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CGT Research Series Phase 2:

Understanding Use Cases of the Common Ground Taxonomy

HONG KONG GREEN FINANCE ASSOCIATION • GUANGDONG GREENFINANCE COMMITTEE
GREATER BAY AREA GREEN FINANCE ALLIANCE

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EXECUTIVE SUMMARY

IPSF's Common Ground Taxonomy (CGT) provides a comprehensive mapping and comparison between EU and China taxonomies and the mapping analysis can be considered as major first step towards convergence of global standards of green definitions.

As per the CGT, the environmental objectives of the EU and China Taxonomies can be broadly mapped against each other at a high level, despite some differences in categorization and variations at a more granular level. These broad environmental objectives are also relevant for the Greater Bay Area (GBA).

As one of the three key mega-regions in China, the GBA has a total GDP of USD 2 trillion in 2021, equivalent to the GDP of Canada, or 11% of the combined GDP of mainland China, Hong Kong Special Administrative Region and Macau Special Administrative Region.[1] Some of the key environmental topics, especially those covered under cooperation between Hong Kong and Guangdong province, include: improvement of air quality, protection of the water environment, forestry and marine resources conservation as well as combating climate change.[2]

For Hong Kong, its Climate Action Plan 2050 has set out four major decarbonisation strategies, namely "net-zero electricity generation", "energy saving and green buildings", "green transport" and "waste reduction"[3], which would fit into objectives covered under the CGT. The CGT Categories covering electricity generation from renewable sources, construction and renovation of buildings, manufacturing of clean energy vehicles, infrastructure enabling low-carbon transport, and waste management and remediation activities are particularly relevant, although the specifics could differ given the difference in decarbonization pathways. Hong Kong's Green and Sustainable Finance Cross-Agency Steering Group also previously committed to adopting CGT as a reference in developing Hong Kong's own taxonomy.

Similarly, the Guangdong Provincial Development and Reform Commission recently released Guangdong Provincial plans[4] to achieve carbon peaking and carbon neutrality. This is aligned with China national's "Working Guidance for Carbon Peaking and Neutrality in full and faithful implementation of new development philosophy" that includes planned investments to scale up renewable wind and solar power, grid capacities, forest coverage alongside broader plans to facilitate sectoral transition and promotion of green economy[5].

In light of these developments, we previously published "CGT Research Series Phase 1: Principles for advancing the adoption of the Common Ground Taxonomy in Hong Kong SAR and the Greater Bay Area" where the research shared more on the opportunities that CGT presents for the development of sustainable finance in Hong Kong.

As a follow-up to that research, this Phase 2 report focuses on the understanding of the use cases of the CGT in Hong Kong and beyond.

1. https://ihsmarkit.com/research-analysis/chinas-greater-bay-area-becomes-key-mega-region-in-global-economy-june22.html#:~:text=The%20Greater%20Bay%20Area%20has,to%20the%20GDP%20of%20Canada
2. https://www.info.gov.hk/gia/general/202112/16/P2021121500539.htm
3. https://www.gov.hk/en/residents/environment/global/climate.htm
4. Guangdong Provincial Development and Reform Commission 广东省发展和改革委员会 - 中共广东省委 广东省人民政府关于完整准确全面贯彻新发展理念推进碳达峰碳中和工作的实施意见 (gd.gov.cn)
5. State Council Guangdong gives green push with manufacturing (www.gov.cn)

Given the 3 primary groups of users of the CGT, we consider 6 use cases across key areas involving financing and investment activities, regulation, disclosures and policy setting. The following table is a summary of the 6 use cases identified:

