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New Rules for China's Green Bonds and Transition Bonds

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On October 10, 2024, China's National Association of Financial Market Institutional Investors (NAFMII)[1] released a "Notice on Further Refinement of Mechanisms for Green Bonds and Transition Bonds" (hereafter "the notice" or "the notice on new rules"). The new rules outlined in the notice include measures to support the issuance of green bonds and transition bonds in the China Interbank Bond Market (CIBM) under the regulatory authority of the People's Bank of China (PBOC) and measures to strengthen-related information disclosures.

This paper begins with an overview of the current state of green bond and transition bond issuance in China and then presents the main points of the new rules and concludes with a brief summary of future challenges and prospects for the green bond and transition bond markets in China.

Overview of China's Green Bond and Transition Bond Markets

This section presents an overview of the current state of the green bond and transition bond markets in China and the related regulations. The Chinese government has stated that transition bonds include transition bonds that specify the areas where raised funds can be used and sustainability-linked bonds (SLBs) that do not have any restrictions on the use of procured funds.[2] Transition bonds broadly consist of two types: transition bonds issued in the CIBM and low-carbon transition corporate bonds issued on the Shanghai, Shenzhen, and Beijing stock exchanges. SLBs have the same two types: bonds issued in the CIBM, and low-carbon transition-linked bonds issued on the Shanghai, Shenzhen and Beijing stock exchanges.[3]

Current state of China's green bond and transition bond markets

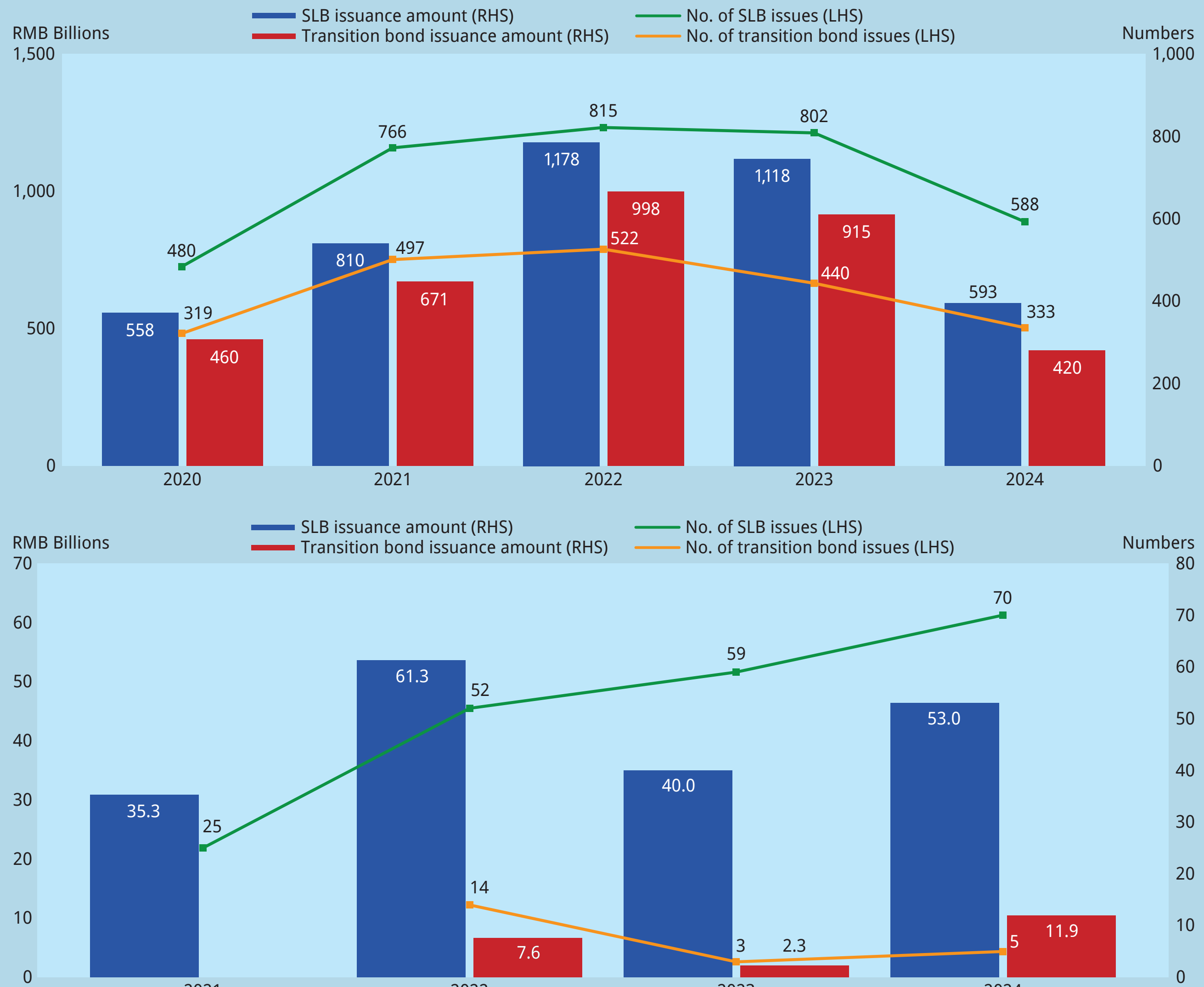
- **Green bond market has seen a decline in bond issuance**

