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# Who is Who No. 3

Chinese Commercial Banks: An NGO Guide





## Contents

|   |           |
|---|-----------|
| <b>Introduction</b> .....   | <b>4</b>  |
| <b>An overview of the commercial banking sector in China</b> .....  | <b>4</b>  |
| <b>The biggest players in the sector</b> .....  | <b>5</b>  |
| <b>How do major Chinese commercial banks operate?</b> .....   | <b>6</b>  |
| A closer look: State-owned commercial banks .....   | 7         |
| A closer look: Joint stock banks .....  | 7         |
| Partnership with international financial institutions .....   | 7         |
| <b>How are the Chinese commercial banks regulated?</b> .....  | <b>9</b>  |
| The regulators and their mandates .....   | 9         |
| Financial regulatory focus .....  | 10        |
| <b>Environmental and social requirements for Chinese commercial banks</b> .....                           | <b>10</b> |
| Commercial banks to align with China’s carbon neutrality goals .....                                      | 10        |
| Commercial banks to follow green finance policies .....   | 11        |
| Commercial banks to integrate ESG risk management in credit granting .....                                | 11        |
| Commercial banks’ overseas investments to comply with local laws and strive for<br>higher standards ..... | 12        |
| Commercial banks to disclose environmental information .....  | 12        |
| <b>Engaging with Chinese commercial banks</b> .....   | <b>14</b> |
| List of abbreviations .....   | 16        |
| Source .....  | 17        |

## Introduction

Chinese commercial banks are becoming an increasingly prominent source of funding for companies and projects in and outside China. Like their international peers, the Chinese commercial banks provide large sums to companies and projects that carry clear or potential environmental and social risks. For example, Chinese banks provided USD 749 billion in loans and underwriting services to the global coal industry from January 2019 to November 2021. This figure makes China the largest source of funding for the coal industry in the world according to research by Urgewald, a non-profit environmental and human rights organisations, and its partners.<sup>1</sup> Burning coal carries dire consequences for the Earth's atmosphere and human health.<sup>2</sup> Coal is also responsible for over 40 % of energy-related CO<sub>2</sub> emissions.<sup>3</sup>

Civil society organisations around the world are becoming more aware of the role Chinese banks play in financing companies and projects that can cause human and environmental harm. This report was produced to help interested communities and civil society organisations to better understand the commercial banking sector in China, including how major Chinese commercial banks operate and how they are regulated. The report also provides some entry points for organisations seeking engagement with the Chinese commercial banks. To this end, we provide an overview of recent and future developments in China's policies on climate and energy, as well as the evolving sustainability requirements for the commercial banking sector.

## An overview of the commercial banking sector in China

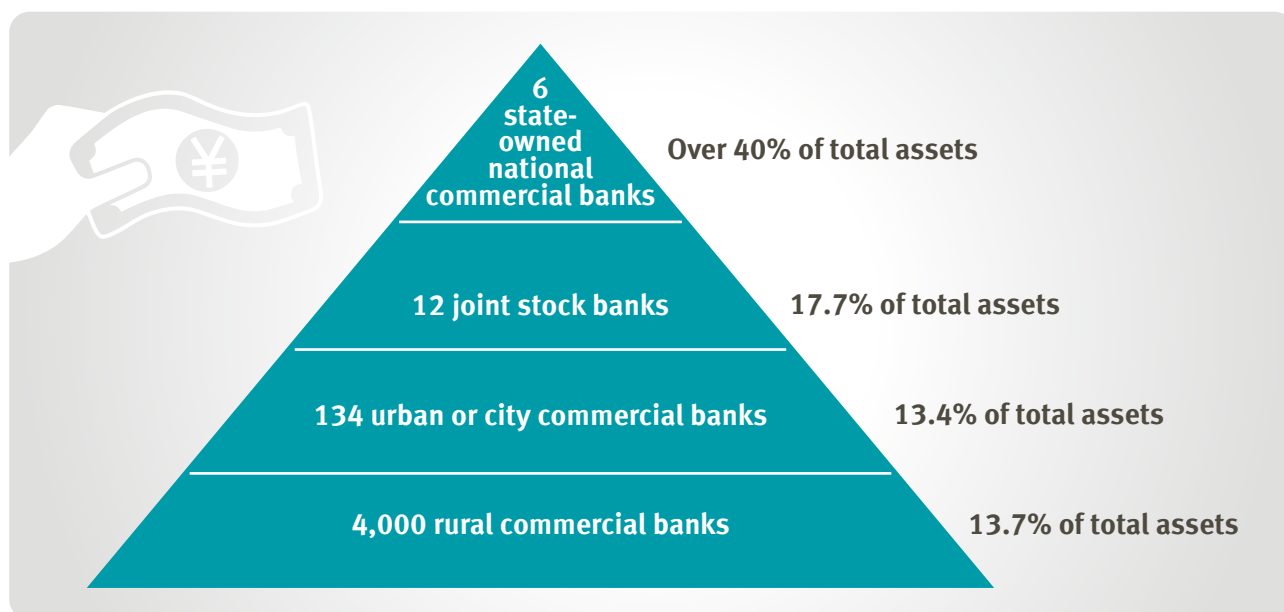
There are 4,599 banks and financial institutions in China, as of June 2022.<sup>4</sup> Out of this number, exceptions from the Chinese commercial banking sector are: the China Development Bank (an institution that provides developmental finance), the two policy banks (the Export and Import Bank of China and the Agricultural Development Bank of China), the over 40 foreign banks; and a few hundred financial institutions that do not offer banking services.

One way to understand the diverse Chinese commercial banking sector is to see it as a four-tier system. The main defining factor of each tier is the bank's controlling owner. Other important factors include the geographic and sectoral focus of the banks.