KEY CGT USE CASES

Category	Use Case	Detailing of Use Case	Users			Existing Examples
			Financial Management Professionals	Corporate	Government	
Financing and Investments	Debt financing	Increase comparability of sustainable finance 1. Labelling with reference to CGT 2. Capacity building tool	Y	Y		Green debt issuances referring to CGT
	Investment Strategies	Widen investor base and products 1. Harmonize investment process 2. Equity selection tool 3. Climate solutions in real assets 4. Engagement Framework	Y			Various funds/ strategies referencing taxonomies
	Benchmark & Index	CGT aligned tracking of securities 1. CGT-aligned green bond index	Y			Various index and benchmarks
Regulation and Disclosures	Corporate Disclosures	Standardized disclosures 1. CGT aligned Disclosure		Y	Y	EU: Taxonomy Regulation (TR), Corporate Sustainability Reporting Directive (CSRD)
	Investor Disclosures	Standardized label/ disclosures 1. General disclosures (all funds) 2. ESG Fund Labelling and Disclosure 3. Sustainability Preferences	Y		Y	EU: TR, Sustainable Finance Disclosure Regulation (SFDR), Markets in Financial Instruments Directive (MiFID)
National Policy	Policy Setting	Regulation framework and policy tool 1. CGT-based regional taxonomy 2. CGT-referencing policy making	Y	Y	Y	EU: do-no-significant-harm (DNSH), EU Ecolabel, Climate Benchmark

CONTEXT: WHAT CGT IS AND WHAT CGT IS NOT

As defined in IPSF's CGT Instruction Report, CGT serves as a mapping exercise and comparison between China and EU's taxonomies. In particular:

The Common Ground Taxonomy is...	The Common Ground Taxonomy is not...
An analysis on approaches of the EU taxonomy and China taxonomy, and the methodology for comparing and identifying commonalities and differences between some features of the two taxonomies	A legal documentation by the EU and China which entails requirement/obligation for either jurisdiction to change their taxonomy.
An evolving tool that may help different actors to understand the types of activities that could be covered under the respective taxonomies within the scope of the comparison exercise	A single taxonomy or exclusive definition of environmentally sustainable economic activities covering all environmental objectives, such as biodiversity, pollution prevention, etc.
A technical document for voluntary reference by interested parties within the limits of the scope of the comparison exercise	Covering all eligibility features or all activities in the EU and China taxonomies as explained in the instruction report.
An analytical tool or reference for other jurisdictions to consider when developing their own taxonomies	A proposal for international standards or legal document that imposes any global standard on other jurisdictions.

Source: IPSF's CGT Overview[6]

Indeed, a common misconception is that CGT is itself a taxonomy standard, however as per the table, CGT is more a comparative analysis. Jurisdictions may consider developing a regional taxonomy with reference to CGT if it needs a comprehensive framework to define environmentally sustainable economic activities and indicate the corresponding technical and legal standards in detail. Beyond a reference of the regional taxonomy, CGT is a helpful analytical tool and frame of reference with a variety of use cases. Therefore, this report aims to explore diverse potential usages of CGT, and how CGT can advise on initiatives and support interests from the private and public sectors

6. IPSF CGT Instruction Report Common ground taxonomy – Climate change mitigation instruction report (europa.eu)

USE CASES OF THE CGT

In defining the path forward for a CGT-base taxonomy, a vital starting point is to understand the set of use cases in which a taxonomy can help in. This starts with understanding the potential key users of the CGT before looking more deeply at the range of use cases.

KEY USERS

Category	Examples	Key Objectives desired from taxonomy
Financial Market Participants	Asset owners, asset managers, banks, insurers, financial service providers	Enhance consistency and comparability of sustainability standards
		Reference standard to help in developing sustainable finance products and strategies
Corporates	Publicly listed or private companies required to give disclosures	Clear standard of reference for disclosure and reporting of activities
		Reference standard for prioritizing green activities and capex; facilitate information sharing in capital and debt markets
Policy Makers	Government bodies, central banks, and other regulators	Address greenwashing risks in corporate and financial disclosures; improve confidence in green products
		Reference standard for use in policy setting
		Strengthen credibility and credentials of sustainability and green finance market

USE CASE 1: DEBT FINANCING

1.1 USE CASE OVERVIEW

The key objectives for the application of the CGT in relation to debt financing such as green bonds and green loans can cover at least the following:

1) To **increase comparability** of sustainable finance taxonomies and definitions of green, sustainable activities.

