Top 10 Trends in Sustainable Investment in China 2020

1. Climate Change Becoming an Important Issue for the Financial Industry

Climate change attracted increasing attention from the international community and the global finance industry in 2019. As pointed out by the United Nations Environment Programme (UNEP), the global temperature is likely to rise by 3.2-degree Centigrade even in an optimistic scenario, which would bring more widespread and destructive climate impacts. The transitional risks and physical risks brought by climate change will influence the financial industry in multiple ways. The financial industry may face decreasing value of collaterals and properties, uncertainties in transition to a low-carbon economy, etc. In April 2019, the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) published a report to advocate central banks worldwide to incorporate climate-related risks into the financial stability monitoring and prudential supervision. China has started taking active measures to address climate change: the pilot working group of China-UK climate and environmental information disclosure has further expanded and has completed the first stage goal of starting environmental and climate information disclosure. In January 2020, Ping An Insurance (Group) Company of China, Ltd. became the first Chinese asset owner to sign up to the Climate Action 100+.

We expect that regulators and financial institutions in China will accelerate their actions on climate change. The central bank may incorporate climate and environmental risks for the financial industry into the macro policy framework, and issue guidance for financial institutions to strengthen the analysis and disclosure of climate-related risks. We recommend banks, insurance companies, and asset management institutions pay more attention to climate risks, conduct related scenario analysis and stress testing, and keep improving the capability of climate-related risk management.

2. ESG Information Disclosure Becoming More Material

ESG information disclosure is an important part of listed companies' information disclosure. Standardized, comprehensive, and material ESG information disclosure could make the market better assess a company's risk management ability for sustainable development. Promoted by regulators, the number of Chinese listed companies with ESG information disclosure has increased significantly in recent years. In 2019, 945 listed A-share companies, accounting for 26 percentage of all A-share companies, issued Corporate Social Responsibility (CSR) reports. And the rate of ESG reporting among the CSI 300 companies exceeded 80 percent.

Driven by regulation and the market, we expect that the materiality of listed A-share companies' ESG information will be gradually enhanced, and the rate of quantitative information disclosure will increase in 2020. Regulators have repeatedly indicated that the ESG information disclosure standards, especially for environmental information, will be raised in 2020. In the new version of the ESG Reporting Guide issued by the Hong Kong Stock Exchange, many amendments are related to the quantitative disclosure such as mandatory disclosure of emissions, energy use, water efficiency, waste reduction and so on. An increasing number of investment institutions hope invested enterprises enhance ESG information disclosure, which may in turn effectively drive increasing materiality of ESG information disclosed. We suggest listed companies actively collect and disclose quantitative ESG information to align with the regulatory requirement and investors' expectations. We also recommend investment institutions promote companies' ESG disclosure through active ownership, engagement, etc.

3. ESG Investment Products Being More Diversified with Improving Recognition among Investors

Driven by both policies and the market, various investment institutions launched ESG investment products in 2019. According to statistics from 2019 China Sustainable Investment Review by China SIF, as of November 2019, 42 fund management companies have launched 95 pan-ESG mutual fund products, 15 of which were launched in 2019. ESG products from, for example, E Fund, China

Southern Asset Management, and Hwabao Fund have received positive feedback from the market. Meanwhile, some bank investing departments also issued ESG wealth management products, among which the ESG product from Huaxia Bank raised more than RMB 10 billion through 5 phases. Both Bank of China and China Industrial Bank have launched or planned to launch ESG products at the end of 2019.

We expect that more diverse ESG investment products will rapidly develop in 2020. Firstly, we expect there to be more types of institutions launching such products. Apart from the mutual fund companies and wealth management arm of banks, insurance asset management companies and private funds will follow the trend. Also, the type of products will become more diversified. Apart from active funds and ETF funds, there will be an increase of ESG quantitative funds and bond funds. With more investment products appear in 2020, recognition of ESG products will be significantly improved among investors in the market. We suggest asset management institutions build capabilities in ESG investment research and product development as soon as possible to seize the opportunity in a rapid developing market.