- » **The state-owned national commercial banks** are the biggest, by assets and by geographic or sectorial reach. The central government of China is these banks' primary and dominant owner. They serve nationwide customers and generally have branches across the country. The 'Big Four' among them – Industrial & Commercial Bank of China, China Construction Bank, Agricultural Bank of China, and Bank of China – are also the world's largest banks by assets in 2021, according to a ranking by Standard & Poor's, a business intelligence company.<sup>5</sup>
- » **The joint stock commercial banks**, also known as joint equity commercial banks, form the second tier of the Chinese commercial banking landscape. First established during the late 1980s, these are a group of banks that are not solely owned or controlled by central or local governments. Instead, they have mixed ownership that includes the state, the state-owned enterprises (SOEs), private enterprises and individuals.<sup>6</sup>

- » **The urban or city commercial banks** are often owned or controlled by the city government or state-owned companies. Most of them are of much smaller scale and usually only serve local economies. Still, the largest ones now operate similarly to the joint stock commercial banks and serve clients in other regions or are listed on national stock exchanges. Some even have overseas branches in Hongkong or Southeast Asia.<sup>7</sup>
- » **The rural commercial banks** form the fourth and last tier of the commercial banking sector in China. This group of banks consists of a few slightly different banks, including the rural commercial banks, the rural village and town banks and the rural credit co-operatives. These banks often have links to local governments, but many of their shareholders are in fact private businesses, including other commercial banks. There are a few thousand rural commercial banks across China, yet they account for just over 13% of the total assets in the banking sector.<sup>8</sup> These much smaller banks are typically based in villages and towns and serve the local and rural communities and businesses.

If we order the commercial banking system by the number of institutions, the four-tiered banking system takes the shape of an Egyptian pyramid. As of the end of 2019, there are only six state-owned national commercial banks at the top, followed by 12 joint stock banks, and then 134 urban or city commercial banks. Close to 4,000 rural commercial banks form the last layer of the pyramid. But if we look at the distribution of the assets, we will see a reverse pyramid. The six state-owned commercial banks' total assets accounted for 40.2% of the entire sector, while the joint stock commercial banks accounted for 17.7%, the urban/city commercial banks accounted for 13.4%, and thousands of rural financial institutions, including the rural commercial banks, only accounted for 13.7%.<sup>9</sup>



## The biggest players in the sector

The People's Bank of China (PBOC) - China's central bank, in 2021, announced the 19 most important banks in the Chinese financial system (see Table 1).<sup>10</sup> These are the banks that have big assets, many clients, branches,

and operating licenses and are highly interconnected to other major financial institutions, for example, by offering significant amount of inter-bank loans.<sup>11</sup>

**Table 1. The 19 most important commercial banks in China in 2021 in a descending order** (source: The People's Bank of China)

| Importance                             | Names of the banks  | Types of the banks   |
|--|---|--|
| <b>The most important group</b>        | Industrial and Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China | These are the so-called 'Big Four', the largest state-owned commercial banks.  |
| <b>The second most important group</b> | Bank of Communications  | Bank of Communications is another state-owned commercial bank.   |
|  | China Merchants Bank, Industrial Bank   | China Merchants Bank, Industrial Bank are joint stock commercial banks   |
| <b>The third most important group</b>  | China Postal Savings Bank   | China Postal Savings Bank is a state-owned commercial bank.  |
|  | China CITIC Bank, China Minsheng Bank, Shanghai Pudong Development Bank                                     | The rest, China CITIC Bank, China Minsheng Bank, are joint stock commercial banks.                                       |
| <b>The fourth most important group</b> | Ping An Bank, China Everbright Bank, Hua Xia Bank, China Guangfa Bank                                       | The first four, Ping An Bank, China Everbright Bank, Hua Xia Bank, China Guangfa Bank, are joint stock commercial banks. |
|  | Bank of Ningbo, Bank of Shanghai, Bank of Jiangsu, Bank of Beijing  | The last four, are city/urban commercial banks.  |

## How do major Chinese commercial banks operate?

In China, the biggest commercial banks, have extensively diversified their business to non-banking services. This means that, in addition to the traditional offering of savings and lending services, they also actively provide insurance and investment products to both corporate and retail customers. For example, a retail customer may be able to buy life insurance, or a bank or a company may get the bank to manage its corporate pension fund.

Since the banks need to first acquire a dedicated license for the financial services they provide, looking at the types of non-banking licenses each major commercial bank holds will provide us with a good understanding of the types of services that the banks offer (see Table 2). On average, the state-owned commercial banks tend to hold more licenses than the joint stock banks. The nine joint stock banks' non-banking services are more focused on financial leasing and wealth or investment management.

**Table 2. Major Chinese banks' non-banking licenses in June 2020** (source: Stock Broker China<sup>12</sup>)

|                                |   | Broker license | Insurance license | Trust license | Investment fund license | Financial Lease license | Consumer Finance license | Futures license | Financial Management license | Financial Asset Investment (debt-to-equity swap) license |
|--------------------------------|---|----------------|-------------------|---------------|-------------------------|-------------------------|--------------------------|-----------------|------------------------------|--|
| 6 state-owned commercial banks | Industrial and Commercial Bank of China | ✓              | ✓                 |               | ✓                       | ✓                       |                          |                 | ✓                            | ✓  |
|                                | China Construction Bank                 | ✓              | ✓                 | ✓             | ✓                       | ✓                       |                          | ✓               | ✓                            | ✓  |
|                                | Bank of China                           | ✓              | ✓                 |               | ✓                       | ✓                       | ✓                        |                 | ✓                            | ✓  |
|                                | Agricultural Bank of China              | ✓              | ✓                 |               | ✓                       | ✓                       |                          |                 | ✓                            | ✓  |
|                                | Bank of Communications                  | ✓              | ✓                 | ✓             | ✓                       | ✓                       |                          |                 | ✓                            | ✓  |
|                                | China Postal Savings Bank               |                |                   |               |                         | In process              | ✓                        |                 | ✓                            |  |
| 9 joint stock banks            | China Merchants Bank                    | ✓              | ✓                 |               | ✓                       | ✓                       | ✓                        |                 | ✓                            |  |
|                                | Industrial Bank                         | In process     |                   | ✓             | ✓                       | ✓                       | ✓                        | ✓               | ✓                            | In process   |
|                                | Shanghai Pudong Development Bank        | ✓              |                   | ✓             | ✓                       | ✓                       |                          |                 | In process                   | In process   |
|                                | China Minsheng Bank                     | ✓              |                   |               | ✓                       | ✓                       |                          |                 | In process                   |  |
|                                | China CITIC Bank                        | ✓              |                   |               |                         | ✓                       | ✓                        |                 | ✓                            |  |
|                                | China Everbright Bank                   | ✓              |                   |               |                         | ✓                       | ✓                        |                 | ✓                            |  |
|                                | Ping An Bank                            |                |                   |               |                         |                         |                          |                 | ✓                            | In process   |
|                                | Hua Xia Bank                            |                |                   |               |                         | ✓                       | In process               |                 | ✓                            |  |
|                                | Zhe Shang Bank                          |                |                   |               |                         | ✓                       |                          |                 | In process                   |  |