   Taxonomies play an important role in helping determine what activities or assets are green or sustainable. According to a study by Climate Bonds Initiative (CBI), a growing number of jurisdictions around the world have developed classification schemes of sustainable economic activities, raising the worry of market fragmentation and the need for harmonisation and interoperability between taxonomies.[7] The CGT is expected to play a pivotal role in increasing comparability of sustainable finance taxonomies and definitions of green, sustainable activities between the EU and China. The CGT could potentially be expanded to include other jurisdictions and the comparability would then be broadened to encompass taxonomies globally.

2) To **facilitate assessment** by issuers, investors, external reviewers and other market participants.

   CGT can encourage issuers/ borrowers to adopt a more specific definition of green and sustainable activities based on quantitative metrics and thresholds in assessing their assets and improving reporting. Although, theoretically speaking, the issuers/ borrowers could issue green debt instruments by aligning with the relevant principles without setting quantitative thresholds, investors and lenders alike often require an assessment on whether the specific activities within the categories are sufficiently green or sustainable to be labelled as such. For example, it could be used in the **feasibility assessment of green Panda bond**, a renminbi denominated bond sold onshore in China by a non-Chinese issuer, by leveraging works done on project/asset selection criteria for offshore green bond issuance.

3) To **improve transparency** and potentially **enhance credibility** of the (re)financed activities.

   As explained in the CGT Strategy, *"the Common Ground Taxonomy will provide transparency to all investors and companies by constituting a unique common reference point for the definition of investments that are considered as environmentally sustainable across relevant IPSF jurisdictions"*.

   For onshore issuances, assuming these are already aligned with the China Taxonomy, referring to the CGT could help demonstrate the extent of the alignment with the criteria of the EU Taxonomy if use of proceeds falls under those activities covered under the CGT.

7. https://www.climatebonds.net/2022/03/new-report-global-green-taxonomy-development-alignment-and-implementation

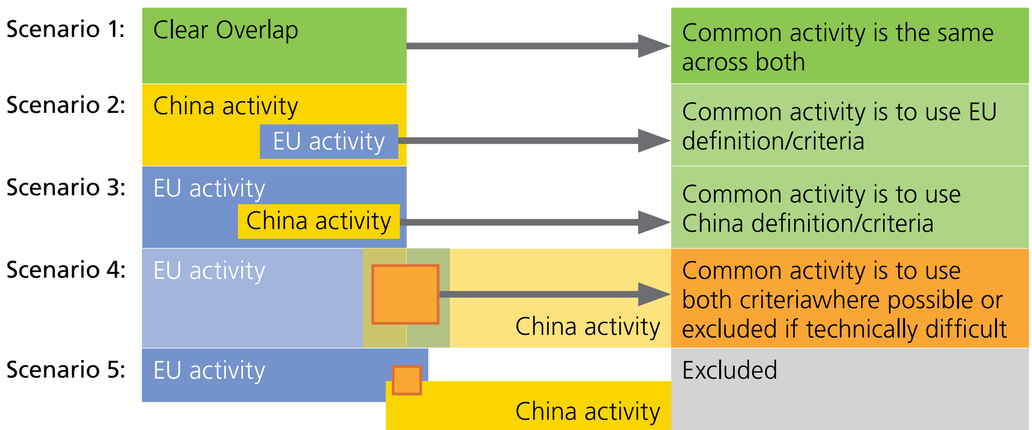
1.2 DETAILING OF USE CASE IN THE HONG KONG AND OTHER GBA REGIONS

1.2.1 Labelling with reference to CGT

1.2.1.1 Labelling for new green financing instruments

In Hong Kong, there is currently no local green and/or sustainable finance taxonomy. To structure sustainable debts such as green bonds and loans, local issuers and underwriters currently rely on international guidelines, taxonomies or standards as a starting point, such as ICMA Green Bond Principles, Climate Bonds Taxonomy and EU Taxonomy, as well as internal taxonomies or guidelines from the appointed external reviewer(s) such as the Second Party Opinion providers. Adopting the CGT was identified as part of Hong Kong's Green and Sustainable Finance Strategy ("Strategy") by the Green and Sustainable Finance Cross-Agency Steering Group ("Steering Group"), co-chaired by the Hong Kong Monetary Authority and Securities and Futures Commission, back in December 2020.[8] Both Hong Kong regulators are part of the International Platform on Sustainable Finance (IPSF), which hosts the working group that is working on the CGT.