China's green bond issuance[4] has been on a downward trend since peaking at RMB1,178.2 billion in 2022. Total issuance in 2023 was RMB1,118.1 billion, down RMB60.1 billion (5.1%) year-on-year, while issuance in 2024, as of November 20, was just RMB592.9 billion, a year-on-year decline of RMB319.2 billion (35%) (Figure 1). The main reasons for the downtrend in green bond issuance are a decline in issuer incentives due to deteriorating market conditions and a decrease in green projects.

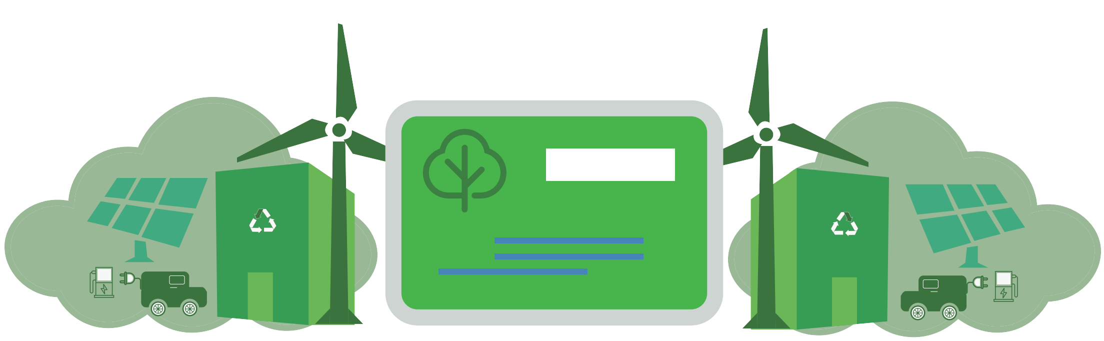
- **Transition bond market still in the pilot stage**

China's transition bond market began with the introduction of SLBs in 2021. A comparison of SLBs and transition bonds shows the number of SLB issues and their total issuance amount are much greater than that for transition bonds. However, while the number of SLB issues continued to increase from 2021 through 2024, the total issuance declined rather sharply in 2023, from RMB61.3 billion in 2022 to RMB40.0 billion, and continued to fall in 2024. Meanwhile, transition bond issuance (including low-carbon transition corporate bonds), which began with pilot operation in May 2022, totaled only five issues in 2024 but the total issuance amount was a record high RMB11.9 billion, thanks to a single large issue (RMB10 billion) by China Baowu Steel Group Corporation Limited, a major steel company.

Figure 1: Green Bond Issuance in China



Notes: (1) Data on CIBM green bond issuance includes bonds issued at the same time on securities exchanges.
(2) SLBs data includes issues of low-carbon transition-linked bonds. Transition bond data includes issues of low-carbon transition corporate bonds.
Source: Nomura Institute of Capital Market Research (NICMR), based on data from Wind



Regulatory structure of China's green bond and transition bond markets

In China, the issuance of green bonds and transition bonds is subject to a regulatory system in which rules are set by various supervisory authorities, with rules for individual issues set by the authority responsible for overseeing the targeted area. The issuance of green bonds is guided by uniform standards that apply to all green bonds, as stipulated in the China Taxonomy and the China Green Bond Principles (CGBP). However, as of November 2024, China had no uniform standard for transition bonds across all markets (Table 1). In addition, the main issuance markets are broadly divided into the CIBM, which is under the regulatory authority of the PBOC, and the securities exchange markets (Shanghai, Shenzhen, and Beijing), which are regulated by the China Securities Regulatory Commission (CSRC). The notice on new rules applies to green corporate bonds and transition bonds (including SLBs) issued in the CIBM.