## A closer look: State-owned commercial banks

We take a closer look at two of the largest state-owned commercial banks to better understand their structure and operations.

The **Industrial and Commercial Bank of China (ICBC)** has set up at least six subsidiaries, each holding a different license, to provide a range of financial services. It seems that the ICBC has set up these subsidiaries to specifically engage in these activities, while the bank itself mostly engages in retail and commercial banking as well as wealth management. The ICBC also partners with international financial entities such as AXA and Credit Suisse to offer services like insurance and investment funds.

How are state-owned banks' different operations structured? In the case of ICBC, the bank itself offers personal and corporate banking services. As part of the corporate banking service, it also offers investment banking service, which includes, for example, advisory services and financing for mergers and acquisitions. It also provides other services such as wealth management for institutional investors and the management of pension funds for companies.

The **Bank of China's (BoC)** structure and business scope are fairly similar to those of the ICBC. According to its 2021 annual report, most of its business relates to commercial banking services, such as providing financing for companies (38.4%) and individuals (39.13%).<sup>13</sup> The commercial banking part of the BoC's business entails extensive local branches across China and many international branches across Asia, Africa, Europe, and America. The bank has 14 other subsidiaries that manage business related to insurance, securities, investment, and more.<sup>14</sup>

By the end of 2020, five Chinese state-owned commercial banks opened 105 branches and 62 affiliated entities in 51 countries and regions, employing 520,000 people.<sup>15</sup> These five major state-owned commercial banks are the key players in overseas investment, along with Chinese development and policy banks.

Our understanding is that whilst major Chinese state-owned banks do not have a dedicated department or unit specialised in one specific sector, such as energy or mining, their management would usually formulate sector-specific policies, often not published in full, to guide the banks' financing decision making. Decision making on a specific case, say whether to grant credit to a certain company, is likely to be led by a department with expertise in credit or investment, in close coordination with other departments such as risk management and compliance.

When it comes to overseas financing, over the past decade, Chinese regulators have gradually set out more explicit requirements for Chinese banks to consider environmental and social risks when investing overseas (see section: *Commercial banks' overseas investment to comply with local laws and to strive for higher standards*).

## A closer look: Joint stock banks

Broadly speaking, the joint stock banks can be divided into two groups.

One group is the likes of **Shanghai Pudong Development Bank (SPDB)** that has a relatively simple corporate structure. Most of non-banking operations are set up either as subsidiaries of the bank, or joint ventures between the bank and other entities.

The other group includes the **China CITIC Bank, the Everbright Bank, and the Ping An Bank**. These banks are owned and controlled by a parent company, known as a financial holding company (FHC). The FHCs own and control subsidiaries engaged in banking, insurance, investments, and other financial and non-financial business. Regulators expect holding companies to coordinate and streamline their various operations.

Take the CITIC Group as an example. CITIC Group is a FHC that also acts as a parent company to many subsidiaries specialised in banking, trust and consumer finance. At the core of the FHC's operations is China CITIC Bank. Majority-owned by the China CITIC group<sup>16</sup>, China CITIC Bank is a Shanghai- and Hongkong-listed company that provides both retail and commercial banking services. The bank also controls a Hongkong-based bank called CITIC Bank International (China).

The China CITIC Bank offers a range of services, including the financial leasing business that supports Chinese companies' overseas investment and the expansion into renewable energy. The bank's securities and future businesses are interconnected, and it has partnered with Prudential for its insurance and fund management services.

## Partnership with international financial institutions

The major Chinese commercial banks have deepened collaboration with their international peers in recent years by setting up multiple joint ventures, especially in sectors such as insurance and investment management. Below are some examples of existing joint ventures:

- » **Industrial and Commercial Bank of China** has joint ventures with Credit Suisse<sup>17</sup> and AXA Group<sup>18</sup>, focused on fund management and insurance, respectively.

- » **Agricultural Bank of China** has set up a joint fund management company ABC-CA Fund Management Co., with French Amundi Asset Management and Chinese Chinalco Capital Holdings Company Limited, a Chinese holding company.<sup>19</sup>
- » **Bank of Communications** has set up BOCOM MSIG Life, an insurance company jointly owned by the bank and the Japanese MS&AD Insurance Group.<sup>20</sup> The bank also set up BOCOM Schrodgers, a fund management company with the British asset manager Schrodgers.<sup>21</sup>
- » **China Merchants Bank** has a joint venture with Cigna, the American healthcare and insurance company, focused on the insurance business.<sup>22</sup>
- » **Shanghai Pudong Development Bank** has a joint venture, AXA Spdb Investment Managers Co., with AXA group, focused on fund management.<sup>23</sup>
- » **China Minsheng Bank** has a joint company, Minsheng Royal Fund Management, with the Royal Bank of Canada.<sup>24</sup>
- » **CITIC Bank** has two joint ventures with Prudential, CITIC-Prudential Life Insurance Company Limited<sup>25</sup>, focused on insurance, and CITIC-Prudential Fund Management Company<sup>26</sup> on fund management.