As CGT details the outcome of the analysis between the EU Taxonomy and China Green Bond Catalogue (2021), five scenarios are presented based on their characteristics in terms of comparability. In practice, Scenario 1 (clear overlap), Scenario 2 (EU more stringent or detailed) and Scenario 3 (China more stringent or detailed) can expect greater applications in structuring green financing instruments to facilitate cross-border recognition of green definitions, especially in cases where international investors may not be very familiar with technical criteria/ standards used to assess projects/ assets located in China.



Source: CGT Instruction Report

8. https://apps.sfc.hk/edistributionWeb/gateway/EN/news-and-announcements/news/doc?refNo=20PR128

TABLE 1:
Distribution of current 72 CGT activities by overlap scenario and by ISIC Section

	Areas with clear overlaps	EU criteria are more stringent	China criteria are more stringent	Identifiable overlap	TOTAL
Agriculture, forestry and fishing		4			**4**
Manufacture		5	11	15	**31**
Electricity, gas, steam and air conditioning supply	2	11	1	2	**16**
Water supply; sewerage, waste management and remediation activities		3		3	**6**
Construction		4	1	3	**8**
Transportation and storage		2		3	**5**
Others		1		1	**2**
Sub-total	2	30	13	27	**72**

For **onshore issuers and borrowers**, in addition to Scenario 1 "clear overlap" activities and criteria, it is possible to **demonstrate alignment with the stricter requirements** between those under the EU and China taxonomies if use of proceeds fall under the activities covered under the CGT. Generally speaking, for issuers in the manufacturing sector, especially those with activities falling under the scenario where "China criteria are more stringent" under the CGT, it would be possible for them to potentially demonstrate partial alignment with eligibility criteria in international market standards such as the EU Taxonomy, depending on the categories of activities and the details available. **Table 2** below summarises green bond and loan transactions that have explicitly referred to the CGT to date.

TABLE 2:
Green debt issuances that have explicitly referred to the CGT

Issuer	Type of instrument	Date	Issuance Amount	Version of the CGT referenced	CGT Categories referenced
China Construction Bank Macau Branch[9]	Green bond	January 2022	USD500 mn	November 2021	• D1.3 Electricity generation from wind power • H1.1 Construction and operation of public transportation system in urban and rural areas
China Merchant Bank Sydney Branch[10]	Green Bond	February 2022	USD408 mn	November 2021	• **D1.3 Electricity generation from wind power**
Industrial Bank Hong Kong Branch[11]	Green bond	May 2022	USD650 mn	November 2021	**Renewable Energy (Solar and Wind Power Generation)**[12] • D1.1 Electricity generation using solar photovoltaic technology • D1.3 Electricity generation from wind power **Low Carbon and Low Emission Transportation (Construction and operation of public transportation system in urban and rural areas)** • H1.1 Construction and operation of public transportation system in urban and rural areas
Bank of China Frankfurt Branch[13]	Green bond	June 2022	USD500 mn	June 2022	• C5.3 Manufacture of energy-saving pumps and vacuum equipment • C5.9 Manufacture of energy-saving transformers, rectifiers, inductors and electric welding machines • D1.3 Electricity generation from wind power • D1.8 Storage of electricity • H1.1 Construction and operation of public transportation system in urban and rural areas
Huaneng Tiancheng Financial Leasing Co., Ltd[14]	Green loan/ account receivable financing	June 2022	CNY187 mn	November 2021	• D1.3 Electricity generation from wind power
Trina Solar Energy Development Pte. Ltd.[15]	Green loan	September 2022	USD250 mn	June 2021	• D1.1 Electricity generation using solar photovoltaic technology • C2.4 Production of solar generators