Table 1: Current Rules in China's Green Bond and Transition Bond Markets

<table>
<tr><td>Green Bond Types</td><td>Green State-owned Enterprise (SOE) Bonds</td><td>Green Corporate Bonds</td><td>Green Finance Bonds</td><td>Green Debt Financing Instrument/
Green Corporate Asset-backed Securities (ABS)</td></tr>
<tr><td rowspan="2">Green Bond Uniform Standard</td><td colspan="4">Green Bond Endorsed Projects Catalogue (2021 Edition) (China Taxonomy)</td></tr>
<tr><td colspan="4">CGBP</td></tr>
<tr><td rowspan="2">Rules for Issuance of Individual Green Bonds</td><td>Shanghai-Shenzhen Stock Exchanges:
"Notice Regarding Trial Use of Green SOE Bonds"</td><td rowspan="2">National Development and Reform Commission:
"Green Bond Issuance Guidelines"</td><td>PBOC:
"Notice Regarding Issuance of Green Finance Bonds in the Interbank Bond Market"</td><td>NAFMII:
"Guidelines for Non-Financial Enterprise Green Debt Financing Instrument"</td></tr>
<tr><td>China Securities Regulatory Commission:
"Guiding Opinions on Support for Development of Green Bonds"</td><td>PBOC:
"Notice Regarding Regulatory Oversight of Green Finance Bonds over Entire Duration Period"</td><td>NAFMII:
"Notice on Further Refinement of Mechanisms for Green Bonds and Transition Bonds"</td></tr>
<tr><td>Green Bond Issuance Markets</td><td>Securities exchange markets</td><td>Securities exchange markets & CIBM</td><td colspan="2">CIBM</td></tr>
<tr><td>Transition Bond Types</td><td>Low-carbon Transition SOE Bonds</td><td>Low-carbon Transition-Linked Bonds</td><td>SLBs</td><td>Transition Bonds</td></tr>
<tr><td rowspan="2">Rules for Issuance of Individual Transition Bonds</td><td colspan="2" rowspan="2">Shanghai Stock Exchange:
"Guidelines for Application of Rules for Examining Listing Criteria for SOE Bonds No.2 - Specific Varieties of SOE Bonds (Revised in 2022)"</td><td>NAFMII:
"10 FAQs about SLBs"</td><td>NAFMII:
"Notice Regarding Trial Use of Transition Bonds"</td></tr>
<tr><td colspan="2">NAFMII:
"Notice on Further Refinement of Mechanisms for Green Bonds and Transition Bonds"</td></tr>
<tr><td>Transition Bond Issuance Markets</td><td colspan="2">Securities exchange markets</td><td colspan="2">CIBM</td></tr>
</table>

Source: NICMR, based on various materials

Main Content of the New Rules

The new rules evidently are intended to reinvigorate and stimulate issuance of green bonds and transition bonds in China. The new rules also include provisions to strengthen information disclosures that take into account the interests of investors (Table 2). This section introduces the main content of the new rules, based on this perspective.

Measures promoting the issuance of green bonds and transition bonds

- **Measures easing restrictions on the use of funds procured by green and transition bond issuance**

The new rules include provisions easing restrictions on the use of funds raised through the issuance of green bonds and transition bonds in CIBM. First, in addition to the traditional use of green bonds for the construction and operation of green projects, supplementing the working capital of supporting projects, or repayment of interest-bearing debts of green projects, green bond issuers can now use the procured funds to recover their own capital spent on green projects or used for the repayment of green interest-bearing loans