### Are there private banks in China?

Officially there are 19 private banks, known as *min ying* banks (meaning ‘privately run’ in Chinese) in China<sup>27</sup> and they are of small scale and focused on local economies. These banks only have shareholders from the private sector.

Other than these, most other Chinese commercial banks are not private and are much closer to the government than their Western peers. Though they differ from Chinese policy banks that are created to finance Chinese policy priorities, different types of Chinese commercial banks, especially the major state-owned commercial banks, have long engaged in policy lending – providing financing according to national or local government’s priorities. The Chinese state has written off their non-performing loans on several occasions. Below is a brief history of China’s banking system, which will help better understand the relations between the banks and the state.

### A brief evolution of the banking system in China<sup>28</sup>

After communist China was established in the late 1940s, the PBOC remained the sole bank until 1978. A reform took place then to set up a two-tier banking sys-

tem where PBOC functioned as a central bank, and four state-owned banks were added: The Agricultural Bank of China (ABC), China Construction Bank (CCB), Industrial and Commercial Bank of China (ICBC), and Bank of China (BOC). In the then-planned economy, these specialised banks operated as the government’s financiers, providing funds to state-owned companies under government instruction. These banks enjoyed a monopoly, but since their lending was directed by government rather than by economic viability, bad loans started to accumulate.

In 1994, China set up three new policy banks and formally recognised the four state-owned banks as commercial banks. From then on, they were expected to be ‘profit-driven’ rather than ‘policy-driven’ – in other words, to operate more like private banks in the West. However, the ‘Big Four’ banks continued to engage in policy lending since they already had a national presence and large capital.

During this period, some joint stock commercial banks were set up, often controlled by one or a group of state-owned companies. Compared with the biggest national state-owned banks, these joint stock banks enjoyed relative independence from the government and were believed to be more profitable and had fewer non-performing loans. At the same time, some large cities in China, such as Beijing, Shanghai and Shenzhen, turned their urban credit co-ops into city commercial banks. They adopted shareholding ownership like those of the joint stock commercial banks. Their services were usually limited to the city area.

The emergence of these new banks intensified competition in the Chinese banking sector, but the four state-owned commercial banks continued to enjoy market dominance. This is not only because they run at a much larger scale with branches across the country but also due to the implicit state support they enjoyed. For example, the deposits in these banks are guaranteed by the state, and the central bank fixes the interest rate, so other banks cannot compete by offering more attractive rates.

On the other hand, the national state-owned banks still need to support government projects and companies that the government favours. At local levels, the governments had the power to appoint key personnel at these banks, therefore exerting strong influence over them. As a result, they accumulated a staggering level of non-performing loans, to the tune of RMB 2.5 trillion in 1999.

The Asia financial crisis and China’s imminent accession into the WTO forced Chinese regulators to seriously tackle the bad loan problem in the country’s banking system. China created four asset management companies to offload the loans from the four state-owned national commercial banks at the turn of the 21st century. In the decade that





Protest against coal power and coal mining in Kenya (12. Juni 2019). © Paul Basweti / Greenpeace

followed, the banks either got their bad loans transferred to the asset management companies or received a direct capital injection from the central government.

Since 2005, the big state-owned commercial banks are allowed to be listed. The government considered it a

great option to maintain a controlling stake in the banks while diversifying their funding sources. Foreign banks bought shares of the state-owned banks but did not influence corporate governance structure. Many international banks, such as Goldman Sachs and UBS, held stakes in major commercial banks in China for about a decade.<sup>29</sup>

## How are the Chinese commercial banks regulated?

### The regulators and their mandates

The **People's Bank of China (PBOC)** and the **China Banking and Insurance Regulatory Commission (CBIRC)** are the two main regulators of the commercial banking sector in China, but they have different focusses.

The PBOC concerns itself with the 'big picture' – such as developing regulatory framework by proposing laws, rules, and guidance, as well as maintaining financial stability by assessing and managing risks at macro level. The CBIRC partially cooperates with the PBOC in 'prudential supervision', i.e., the official monitoring to ensure the safety and soundness of the banking sector. However, the main mandate of the CBIRC is to ensure each bank is as sound and healthy as possible at micro level.<sup>30</sup>

In addition, the CBIRC functions as an operational regulator. It assesses and ensures the banks' compliance with relevant laws and rules. It ensures only qualified entities receive and hold the banking and other relevant licenses; issues specific guidelines, such as those related to environmental and social risk management; monitors the behaviours of individual banks; and assesses risks in the banking sector. The CBIRC also has enforcement powers, such as issuing fines and referring the non-compliant bank to the judicial system for further investigation and even to face prosecution. The PBOC can recommend that

the CBIRC inspect certain banks and work with PBOC and the Ministry of Finance to deal with any crisis that may occur in a specific bank.

When it comes to administrative hierarchy in the Chinese bureaucracy, the PBOC ranks higher than the CBIRC since the PBOC is one of the 26 cabinet departments of China, while CBIRC is an institution directly under the State Council but not part of it.<sup>31</sup> However, in practice, PBOC is not CBIRC's superior as they play different roles in the Chinese administration.

There are two other sets of regulatory bodies.

- » One is the **Financial Stability and Development Committee (FSDC)** under the State Council. The Committee can be understood as a coordination mechanism amongst the government departments, including the State Administration of Foreign Exchange, Ministry of Finance and Reform, and Development Commission.<sup>32</sup>
- » The second is a network of **Local Financial Supervision Administrations** (Financial Work Offices) that were set up in 2017. These are embedded in local governments – usually at the provincial levels – which are expected to ensure financial stability at the local level according to draft Local Financial Supervision and Administration Regulations.<sup>33</sup>

### Recent history of Chinese banking supervision

Historically, the PBOC, China's central bank, was the only financial regulator. As the Chinese financial sector developed, it became increasingly apparent that part of the PBOC's supervision responsibilities needed to be assigned to a separate entity. In the 1990s, China set up regulatory commissions for the securities and insurance sectors, taking over sector-specific supervisory responsibility from the PBOC. In 2003, the China Banking Regulatory Commission was set up. It took up part of the PBOC's responsibility to supervise banking financial institutions such as banks, financial asset management companies and trusts.<sup>34</sup> Since then, the PBOC's main task has been to ensure financial stability. During the 2018 governmental structural reform, the Banking Regulatory Commission was merged with the Insurance Regulatory Commission to form the China Banking and Insurance Regulatory Commission (CBIRC). Part of the regulatory mandate was transferred to the PBOC, including drafting laws and rules governing the banking sector and prudential supervision.