9. https://www.hkex.com.hk/-/media/HKEX_Common/Market/Stage/Product-Page/Bonds/China-Construction-Bank-Corporation/40971_Green-Bond_20211222/40971_Preissuance-Attestation-Report_CECEP.pdf
10. http://s3gw.cmbchina.com/lb50.01-cmbweb-prd/cmbir/20220223/5702a65a-95b6-4937-8a0b-298ed85120ec.pdf
11. https://www.hkex.com.hk/-/media/HKEX_Common/Market/Stage/Product-Page/Bonds/Industrial-Bank-Co-Ltd-Hong-Kong-Branch/5234_Green-Bond_20220519/5234_Pricing-Supplement_20220511.pdf
12. The exact CGT activity code names (e.g. D1.1) are not explicitly mentioned in bond documentation, nor in the pre-issuance certification report issued by HKQAA. The CGT activities listed here are identified by report authors based on descriptions of the use of proceeds in the bond documentation.
13. https://pic.bankofchina.com/bocappd/report/202206/P020220608319443482227.pdf
14. https://www.db.com/news/detail/20220615-deutsche-bank-helps-huaneng-leasing-with-sustainable-trade-finance-aligned-to-china-s-common-ground-taxonomy?language_id=1
15. Company disclosure.

In the **offshore market**, we expect natural adoption of CGT by issuers and borrowers as an effective tool to tap international liquidity from banks and investors globally. This is further encouraged by regulators in mainland China evident in the recent launch of the China Green Bond Principles. According to the China GBP, green bond issuers can reference CGT or EU Taxonomy when selecting and evaluating green projects eligibility. Continuous regulatory efforts highlight the value of the CGT for offshore green bond issuances to attract broader investors.

For instance, as EU Taxonomy Regulation is mandating investors to disclose portfolio alignment to EU Taxonomy, the ability to select green projects that are in line or exceed EU's technical criteria will allow Chinese borrowers to gain support from these investors. The benefit of referencing CGT can lower the transaction costs incurred on all parties from issuers, underwriters, external reviewers and investors.

As **international companies** continue to expand its footprint in mainland China, and therefore would have the need for green financing in the RMB market to leverage China's 2030/2060 dual decarbonisation opportunities. Utilizing the CGT will allow multinationals to reach out to Chinese investors and banks who are active in supporting low carbon financing onshore.

However, two key elements under the EU Taxonomy, namely i) Do No Significant Harm (DNSH) and ii) Minimum Social Safeguards, are not covered by the China Taxonomy, and hence any claims for alignment with stricter requirements under the CGT will have to take this into considerations. The purpose of DNSH is to ensure that the sustainable activities are not penalizing any of the other environmental objectives under the EU Taxonomy, while the Minimum Social Safeguards refers to the 8 fundamental conventions of the International Labour Organization. While the China Green Bond Catalogue does not clearly spell out DNSH and Minimum Social Safeguards, it makes references to local environmental and labour regulations which would provide insights on the extent to which DNSH and Minimum Social Safeguards would be met. Examples of these include regulations governing water consumption, air pollution, hazardous waste, amongst others. As such, CGT should not be used on a standalone basis, but in conjunction with ICMA Green Bond Principles for offshore issuances or China Green Bond Principles in the domestic market in terms of governance of green bonds. The equivalent applies to the green loan markets.

TABLE 3 below shows the distribution of projects and loan proportion by CGT categories for the June 2022 green bond issued by Bank of China Frankfurt Branch.