Table 2: Main Content of the New Rules

	Category	Content
Measures to Support Issuance of Green Bonds and Transition Bonds	Green Bond Finance-related	Issuers should establish a supervisory management account for the funds raised. The account custodian should ensure that raised funds are used to finance green projects.
		Assuming the planned use of raised funds is unaffected, the issuer can temporarily invest any surplus funds in government bonds, policy-bank financial bonds, local government bonds, etc.
		Issuers can use procured funds to recover own funds spent on green projects or used for the repayment of green interest-bearing loans within the past three months. In addition, if certain criteria are met, issuers can use procured funds to replace an equity investment in green projects previously funded by own-capital within one year of the bond's issuance.
	Transition Bond–related	Expansion of issuers able to issue transition bonds (no longer limited to issuers in eight previously designated industries.
		Expansion of projects that can be financed by transition bond proceeds (all projects aligned with the transition taxonomy).
	SLB-related	Relaxation of factors selected as key performance indicators (KPIs) for SLBs. Previous requirement that operating revenue from a selected business account for at least 30% of the issuer's total operating revenue has been eliminated, and issuers are now encouraged to use sustainability goals, development goals in prioritized regions, and development plans highly relevant to their core business as KPIs.
		Changed the evaluation of issuer's financial and structural conditions to one that considers the achievement of sustainability performance targets (SPTs) and suggested offering lower interest rates as an incentive for achieving SPTs.
		Issuers are encouraged to disclose environmental, social, and governance (ESG)-related information and set an SPT that is linked to the issuer's ESG-related score.
	Intermediaries-related	Issuance and underwriting of green bonds and transition bonds will be used as regular indicators to evaluate the performance of lead underwriters.
		Market makers (securities firms, etc.) are being encouraged to undertake market-making activities that will support issuance of green bonds and transition bonds.
	Support Measures for Central State-owned Enterprises (CSOEs) and Private-sector Issuers	A certain percentage of debt related to the issuance of green bonds and transition bonds will be excluded from CSOE liabilities when calculating their asset-liability ratios (total liabilities/total assets).
		Securities companies and other financial institutions are being encouraged to provide credit enhancement measures to private-sector companies issuing green bonds and transition bonds.
Measures That Take into Account Interests of Investors	Optimization of Green Bond Information Disclosure Mechanisms	Registration stage: Required disclosures include only the type of green project to be funded, the project selection criteria and selection process, and the plan for using bond proceeds. No disclosure is required if the specific project has not yet been decided.
		Issuance stage: Issuers are sorted into two types: mature companies and other companies. The former are simply required to disclose the same information that they provided at the registration stage. Other issuers will need to disclose more detailed information in their issuance documents, such as their plans for using and managing the raised funds, project compliance compatibility, and the expected indicators of the project's environmental impact.
		Bond's duration: Issuers are required to disclose their use of bond proceeds, project progress, etc., on annual and semiannual bases by 30 April and 31 August each year.
Other	Expansion of the Range of Green-related Products	Recommending issuance of bonds linked to carbon emission credits and corporate bonds secured by carbon emission credits.
		Encouraging the use of green asset-backed securities.

Source: NICMR, based on China's NAFMII release: "Notice on Further Refinement of Mechanisms for Green Bonds and Transition Bonds" within the past three months.[5] In addition, issuers can now temporarily invest surplus funds from a previous green bond issue in government bonds, policy-bank financial bonds,[6] and local government bonds.

Second, restrictions on the use of funds procured through the issuance of transition bonds also have been relaxed. Previously, transition bond proceeds could be used only for (1) green projects related to economic activities included in the China Taxonomy that do not meet certain technical standards, and (2) five types of projects[7] that comply with the goals of achieving carbon peak-out and carbon neutrality.[8] Taxonomies in China include municipal taxonomies, such as Huzhou and Shanghai's catalogue for supporting transition finance activities, and the National Development and Reform Commission's *Green and Low-Carbon Transition Industry Guidance Catalog (2024 Edition)*.

- **Relaxation of transition bond and SLB issuance requirements**

The new rules include two main measures that ease the restrictions on issuance of transition bonds and SLBs. The first is the expansion of potential bond issuers. To date, transition bond issuance was targeted at issuers in eight industries—electric power, building materials, steel, nonferrous metals, petrochemicals, chemicals, paper manufacturing, and civil aviation. However, the new rules make issuance possible for all industries that have transition needs.