### Financial regulatory focus

Financial security and stability remain high on the Chinese financial regulators' agenda. China's President Xi emphasised that 'financial security is an important part of national security' and called for 'strengthening supervision' mainly to ensure stability in the financial system during the fifth National Financial Work Conference ('the Conference') in

2021.<sup>35</sup> Since its inception in 1997, the Conference is the highest level of policy gathering that sets the direction for major financial reforms and subsequent policies.

A series of financial regulatory reforms unfolded in recent years, including setting up a new regulatory coordination mechanism, merging regulatory bodies and consolidating local supervisory powers. This reform arguably is still ongoing as several major banking laws are being revised. For example, a new Financial Stability Law is being formulated<sup>36</sup>, and laws on commercial banks and the central bank are also being revised.<sup>37</sup>

Furthermore, China is moving away from the sector-specific regulatory approach. Before, specific regulatory bodies would oversee the entire operation of entities in a specific sector. For example, the former Banking Regulatory Commission was mainly or solely responsible to oversee the banks. Since banks now offer a wide range of services beyond banking, and other non-banking entities, such as tech companies, may also provide banking-equivalent services, regulators also need to adapt. For example, now a bank will not only be supervised by the banking regulator but also by the insurance or securities regulators for its respective products.<sup>38</sup>

The Chinese financial regulators have also been proactive in tightening controls of tech companies that provide financial services. For example, the tech giant Ant Group, who offers a range of financial services, from payments to microloans, had to abort its IPO plans in 2020 and is reportedly working with the authorities to ensure all its financial operations were placed under regulatory supervision in August 2022.<sup>39</sup>

## Environmental and social requirements for Chinese commercial banks

### Commercial banks to align with China's carbon neutrality goals

1. Dual Carbon Goals: China's president Xi has made global commitments at the UN General Assembly in 2020, setting China on a path to achieve a carbon emissions **peak by 2030 and carbon neutrality by 2060**.<sup>40</sup>
2. At the UN General Assembly in 2021, the president announced China's decision not to build new coal-fired power projects abroad.<sup>41</sup>
3. To implement the Chinese leadership's climate ambition, China is developing a decarbonisation policy framework, known as the **'1+N policy framework for carbon peaking and carbon neutrality'** – which consists of an overarching policy, supported by various **sector-specific roadmaps**.<sup>42</sup>

In October 2021, the overarching policy, **The Working Guidance for Carbon Dioxide Peaking and Carbon Neu-**

**trality in Full and Faithful Implementation of the New Development Philosophy**, was issued.<sup>43</sup> According to it, China aims to gradually increase the share of non-fossil energy consumption to around 20 percent by 2025, around 25 percent by 2030, and over 80 percent by 2060. China will do so by 'firmly curbing irrational expansion of energy-intensive and high-emission projects' (article 7) and 'strictly controlling fossil fuel consumption' (article 11). As for coal, this overarching policy states that the country will 'strictly limit' coal consumption running up to 2025 and aim to 'phase down' coal consumption from 2025 to 2030.

The overarching policy also set clear expectations for the financial sector to align its investment with China's peak carbon peaking and carbon neutrality goals, known as 'dual carbon goals', and to 'strictly control investment in high-carbon projects in areas such as coal-fired power, steel, electrolytic aluminium, cement, and petroleum chemicals production' (article 30).

## Commercial banks to follow green finance policies

Green finance is a key policy area in China, with a big focus on guiding private financial flows, like those from the commercial banks, into supporting green, non-polluting, and low-carbon businesses. Green finance policies are now closely linked to achieving China's climate goals.

### What businesses are considered green by the commercial banks in China?

The golden rule is set by **The Catalogue of Green Bond Supported Projects (the Catalogue)**.<sup>44</sup> The Catalogue was initially produced in 2015 to guide the development and trading of green bonds, one of the first green finance products in China, but it now serves effectively as China's green finance taxonomy.<sup>45</sup>

The Catalogue was recently revised in 2021. One significant highlight was that the 2021 version has **removed 'clean coal' projects** from the supported list. Before the revision, projects aimed at making the mining and utilisation of coal efficient and less polluting or better managing the waste from coal mining and processing would be eligible to get green bonds.<sup>46</sup> Another notable development is that the Catalogue also included a **'no significant harm' principle** for projects embedded in ecosystems such as forests, oceans and rivers (for hydro projects).<sup>47</sup> This development possibly was influenced by China's recent efforts to synchronise with the **EU's sustainable finance taxonomy**, which includes the 'no significant harm' as a key principle.<sup>48</sup>

### What sectors and assets are not green?

China's overarching decarbonisation policy framework asks the banks to strictly limit lending to the so-called 'dual high' industries – industries that are highly polluting or cause high carbon emissions. These are currently limited to six sectors including coal power, petrochemical, chemical engineering, the production of steel and building materials, and non-ferrous metal smelting.<sup>49</sup> Aside from this, no clear policy signals or official statements exist to systematically define what sectors and assets are not green. However, a few high-profile green finance advocates have in recent years been consistently talking about the need to extend the understanding and management of assets that are not green. Ma Jun, a former chief economist at the Central Bank of China, said in a public presentation in May 2021 that the financial institutions must calculate and disclose their exposure to brown assets, which he defined as 'carbon-intensive assets'. Because if they 'don't know what's the exposure, (they) won't know what's the risk; therefore, won't be preventing and managing these risks', argued Ma Jun who called for the regulators and banks to 'define the scope of the brown assets clearly'.<sup>50</sup>

## Commercial banks to integrate ESG risk management in credit granting

Chinese financial regulators are increasingly looking into limiting the financing of not-so-green businesses by introducing requirements around Environmental, Social and Corporate Governance (ESG) risk. So far, these requirements are crafted by the banking regulator CBIRC as 'soft law', appearing in guidelines and guiding opinions, rather than in laws and regulations which would have clearer provisions on penalties.