CGT Categories	Number of Projects[9]	Loan Proportion[9]	CGT overlap scenario[16]
C5.3 Manufacture of energy-saving pumps and vacuum equipment	1	1.44%	China criteria are more stringent
C5.9 Manufacture of energy-saving transformers, rectifiers, inductors and electric welding machines	1	1.03%	China criteria are more stringent
D1.3 Electricity generation from wind power	7	46.78%	Areas with clear overlaps
D1.8 Storage of electricity	2	22.98%	Identifiable overlap
H1.1 Construction and operation of public transportation system in urban and rural areas	3	27.77%	Identifiable overlap

Note: Project List by CGT Categories as per the Bond's Appendix I document and Corresponding CGT Overlap Scenarios.

1.2.1.2 Re-labelling for outstanding green bonds

For outstanding green bonds, there are also opportunities to re-label those by making reference to the CGT including scenario outcomes (see scenario table in 1.2.1.1), as this may help expand the investor base/ appetite for such bonds in the secondary market.

This is especially relevant to the existing onshore green bonds pool that is held by domestic investors. With the ability to re-assess CGT alignment, it will provide a transparency boost in terms of green project quality in general, and can potentially generate interests from international investors absorbing some of these green bonds through channels such as Bond Connect and QFII.

Such re-labelling exercise could be explored by issuers voluntarily in the process of preparing annual post-issuance reporting and corresponding external review with minimal incremental cost. On the other hand, it is also possible and beneficial in fact for market watchdogs to assess CGT alignment as a top-down approach as they regularly monitor the green asset pools and promote market best practices in their respective jurisdictions.

16. CGT Table of Activities (updated): https://finance.ec.europa.eu/system/files/2022-06/220603-international-platform-sustainable-finance-common-ground-taxonomy-table-activities_en.pdf

1.2.2 Capacity building tool

CGT and associated documents could be used as a capacity building tool to help issuers/ borrowers understand the differences between Chinese and EU taxonomies and prepare them to structure future sustainable debt instruments with quantitative thresholds.

- **The CGT Instruction Report** provides a summary of the background of the CGT project (section 2.1 of the CGT Instruction Report), as well as the EU Taxonomy and China Green Bond Catalogue (section 2.2 of the same report). Issuers/ borrowers could develop a reasonable understanding of the two taxonomies without having to go through the lengthy taxonomy documents themselves, although the CGT does not include all the detailed requirements of the taxonomies.

- **The CGT Table of Activities** clearly lays out differences between taxonomies at activity level. Issuers can assess the level of environmental/sustainability performance that their potential projects and/or assets to be (re)financed by the proposed bond issuance(s) would be able to meet. Most importantly, for activities falling under categories covered by the CGT, issuers/borrowers can see whether they are meeting the more stringent criteria saved for the DNSH and Minimum Social Safeguards requirements.