The second measure includes changes to the factors that SLB issuers select as KPIs and a revision to the evaluation of issuers' financial and structural conditions that indicate achievement of SPTs. Regarding KPIs, the requirement that the operating revenue of the selected business accounts for 30% or more of the issuer's total operating revenue has been replaced by an emphasis on such selection factors as the issuer's sustainability goals, development goals in prioritized regions, and development plans with high business relevance. Issuers are expected to select factors that will make a strong contribution to achieving sustainability. As for the revision to evaluations of issuers' financial and structural conditions, in addition to the existing penalty of imposing a higher interest rate for not achieving SPTs, it has been suggested that setting a lower rate if SPTs are achieved should be introduced as an incentive.

- **Measures to support issuance that respond to the needs of state-owned and private enterprises**

The new rules include the introduction of measures to support issuance by state-owned enterprises[9] and private enterprises. These measures include (1) excluding from a state-owned issuer's total liabilities a certain percentage of debt taken on when issuing green bonds and transition bonds when calculating the issuer's asset-liability ratio (total liabilities/total assets)[10], and (2) encouraging securities companies and other financial institutions to provide credit enhancement measures to private-sector companies issuing green bonds and transition bonds. The first measure will mitigate the impact on a state-owned issuer's asset-liability ratio when it raises funds, while the second measure will reduce private-sector companies' credit risk and therefore facilitate their issuance of green bonds and transition bonds.

Strengthen information disclosures for investors

The new rules' measures to strengthen information disclosures divide the green bond issuance process into three stages: (1) registration with NAFMII, (2) the time of a bond's issuance, and (3) the full length of a bond's duration. Information disclosure requirements at the registration and issuance stages were eased, while disclosures required during a bond's duration were expanded.

The new rules limit the disclosures required at the time of a bond's registration to (i) the type of green project to be funded by the issue, (ii) the selection criteria and process, and (iii) the plan for using bond proceeds. Disclosure of concrete project details is not required if a specific project has yet to be decided at the time of the issuer's registration with NAFMII. At the time of a bond's issuance, issuers are divided into two types: mature companies[11] and other companies. Mature companies are simply required to disclose the same information that they provided at the registration stage, while all other companies are required to disclose more detailed information in their issuance documents, such as their plans for using and managing the raised funds, the project's compliance compatibility, and expected indicators of the project's environmental impact. Lastly, the new rules for disclosure for the entire period of a bond's duration require all issuers to make annual disclosures for the previous fiscal year by April 30, and semiannual reports for the first half of the current fiscal year by August 31. If a specific green project has not been disclosed at the time of a bond's issuance, the issue's lead underwriter must conduct due diligence every six months.

The revised disclosure requirements at the registration and issuance stages benefit green bond issuers by simplifying the registration process and shortening the review period, which contributes to a more efficient issuance process. Strengthening information disclosures during a bond's duration will enable investors to deepen their understanding of green bonds, which may lead to more rational investment decisions. Expanding information disclosures is also expected to increase the transparency of green bonds and transition bonds, which may lead to increased investment in these bonds.

Future Challenges and Prospects

The new rules governing the issuance of green and transition bonds in China are a significant development that, in addition to promoting green efforts seen to date, clearly indicate support for a "green transition" that promotes the decarbonization of industries that have been key to China's economic development but also have been responsible for the emission of large amounts of greenhouse gases. These rules for China's Interbank Bond Market, while not a nationwide standard, are expected to contribute to an increase in the issuance of green bonds and transition bonds in China.

Meanwhile, green finance and transition finance in China still face many challenges. Although China has established uniform standards for its green finance sector, such as the China Taxonomy and the CGBP, green bonds issued in China under these standards do not necessarily comply with international standards and therefore may not be attractive to foreign investors.[12] As a result, there currently is a lack of investment by foreign investors in China's green bonds and transition bonds.

