saw progress in the development of measures to cut lending to environmentally harmful projects. Some of the banks assessed had introduced procedures before and after loans are disbursed to better monitor or restrict lending to China's dirtiest companies, such as those active in construction or chemical production. ICBC and a handful of other banks adopted the "one-ballot veto", which is a catchy name for making environmental compliance a prerequisite for credit.

Unfortunately, the report found that these measures were not yet advanced enough to prevent lending to risky projects. China Merchants Bank, China Everbright Bank and others still lined up to finance the Xianglu Group in its plans to build a petrochemical plant in Xiamen that would produce 800,000 tonnes of highly carcinogenic chemicals each year within a stone's throw of residential areas. ICBC and several of its peers still lent to Huaneng Group and Huadian Corporation, both of which are involved in large, controversial hydropower projects on the middle reaches of the Jinsha River in northern Yunnan. Huaneng and Huadian were sanctioned by the MEP in June 2009 for severe violations of national environmental-protection standards, including constructing dams without MEP-approved environmental impact assessments. Without more information from these institutions on how they implement the "one-ballot veto" and other policies, we are left scratching our heads as to how Xianglu, Huaneng and Huadian slipped passed the banks' checks.

But some banks are eager to point out that they have had success in reducing lending to energy-intensive and polluting projects and companies, and are demonstrating that with hard numbers. China Construction Bank, for example, exceeded its own expectations by cutting lending to companies in the cement, steel and other energy-intensive and polluting industries by 120% on the figure planned for 2008 and its year-on-year reductions far surpassed those of any of its peer banks in China. ICBC cut almost 50 billion yuan (US$7.4 billion) in loans to dirty industries in 2008, which was 70% better than the previous year. Again, however, disclosure was sparse. More than half the banks included in the study failed to provide any data to demonstrate their efforts to cut lending to dirty industries. And those that did supply the relevant figures seldom did so as a percentage of their total lending.

This stark absence of data highlights the need for better disclosure of information on policies, bank-wide performance trends and projects. Yu Xiaogang notes that, "Information disclosure from China's banking sector is a recent phenomenon, and the content of disclosed information is still very limited… key information may be hidden, especially the environmental and social impacts of specific projects of special concern to the public." As Chinese citizens pay the price for projects such as the Xiamen petrochemical plant and Jinsha hydropower dam, society is demanding greater scrutiny of, and transparency around, corporate behaviour.

In comparison, the availability of environmental and social information is a decisive factor in the assessment of international banks. BankTrack's "Close the Gap" benchmarking report of 50 leading global banks, released in April 2010, only rated publicly available bank policies in recognition of the importance of making open commitments and accepting societal supervision. Of the four Chinese banks included in that report – ICBC, Bank of China, China Construction Bank and Industrial Bank – only the last provided publicly available data on which it could be ranked. As a result, the cumulative showing of Chinese banks was feeble amid the field of international competitors. Commenting on the results, Jora Wolterink, coordinator of the report said, "The overall quality of policies still leaves a lot to be desired. We hope this report encourages banks to continue this process, and to disclose more information on their policies."

The Chinese banking sector has, however, shown its potential as a sustainability leader. In December 2009, Industrial Bank – the first bank to adopt the Equator Principles in China – disclosed information on its first Equator project in a manner no other Equator bank has ever done. The issuance of this public notice acknowledged that the lending decisions of Industrial Bank are important to society and that Industrial Bank is committed to promoting good environmental governance in this project.

Three years after the introduction of the Green Credit Policy, Chinese banks should be commended for their efforts to implement the national policy. These are their first steps towards the transformation of the country's economic development model in the interests of a cleaner environment. Now it is up to these banks to take the next step towards meeting the environmental-protection goals of the government and the expectations of society by publicly disclosing information about their environmental commitments and lending practices.

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Homepage image by Track01 shows a protest against Xianglu Group's petrochemical plant in Xiamen.

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