4. ESG Factors Incorporated into Fixed Income Investments

In the past, the application of ESG in the fixed income area was mainly in thematic products such as the green bond. With increasing ESG risk exposure, bond issuers' creditworthiness is becoming more directly affected by ESG factors, driving investment institutions to consider ESG in the fixed income investment. According to the research by SynTao Green Finance and other institutions, ESG ratings of Chinese companies are correlated to their bond default rates. In December 2019, E Fund and APG jointly launched an ESG-heavy “China Fixed Income Strategy”; in January 2020, MSCI launched 15 ESG fixed income indices.

As the ESG concept is widely accepted by the market with deeper understanding of ESG factors in practices, we expect that there will be more leading institutions integrating ESG consideration into the analysis of fixed income investment in 2020. In 2019, some international credit rating agencies, for example, the Moody's, initiated multiple investments and mergers and acquisitions in the ESG field. The investments indicate that mainstream fixed income marker player is actively following the trend of ESG integration. We recommend investment institutions enhance ESG fixed income investment research capacity, develop related ESG database, and pay closer attention to ESG-related bond, including green bond, social bond, sustainability bond, etc.

5. Further Development of ESG Investment in the Primary Market

In 2019, local PE/VC institutions started to pay attention to the ESG investment and gradually integrated ESG into their investment processes. Nearly 10 PE fund managers, including CGP Investment and Legend Capital, signed the United Nations-supported Principles for Responsible Investment (PRI). Starquest Capital proposed an ESG investment strategy for Fund of Funds (FOF), which won the PRI Awards 2019. As the Asset Management Association of China pointed out, the responsible investment among Chinese PE funds has progressed from spontaneous to conscious development.

Chinese private equity has gradually entered the stage of high-quality development. PE/VC institutions are attaching more importance to long-term value investment, which is consistent with the value of ESG investment. We expect that the ESG investment will rapidly develop in the Chinese PE/VC market. On the one hand, in the context of the two-way opening-up of the capital market, PE/VC institutions could attract more overseas capital through ESG investment. On the other hand, with increasing requirement of listed companies' environmental and social information disclosure, incorporating ESG into investment decision making could help mitigate risks and screen high-quality projects with diversified exit channels. We recommend leading PE/VC institutions establish a comprehensive ESG management system as soon as possible, and consider ESG factors in every stage of PE investment, promoting the high-quality development of the fund as well as the industry.

6. Appearing of SDGs-themed Financial Products

Sustainable Development Goals (SDGs) have become the focus of global development since issued in 2015. In September 2019, China officially released

"China's Progress Report on Implementation of the 2030 Agenda for Sustainable Development (2019)" on the 74^{th} session of the UN General Assembly, which systematically delivered China's progress of implementing the 2030 Agenda. The United Nations Development Programme (UNDP) has launched projects to promote SDGs financing and impact assessments globally including in China. In the past five years, great achievements have been made to meet SDGs, but challenges remain including insufficient financing. To tackle the challenge, financial institutions shall play a vital role.

We expect that more Chinese financial institutions will pay close attention to SDGs in 2020. Financial products aimed at facilitating the achievement of SDGs are also expected to be developed, such as SDGs bonds and funds. We recommend financial institutions look into the link between their investment fields and SDGs, and enhance investment in SDGs, obtaining sustainable investment returns while solving social problems.

7. ESG Promoting the Two-way Opening-up of China's Capital Market

According to the report delivered at the 19th National Congress of the Communist Party of China (CPC), China will not close its door to the world, but only widen opening-up. In the "Guidelines for Establishing the Green Financial System" issued by the seven ministries and commissions in 2016, it is proposed to actively and steadily promote the two-way opening-up of the green securities market and to enhance the "greenness" of outward investment. At present, China has greatly relaxed market access restrictions on foreign securities, futures and funds, and broaden the two-way opening-up through Shanghai-Hong Kong Stock Connect and Shenzhen-Hong Kong Stock Connect. Meanwhile, A-shares have been included in the MSCI indices with an increasing inclusion ratio, and FTSE Russell has also officially included A shares in its index series. Transparency and non-financial disclosures advocated by ESG investment are serving important cornerstones to enhance the confidence of international investors. With ESG investment going mainstream worldwide and developing in China's capital market, we expect that more foreign institutions and capital will enter China in 2020, which will help improve the investor structure of China’s securities market and expand the overall opening-up of China.