In November 2024, the regulatory authorities of China, the European Union (EU), and Singapore unveiled the Multi-Jurisdiction Common Ground Taxonomy (M-CGT), which adds the Singapore-Asia Taxonomy to the previously established EU-China Common Ground Taxonomy (CGT).[13] The M-CGT aims to enhance the interoperability of taxonomies across China, the EU, and Singapore to establish a standardized international taxonomy that will be relatively easy for overseas investors to accept. The application of international standards, such as M-CGT, to new and existing China green bonds is considered to be an important measure for making them more attractive investments to a greater number of overseas investors.[14]

Meanwhile, issues needing to be addressed in the area of transition finance include (1) the lack of transition finance standards, such as a nationwide transition taxonomy, and (2) existing regional-level transition taxonomies that lack medium to long-term science-based transition strategies and technology roadmaps aligned with the timelines for achieving carbon peak-out and carbon neutrality. In response to these issues, the PBOC is in the process of establishing a transition taxonomy for certain industries (steel, building materials, agriculture, and coal-fired power generation).[15] In addition to the need for a nationwide transition taxonomy, experts have called for the establishment of transition finance standards that include the aforementioned regional-level transition strategies and a technology roadmap.

In conclusion, China's revised rules applied to its green and transition bonds need to be consistent with international standards in order to make the bonds more attractive to overseas investors. Increasing the bonds' appeal to overseas investors and attracting green money from overseas investors will be key factors for expanding China's green bond and transition bond markets. From this perspective, China's future policy moves in the green and transition bond sector bear close attention, as they can provide key insights for policymakers in other countries seeking to develop their green and transition bond markets.

Notes

1 NAFMII is a self-regulation organization with membership including participants in the interbank bond market under the regulatory authority of the PBOC.

2 China Central Depository & Clearing Co., Ltd., "White Paper on China Transition Bonds," October 2024.

3 The new rules apply to SLBs and transition bonds issued in the CIBM.

4 The issuance amount covers all green bonds that meet China's domestic standards (i.e., China Taxonomy and China Green Bond Principles). As such, the amount stated here is larger than the amount issued to meet the Climate Bond Standards (CBS) published by the Climate Bonds Initiative (CBI).

5 If certain criteria are met, it is also possible to use green-bond procured funds to cover own-capital financed equity investments in green projects within one year.

6 Policy-bank financial bonds are bonds issued by so-called policy banks (e.g., the China Development Bank), which are state-owned financial institutions engaged in business that supports government policies.

7 Specifically, these projects include (1) high-efficiency coal-fired power generation (clean coal), (2) natural gas clean energy, (3) replacement of production capacity in eight industries, including electric power, building materials, steel, nonferrous metals, petrochemicals, chemicals, paper manufacturing, and civil aviation, (4) applications of green facilities and technologies, and (5) other projects that contribute to the transition to low-carbon emissions.

8 Carbon peak-out refers to reaching a peak in carbon dioxide (CO_2) emissions by 2030. Carbon neutrality refers to achieving net zero CO_2 emissions and absorption by 2060.

9 State-owned enterprises (SOEs) refer to those that report directly to the State-owned Assets Supervision and Administration Commission (SASAC) of the State Council.

10 The SASAC holds an annual meeting of directors of SOEs under its supervision, at which it asks for the submission of performance indicators, including asset-liability ratios. In 2022, it set 65% as the target total asset-liability ratio of all SOEs. While no specific numerical target was set for 2023, the Commission issued a qualitative directive to stabilize asset-liability ratios at a certain level (SASAC website used as a reference).

11 A mature enterprise is an issuer that has previously issued three or more bonds in the interbank bond market in the past 36 months with a total issuance value of more than RMB10 billion.

12 CBI, "China Sustainable Debt State of the Market Report 2023," May 2024.

13 Monetary Authority of Singapore, "The International Platform on Sustainable Finance presents the Multi-Jurisdiction Common Ground Taxonomy to enhance interoperability of taxonomies across EU, China and Singapore," November 14, 2024.

14 In September 2024, a group of experts working with the China Foreign Exchange Trade System (CFETS) issued the "CGT-Labeled Green Bond Practical Report," which included a list of outstanding green bonds in China verified to be CGT-aligned green bonds. As of the end of November 2024, there were 245 CGT-aligned green bonds, with a total issuance value of more than RMB360 billion (Source: Green Finance Committee (GFC) of China Society for Finance and Banking, "GFC's 'Common Ground Taxonomy,' Labeling Expert Group Meeting held in Shanghai," December 10, 2024).

15 Ma Jun, "Cover shortcomings, strengthen synergies, and deepen green finance reform," *China Securities Journal*, July 11, 2024.

GREEN CERTIFICATES

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