The most recent development came on **June 1, 2022**, when the CBIRC issued the **Green Finance Guidelines** which lay out in further details how financial institutions and insurance companies across China should integrate environmental and social risk management in their board, management, and client engagement processes.<sup>51</sup>

There are at least three positive highlights:

**First**, they set clear expectations for banks and insurance companies to better understand their credit customers' environmental and social credentials. Companies are asked to conduct due diligence in this regard and use their financing as leverage to encourage better performance. The guidelines say banks should 'strictly restrict' granting credit to clients that face significant environmental and social risks. For the first time, there is an explicit statement that banks and insurance companies should reduce the carbon emissions of not only their own operations but also their portfolios.

**Second**, the guidelines are not limited to operations in China. Article 25 says, 'banks and insurance companies should actively support the green low-carbon construction of the Belt and Road Initiative'. That means they must strengthen environmental and social risk management concerning their overseas projects, especially those under the BRI. They are expected to request their clients and their main contractors and suppliers to comply with local laws and follow relevant international practices or guidelines to ensure the project is 'substantially consistent' with good international practices.

**Third**, they ask banks to set up a grievance or response mechanism for credit-granting decisions that face significant environmental and social risks. This expectation potentially means that third parties, such as NGOs or impacted communities, can raise concerns with the banks about their investment decisions.

Many questions remain about the implementation of the new guidelines. A key question is what are the consequences for the banks if they continue to support harmful businesses? Much of the strong language on environmental and social risk due diligence in the new guidelines is taken from the 2012 Green Credit Guidelines<sup>52</sup>, which have not stopped Chinese financiers from backing companies with questionable environmental track records.

Encouragingly though, the CBIRC, the banking regulator which is tasked to enforce and ensure rectification if banks violate related regulations, had issued **finest to Chinese commercial banks** for financing companies that either have been causing pollution or failed environmental inspections – though these fines were all related to banks' financing for projects within China<sup>53</sup>. Given the new guidelines have explicitly expanded the ESG risk management requirements to overseas, it could be expected that the CBIRC potentially became proactive in sanctioning non-compliance outside China.

### Commercial banks' overseas investments to comply with local laws and strive for higher standards

Since 2012, the Chinese government has issued a range of policies, mostly in the format of Guiding Opinions to ensure that Chinese banks and companies are taking environmental and social risks into account when investing overseas. A report published by WWF China in 2019 listed 10 such policies and pledges announced from 2012 to 2019.<sup>54</sup> While most such policies emphasises compliance with local laws and regulations, a notable feature is that they all required Chinese investors to integrate environmental and social considerations – beyond legal compliance – into their investment decisions. Some of the policies also required the Chinese banks to urge their clients to have systems in place to engage with stakeholders impacted by their operations.

It is also worth noting that, in addition to the PBOC and the CBIRC, three other regulators are involved in Chinese banks' overseas investments: the Ministry of Ecology and Environment, the Ministry of Commerce, and the National Development and Reform Commission.

### Commercial banks to disclose environmental information

In July 2021, the PBOC published Guidelines for Financial Institutions' Environmental Information Disclosure<sup>55</sup>, which set the format, frequency and content of relevant disclosure by commercial banks and other financial institutions. For example, the guidelines suggested disclosing how short-, medium- and long-term environmental risk impacts the banks' business and strategy and articulating how they intend to respond to these impacts. The disclosure also recommends that the banks carry out stress testing and scenario analysis.<sup>56</sup>

### Major Chinese commercial banks' overseas environment and social risk management

Along with major development banks, ICBC, Bank of China, and China Construction Bank responded to a survey by WWF China on how they gather and use information related to environmental and social risks when they invest overseas, according to a report published in 2019.<sup>57</sup>

These three commercial banks said that their ESG policies include both environmental and social aspects, and they all have dedicated senior management roles to oversee ESG issues. The banks reported setting up their own country risk guides, industry-specific risk guides and databases on clients' environmental performance, which they use to guide their investment decisions. In their overseas credit granting processes, the three banks said they factor in environmental and social risks before, during and after granting credits. Most importantly, the banks said that they'd veto an investment on the basis of its environmental and social risks.

The banks also said that their risk assessment mostly rely on information provided by the clients, the banks' own due diligence and due diligence provided by a third party for risk assessment, in addition to information provided by the Chinese government such as CBRIC, PBOC and the Ministry of Ecology and Environment. When it comes to disclosure, ICBC and China Construction Bank said they had internal environmental and social risk disclosure systems in place.

Since many major commercial banks are also listed companies, China Securities Regulatory Commission's recently revised disclosure format for listed companies<sup>58</sup> will also apply to them. The revised format set mandatory requirements for 'key polluters' and their subsidiaries to disclose environmental information, including pollution discharge and status of pollution control facilities. All listed companies must also disclose any administrative penalties relating to environmental issues.<sup>59</sup>

National rules on disclosure set expectations for Chinese commercial banks to increase transparency, but civil society does not yet have access to the type of information to better understand the banks' environmental and social impacts. A report on Environmental Information Disclosure of Financial Institutions led by ICBC<sup>60</sup> found that the willingness to disclose varies across the banking sector, given the cost of setting up a disclosure mechanism. There is also a lack of guidance from the regulator on how to disclose exposure to carbon assets. The report highlighted the need to increase internal capacity for the banks to better understand and calculate their carbon footprint.



