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MAINLAND CHINA'S SUSTAINABLE BOND MARKET GAINS GROUND

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Mainland China's sustainable bond market has gone from strength to strength recently, with issuers and investors finding new opportunities – and embracing international standards.

The development of the global green, social, sustainability and sustainability linked bond (collectively known as sustainable bonds) market has been nothing short of phenomenal. Global sustainable bond volumes have risen at a compound annual growth rate of 64% between 2015 and 2020, to end last year at $573bn in deal flow, according to HSBC.

The numbers are only growing rapidly, with volumes hitting $552bn by the end of June 2021 – easily on track to surpass last year's issuance.

Asia Pacific borrowers have been a big part of the growth story. Sustainable bond volumes last year in the region jumped an impressive 200% year-on-year. While sustainable bond deals from mainland China – both in the domestic and international markets – fell about 12% last year to $31.3bn-equivalent, the way forward is bright, given volumes by end of June 2021 already stood at $29.3bn.

It's not just a numbers story – particularly when it comes to mainland China.

Chinese issuers brought a burst of innovation to the sustainable bond market last year by introducing a number of new labels and themes – such as blue bonds, transition bonds and sustainability-linked bonds – moving the market beyond just green issuance, said panellists at the China Debt Capital Markets Online Summit 2021, organised by Euromoney Conferences.

In a green bonds focused panel hosted by HSBC, the speakers all agreed that mainland China's sustainable bond market has matured in the past 18 months – in terms of the sophistication and variety of issuers tapping the market and the products up for grabs.

"Sustainable bonds now account for 11% of global bond issuance," said Luying Gan, head of sustainable bonds in HSBC's Asia Pacific debt capital markets team. "With one out of 10 bonds now in a sustainable bond format, this is a market quickly evolving from niche to mainstream."

But more work still needs to be done – particularly around aligning mainland China's local definitions of green and sustainable with global standards.

Offshore vs onshore

Of the $17.7bn raised from green bonds alone in the first quarter of 2021 from mainland China, almost half of the volume met only local definitions, according to Climate Bonds Initiative, for example due to flexibility around allowing up to half of the bond proceeds to be used for general corporate purpose instead of specific green assets.

Ricco Zhang, senior director for Asia Pacific at the International Capital Market Association, said in the panel that there are two recommendations for issuers.

One is to put together a universal framework for all the onshore green bond standards to harmonize the domestic market, or at least to make the market more transparent to ensure that international investors know what they are buying. The second is to continue with efforts to converge with the international market practice.

This alignment with international standards is critical – if mainland China wants to see more foreign investor involvement and grow in depth and breadth.

"Whether it is the broad capital market practice or just green bonds, they all started in the international markets," said Zhang. "The green bond as a financial product was developed because of such consensus reached in the international market already, so too much focus on special Chinese characteristic will probably be harmful for the internationalization of Chinese bond market."

But Timothy Yip, head of debt capital markets for HSBC Bank (China), reckons that international and domestic investors, and international and mainland China's domestic markets, can find a middle ground when it comes to ESG-related bonds.

"A lot of investors and issuers ask: do onshore and offshore markets share the same standards? Why are there differences? What are the differences, and which one is 'correct'?" he said in the panel.

Yip added that in most cases, there is "no set of predetermined outcomes" and the changes simply reflect a difference in the Chinese economy, regulatory landscape, issuer and investor behaviour versus their global counterparts.

"With robust support from the relevant regulators, the green finance concept is gradually gaining traction in mainland China, so expect plenty of opportunities going forward," said Yip. "On alignment on standards, it is fantastic that the Chinese markets continue to find common values with offshore. It is important to keep an open mind and there is certainly no need to force one party to accept another's opinion, in the context that each economy would have its own nuances."

Rising demand and supply

A report from Fitch Ratings, published in May 2021, showed that assets under management among green bond funds hit €22bn globally at the end of the first quarter – up 80% year-on-year. The number of Asia Pacific signatories to the United Nations Principles of Responsible Investment jumped 24% year-on-year in 2020 to 475.

Andrew Wang, general manager of UBS SDIC Fund Management, said that ESG investments have transitioned from being regulation driven to being demand driven.

That comes as little surprise. Wang reckons that ESG-integrated investment can bring better returns to a portfolio, while lowering overall risk.

"It's a must for both making better returns for clients and meeting clients' requirements," added Wang. "At the same time, the investment will bring a positive effect on the development of the whole world. Usually, investors like us will avoid over-heated sectors. But sustainable financing is different – it's a good opportunity, and a direction that both investors and issuers should go in."

The momentum in mainland China is certainly strong, spurred by the kick-off of novel products in the sustainable bond space.

For instance, Bank of China sold Asia's first blue bond last year, while in January 2021, it printed the world's first transition bond to follow ICMA's climate transition finance handbook. China Construction Bank, meanwhile, sold the first sustainability-linked bond from a global systemically important bank and the first dollar SLB from a commercial bank globally.

The Chinese government has made very clear that it is on a journey towards net zero carbon emission. President Xi Jinping pledged in 2020 to hit peak carbon dioxide emissions before 2030 and achieve carbon neutrality before 2060. To propel progress on that front, the People's Bank of China also removed 'clean coal' from its list of projects eligible for green bonds last year – something that had, until then, been at odds with global standards and was often a point of contention for some international investors.

Hence the push from Chinese borrowers to sell transition bonds.

The supply is only set to rise further, driven by governmental support. In mid-July, the National Development and Reform Commission, a regulator in mainland China, said it will encourage more qualified domestic enterprises to sell green bonds overseas, in a bid to meet the country's objectives of moving towards a low-carbon economy.

Among Chinese corporations, especially property developers, innovation has been coming. It began with the first set of green bonds from real estate companies last year, to be eventually followed by sustainability deals in 2021.

One of the issuers is Cifi Holdings (Group) Co, which debuted in the green bond market in July 2020, and followed up with another green deal this May. But the company's head of capital markets and investor relations, Lawrence Leung, thinks this is only the beginning.

"In the past, when we talked about green bonds, people were focusing on areas like the percentage of green buildings or energy saving," said Leung in the panel. "But in the future, more focus will be put on the 'S' and 'G' parts, which include the impact we have on the society, how we treat our stakeholders, clients, employees and suppliers."

Needless to say, the financial sector will have a big role to play in supporting the transition of markets and corporations. HSBC is at the forefront of that development.

In an open letter to customers in October 2020, HSBC's group chief executive Noel Quinn cemented the bank's commitment to environmental sustainability by laying a roadmap for its climate ambition. HSBC plans to reduce carbon emissions from its overall portfolio to net zero by 2050, if not sooner. It will also work with customers to find them solutions that will help them transition towards lower emissions, wrote Quinn.

HSBC has also set up a dedicated environmental, social and governance (ESG) solutions unit to drive its engagement with clients, while investing $100m in clean technology, and additionally launching a $100m philanthropic programme to help scale climate innovation.

Quinn took it a step further by telling leaders of the Group of Seven countries recently that the financial sector has a great role to play to support the transition to net zero.

HSBC's Gan adds: "We are already seeing fantastic development in the sustainable finance market right here, right now, so please join us to take this important agenda forward."