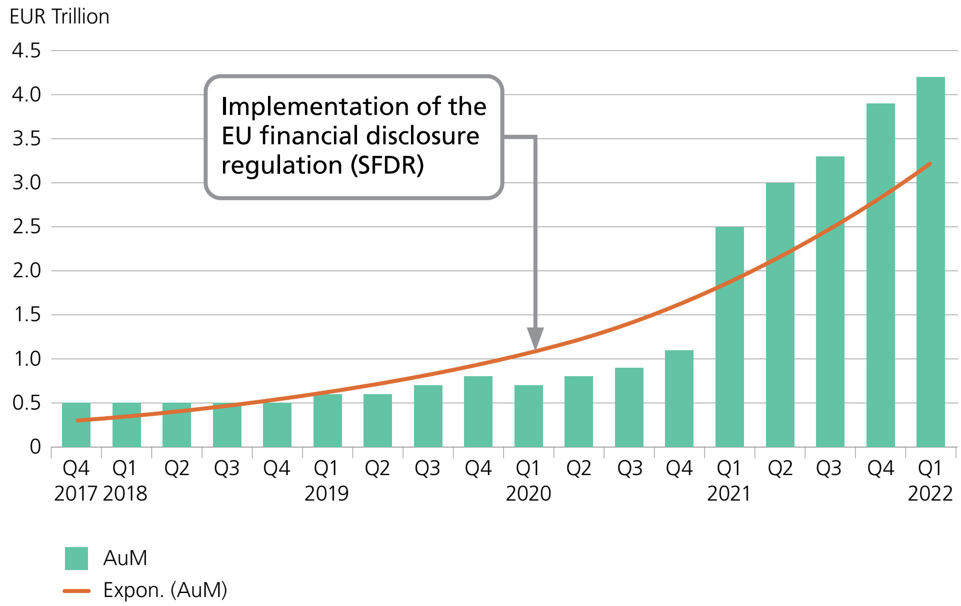
USE CASE 2: INVESTMENT STRATEGIES

2.1 USE CASE OVERVIEW

In this section, we examined the potential uses of the CGT in sustainability investments based on our analyses and various engagements with investors. We consider the CGT will contribute to bridge the understandings on ESG investments cross-border and improve investors' interests, particularly in Chinese onshore market as it develops.

According to Morningstar[17], the inflow to EU Article 9 funds ("dark green" funds with sustainable investment objective) has attracted inflows of EUR5.9bn in the second quarter of 2022, amid investor concerns over a global recession and inflationary pressures. At the same time, Article 8 funds ("light green" funds that promote environmental/social characteristics) bled EUR30.3bn while Article 6 funds (without a sustainability scope) suffered even more. 8 of the top 10 Article 9 funds track either EU Paris-aligned benchmarks or climate-transition benchmarks or alternative energy-themed indexes. They also noted Article 8 and Article 9 funds registered a higher proportion (60%) of new fund launches in Q2 2022.

FIGURE 1:
Trend of Article 8 Funds Since 2017 Q4

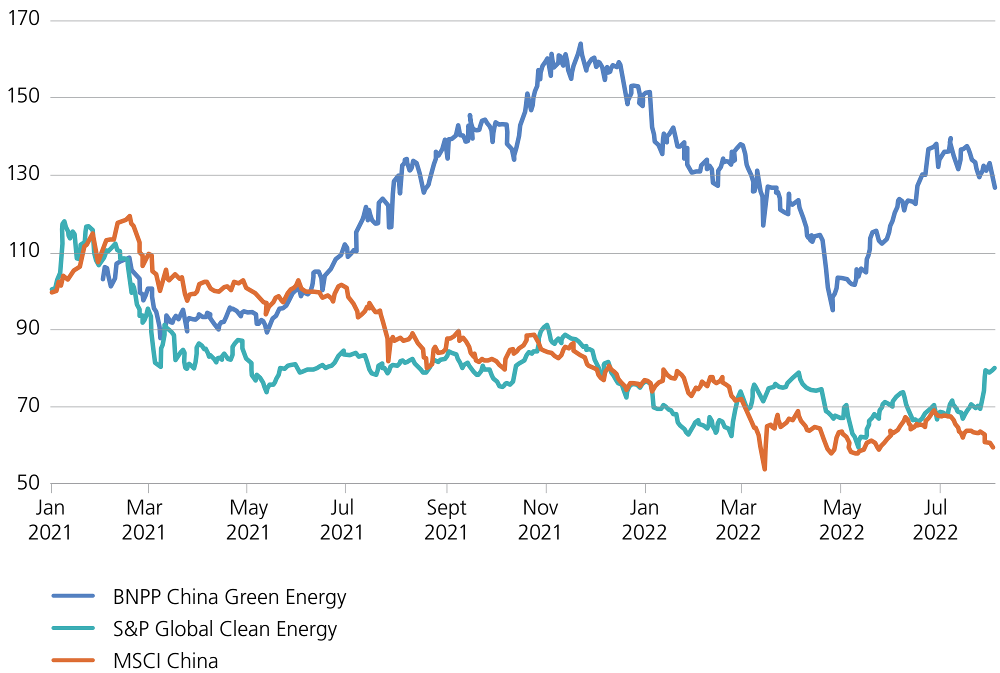


Source: BNP Research

17. https://www.morningstar.com/en-uk/lp/sfdr-article8-article9

Chinese sustainable assets should be particularly attractive for international investors and government policy continues to support the growing green bond market. As the world's second largest supplier of green bonds. Chinese bonds offer higher yield in general compared to some other regions, such as EU. Data from MSCI[18] also shows indexes of Chinese green bonds have outperformed the broad Chinese fixed-income market in recent years. In equities, BNPP China Green Energy Index has outperformed S&P Global Clean Energy Index by 47% since beginning of 2021, providing higher alpha generating opportunities.