### Commercial banks' current practice: a case study on ICBC

Chinese banks are still at an early stage of understanding and incorporating ESG considerations into their operations and their investment decision-making. A recent report, published by the Institute of Finance and Sustainability in Beijing, provides an overview of major Chinese banks' current ESG-related practices.<sup>61</sup> For example, Chinese banks currently manage environmental risks by lending more to low-carbon business and by lowering their operational emissions. The report does not mention an example in which a bank sets a clear policy and proactively reduces investments with high environmental impacts or with high carbon emissions.

Below we take a closer look at the ICBC, one of the largest banks in China and in the world by assets. In China, the ICBC has been generally recognised as a champion in implementing green finance policies.<sup>62</sup> Internationally, however, the bank has drawn criticism, for example for its role in financing coal<sup>63</sup> and other projects and companies with high environmental and social risks.<sup>64</sup>

Following China's announcement of its 'dual carbon goals' mentioned previously, ICBC's public reporting shows that the bank has been actively incorporating China's new climate ambitions into its operations. For example, ICBC's board approved 'Comprehensive Risk Management Rules (2021 Edition)' which allegedly includes 'climate risk management' into its risk management systems. In 2021, the ICBC set up a leadership working group at its headquarters that developed strategies and workplans around implementing China's carbon goals. Its reporting also said that ICBC has made China's dual carbon goals a mandatory factor for consideration when selecting clients as it aims to restrict the financing of carbon-intensive industries.<sup>65</sup>

When it comes to coal financing, the banks' chief economist said that the bank was 'setting up a roadmap and timetable to gradually exit from coal financing' in a public event in China in May 2021. He also said that the bank already had put in place specific policies on coal and coal-power generation which required the bank to strictly limit business and financing related to coal and coal-power generation.<sup>66</sup>

Since the full texts of ICBC's policies on coal and coal power generation do not seem to be publicly available at the time of writing this report, we relied on ICBC's Green Finance report in 2021 for more details. The bank claims it will 'support the clean transition of traditional energy sector'. This could mean that the banks will keep supporting coal power generation so long as it is deemed to be cleaner, for example producing less pollutants. The bank also said it will 'orderly reduce the percentage that the financing for coal power generation and coal mining accounts in its total portfolio'.<sup>67</sup> The commitment to reduce relative, rather than absolute total of financing for coal, could mean that ICBC's total financing for coal power generation and coal mining could still increase when its total investment and financing portfolio grow.

Whilst we do not fully understand how ICBC assesses and determines a potential clients' ESG credentials, we learnt from its reporting that the bank seems to follow two screening systems for clients based in and outside China respectively. For domestic clients, ICBC has a 'Green Classification Measure' which reportedly lays out a four-tier system to assess how environmentally and socially friendly this client is. For overseas clients, the bank is said to be still developing a classification system which reflects requirements set by local laws and regulations.<sup>68</sup>

## Engaging with Chinese commercial banks

The Chinese commercial banks are widely perceived as an enigma as they are usually not responsive to civil society’s communications and requests for meetings. However, there are some small signs of positive change as of late.

In 2020, following engagement with local and international CSOs, the ICBC decided not to finance what would have been Kenya’s first coal plant near Lamu old town, a UNESCO world heritage site.<sup>69</sup> In 2019, following international outcry, the Bank of China announced that it would re-evaluate its funding commitment to a controversial hydropower project in Indonesia which risks driving endangered species, including a rare orangutan species, to extinction.<sup>70</sup> The banks are likely responding to concerted civil society efforts, though it is difficult to know the details and actual impact of the advocacy on the above developments.

Most NGOs – especially those based outside China – that have tried to engage with the Chinese commercial banks would know how difficult this still is to engage with the banks. The major Chinese commercial banks, including the ones like ICBC and the Bank of China with an international presence, are extremely cautious in dealing with NGOs. Our understanding is that they tend to refrain from directly engaging or responding to NGOs that are not registered to operate in China. It will therefore be helpful for organisations outside of China to find a local partner to help them to engage with the banks or simply relay messages. For Groups based outside of can also try to engage with the banking regulators, as well as the China Banking Association, a membership-based organisation that represents the banking sector.

Regardless of how civil society groups choose to engage with Chinese commercial banks, their information, perspectives and concerns are valuable input to align the Chinese banking sector with China’s environmental and climate ambitions. In particular, civil society groups can consider approaching the banks and their regulators with the following topics:

» Advocacy focused on **ensuring implementation of existing laws and policies**

Groups based in countries where Chinese commercial banks provide project loans, for example, may have specific information to raise concerns that the project may violate local laws, or that the project poses clear environmental risk. The groups should consider carrying out targeted advocacy to banks and regulators to strengthen the implementation of relevant policies.

» Advocacy focused on **shaping up future policies**

Civil society groups may also consider opportunities in the current development of green finance policies in China. For example, there is currently still room for Chinese financial regulators to specify what businesses are not green, especially in the overseas context. Increasing accountability may be another fruitful avenue – for example pushing the CBIRC to consider issuing penalties against banks that continue to finance environmentally damaging companies abroad, just as the regulator already does in China. In addition, given China’s clear intention to limit coal financing, relevant advocacy that shows misalignment between financing and China’s climate goals could also be timely.

» Advocacy focused on **strengthening stakeholder engagement**

The Green Finance Guidelines now explicitly ask banks to set up a grievance or response mechanism for credit-granting decisions that pose significant environmental and social risks. This provides an opportunity for civil society groups in and outside China to inform the CBRIC if their engagement with the banks is not successful and for the groups with relevant experience to help design and develop an effective grievance mechanism.

Urgewald plans to release a follow-up paper on “**How to engage with Chinese finances**” which is based on **urgewalds Follow-the-money approach RIMA outputs** ([↗ RIMA liv.doc](#)) and partner CSOs resources (like IDIs **Follow-the-money webpage**: [↗ FTM](#)).