At the same time, China’s institutional investors shall take full account of ESG factors during the overseas investment. In 2019, 27 institutions signed the Green Investment Principles (GIP) for the Belt and Road Initiative (BRI). We expect that Chinese institutions will further strengthen environment and social risk management in making overseas investment, effectively support environmental improvement and tackle climate change while satisfying the huge demand for infrastructure development, greening the “Belt and Road” investment.

8. Local Green Finance Developing from Pilots to New Normal

In December 2019, the State Council officially approved the establishment of a pilot zone for green finance in Lanzhou New District to explore development models of green finance. The pilot zone would accumulate experiences and open paths for the innovative development of green finance in less developed regions in western part of China. Lanzhou New District is the ninth pilot zone for green finance after the other eight in five provinces set up in June 2017. According to the China Green Financial Policy Database of SynTao Green Finance, China has issued 116 green finance or green finance-related policies, including 17 nationwide, 4 cross-province ones, 49 at provincial-level, and 46 at city-level or below. As observed, green finance has been widely developed nationwide and interlinked regionally.

We expect that the number of pilot zones for green finance will continue to increase in 2020. More regional collaborated green finance policies will come up and related experience sharing will be strengthened. 2020 is the third year for the first batch of green finance pilot zones since establishment. Their experience and achievements will be shared and promoted in other regions, which may form a paradigm shift and further promote the sustainable development of green finance in China. We recommend financial institutions enhance the research on local green finance policies, keep track of the policy trends and make full use of the advantages of green finance policies.

9. Further Improvement of the Environment and Social Risk Management in the Banks' Overseas Operations

With the launch of the Belt and Road Initiative, China's banking sector has been increasingly involved in overseas investment, and is confronting with growing concern over the environmental and social impact that may be brought. After issuance of the "Guiding Opinions on Regulating Banking Services for Enterprises Going Abroad and Strengthening Risk Prevention and Control", China Banking and Insurance Regulatory Commission (CBIRC) reemphasized banks' going green while going abroad, and called for banks to establish and improve environmental and social risk management systems in its "Guiding Opinions on Promoting the High-quality Development of the Banking and Insurance Industry" (the Opinions) in December 2019. According to the Opinions, banks and insurance institutions are encouraged to adopt international standards, and enterprises are encouraged to go abroad with green and low carbon business.

To promote high-quality overseas investment in the banking sector, in the past two years, the CBIRC and the Asian Development Bank have jointly held several international seminars on environmental and social risk management and accountability mechanisms for cross-border investment and financing projects of financial institutions. We expect that in 2020, Chinese banks will further improve the effectiveness of environmental and social risk management in overseas businesses, strengthen information disclosure and communication with stakeholders, and gradually establish accountability and grievance mechanisms to ensure the development of green finance overseas.

10. Mutual Promotion of Fintech and Green Finance

In recent years, the collaboration of green finance and Fintech has become a hot topic in the financial sector, and many successful practices have emerged. In 2016, Ant Financial launched the "ant forest" and more than 100 million trees have been planted through the participation of nearly 500 million public users. In 2019, major financial institutions promoted the development of green financial services through Fintech. China Industrial Bank established a professional green finance supporting system, “Green to Gold”, to improve the accuracy of green project identification and enhance the ability of environmental and social risk management. Bank of Huzhou established an internal information system and incorporated the Equator Principles’ requirements on environmental and social risk management into the process of credit management. The CFA Institute also follows the trend and has incorporated Fintech and ESG into the scope of the CFA examination.

We expect that in 2020, there will be more collaboration between Fintech and green finance, which will drive the development of both. Fintech can help financial institutions effectively identify green projects and assess project environmental benefits through technologies such as big data and artificial intelligence. In the medium and long term, the blockchain technology can be used to record and share environmental data. Meanwhile, green finance will provide broad application scenarios for Fintech and facilitate the application. We recommend that financial institutions continue to explore the application of data-related Fintech in green finance and pay attention to the issues of digital security and data privacy in the application of Fintech.