**Selection of regulations and guidelines on Chinese overseas investments** (Source: Nora Sausmikak. “Auf dem Weg zur Regulierung von Lieferkettenverantwortung: Richtlinien in der Volksrepublik China”, urgewald/ PowerShift 2021)

| Name  | Institution  | Year                | Mandatory | Description  |
|---|--|---------------------|-----------|--|
| 1. <a href="#">↘ Guidelines for Environmental and Social Impact Assessments of the China Export and Import Bank’s Loan Projects</a> | EXIM   | 2007                | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> China Exim Bank in/outside China</li> <li>» <b>Content:</b> Standards for environmental impact assessments, consideration of land and resource rights, handling of resettlements</li> </ul>  |
| 2. <a href="#">↘ Green Credit Guidelines/“Green Finance Guidelines for the Banking and Insurance Industry”</a>                      | CBRC/CBIRC   | 2012/1.7.2022       | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Banks</li> <li>» <b>Content:</b> Establishment of risk management mechanisms; compliance with due diligence requirements regarding environmental and social risks in projects abroad; compliance with local laws abroad</li> </ul>   |
| 3. <a href="#">↘ Guidelines for Environmental Protection in Foreign Investments and Cooperation</a>                                 | MEE, MofCom  | 2013                | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Companies operating abroad</li> <li>» <b>Content:</b> Orientation to consider local customs and belief systems, compliance with local laws, Environmental impact assessments, introduction of monitoring for environmental pollution.</li> </ul>                                 |
| 4. <a href="#">↘ China Green Bond Endorsed Project Catalogue / Catalogue of Green Bond Supported Projects</a>                       | PBoC   | 2015/2021           | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Financial market players</li> <li>» <b>Content:</b> Catalog for projects that can be financed with green bonds. 2021 version has removed ‘clean coal’ projects from the supported list.</li> </ul>   |
| 5. <a href="#">↘ Guidelines for Social Responsibility in Outbound Mining Investments</a>  | CCCCMC   | 2014<br>2017 review | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Mining companies operating abroad</li> <li>» <b>Content:</b> Guidance on the consideration of human rights and sustainability principles in the mining sector in the areas of governance, supply chains, environment, participation, occupational health, and safety.</li> </ul> |
| 6. <a href="#">↘ Due Diligence Guidelines for Responsible Mineral Supply Chains</a>   | CCCCMC   | 2015<br>2021        | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Companies along the supply chains of mineral raw materials inside and outside China</li> <li>» <b>Content:</b> Standards for due diligence, Standards for HR risks, Protection of indigenous people.</li> </ul>  |
| 7. <a href="#">↘ Guiding Opinions on Building a Green Financial System</a>  | PBoC, MEE, Ministry of Finance, NDRC, CSRC                   | 2016                | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Financial market players</li> <li>» <b>Content:</b> Guidance on the design of “green” loans, insurance policies, bonds and other financial products</li> </ul>   |
| 8. <a href="#">↘ Guidance on Promoting Green Belt and Road</a>  | MEE  | 2017                | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> not defined</li> <li>» <b>Content:</b> Objectives and principles for making BRI more sustainable in the environmental field.</li> </ul>  |
| 9. <a href="#">↘ Measures for the Administration of the Overseas Investments of Enterprises</a>                                     | NDRC   | 2018                | Yes       | <ul style="list-style-type: none"> <li>» <b>Type:</b> Legislative action</li> <li>» <b>Scope:</b> Companies investing abroad</li> <li>» <b>Content:</b> Notification and approval procedures for foreign investments; requirements for risk assessments.</li> </ul>  |
| 10. <a href="#">↘ Green Industry Guideline Catalogue</a>  | NDRC, MEE, MNR, MIIT, MoHURD, National Energy Administration | 2019                | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Involved authorities and downstream institutions</li> <li>» <b>Content:</b> Definition and description of green industries for investment promotion “What is green/ taxonomy”.</li> </ul>  |

|     | Name   | Institution   | Year    | Mandatory | Description   |
|-----|--|---|---------|-----------|---|
| 11. | <a href="#">↗</a> Guidance on Promoting Investment and Financing to Address Climate Change                           | MEE, NDRC, PBoC, CBIRC, CSRC                                    | 2020    | No        | <ul style="list-style-type: none"> <li>» <b>Type:</b> Guidelines</li> <li>» <b>Scope:</b> Financial market players</li> <li>» <b>Content:</b> Promotion of climate finance in China and along the BRI; approaches to remove the recipient country principle and compliance with Chinese environmental and social standards abroad.</li> </ul> |
| 12. | <a href="#">↗</a> Procedures of Complaint and Consultation Mechanism for the Mining Industry and Mineral Value Chain | supported by CCCMC/ coordinate by Responsible Cobalt Initiative | 2022-23 |           | <ul style="list-style-type: none"> <li>» Open for consultation</li> <li>» <b>Type:</b> Procedures on Complaint mechanisms</li> </ul>  |

## List of abbreviations

|        |   |
|--------|---|
| ABC    | Agricultural bank of China                                  |
| BoC    | Bank of China   |
| BOCOM  | Bank of Communications                                      |
| CBIRC  | China Banking and Insurance Regulatory Commission           |
| CBRC   | China Banking Regulatory Commission                         |
| CCCMC  | China Chamber of Commerce of Metals, Minerals and Chemicals |
| CCB    | China Construction Bank                                     |
| CSRC   | China Securities Regulatory Commission                      |
| ESG    | Environmental, Social & Corporate Governance                |
| EXIM   | Export-Import Bank of China                                 |
| FHC    | Financial holding Company                                   |
| FSDC   | Financial Stability and Development Committee               |
| ICBC   | Industrial & Commercial Bank of China                       |
| MEE    | Ministry of Ecology & Environment                           |
| MIIT   | Ministry of Industry & Information Technology               |
| MoHURD | Ministry of Housing and Urban-Rural Development             |
| MofCom | Ministry of Commerce  |
| MNR    | Ministry of Natural Resources                               |
| NDRC   | National Development and Reform Commission                  |
| PBoC   | Peoples Bank of China                                       |
| SPDB   | Shanghai Pudong Development Bank                            |
| SoE    | State owned Enterprises                                     |



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