FIGURE 2: Performance of Chinese Sustainable Assets[19]



Source: Bloomberg, BNP Paribas

18. https://www.msci.com/www/blog-posts/china-s-green-bond-market/03029315810#:~:text=For%20example%2C%20the%20ChinaBond%20China,Bond%20Index%2C%20at%204.30%25
19. BNP China green energy basket: China 2060: Monetising the green energy transition, dated 15 Dec 2020, https://markets360.bnpparibas.com/evo/contentp/rLHYs4Q

2.2 Detailing of Use Case

2.2.1 Harmonization of investment process

CGT could serve as a tool to harmonize investment process for cross border green finance flow across asset classes. During the investment selection phase, European investors could use the CGT as a guide to filter Chinese assets that are likely to fall under the scope of EU taxonomy, i.e. activities classified as "Areas with clear overlaps" (Scenario 1), "EU criteria are more stringent" (Scenario 2) or "China criteria are more stringent" (Scenario 3). This applies not only at individual security level, but to an entire portfolio construction, that some of the key investment criteria is to fulfil the above conditions. As CGT is considered to have the most straightforward application in the debt financing space, we may expect investment strategies to reflect the evolving market development to include CGT as key criteria in green credit funds going forward.

2.2.2 Equity selection tool

In addition to debt, CGT can be used in equities for the same benefits. The latest version of CGT allows investors to identify activities that are significant in addressing climate mitigation impacts, as such equity investors can use CGT as a scientific basis for stock and industry selection and portfolio development beyond the usual suspects of renewable energy and EV sectors. In Europe, we have started seeing financial participants implement similar strategy. For instance, the FTSE Russell's Green Revenues data model identifies companies providing green products and services and classifies revenues based a classification system that is highly aligned with the EU Taxonomy. The model has been used in FTSE Green Revenues Index Series[20]. Early voluntary adoption of taxonomy disclosures can also be an interesting proxy in search of alpha opportunities of companies making good initial progress on decarbonization.

2.2.3 Climate solutions in real assets

For real assets such as properties and infrastructure funds, CGT can play a role to support investors in quickly identifying credible climate mitigation solutions while investors still need to evaluate such real assets in a more holistic approach by factoring material ESG risk factors.

2.2.4 Engagement Framework

Beyond asset selection and portfolio construction, ESG engagement is another area that can potentially create value and impact for shareholders. Investors may use CGT as an effective tool to identify the alignment of the portfolio towards either EU or China taxonomies, and therefore to prioritize engagement approaches and solutions with investees accordingly.

20. https://www.ftserussell.com/products/indices/green-revenues

USE CASE 3: BENCHMARK AND INDEXES

3.1 USE CASE OVERVIEW

A CGT-based index provides an objective and robust measure to track the performance of a group of securities that are generally aligned with both the EU and China's definition of green investments. It offers benchmark reference to the market and encourages further product development that promotes cross-border sustainable capital flows.

This section explores the scenario of using CGT as a reference for index and benchmark purposes, illustrating its potential and challenges.

3.2 DETAILING OF USE CASE

3.2.1 Creating a Chinese CGT-aligned Green Bond Index

A Chinese CGT-aligned Green Bond Index tracks the performance of the Chinese labelled onshore CNY green bond universe, whose use of proceeds (UoP) are allocated toward assets and economic activities considered eligible in the CGT. Premised on Chinese onshore green bonds that are generally aligned with both the EU and China taxonomies, the index provides additional transparency, comparability and interoperability to the Chinese and the EU labelled bond markets, potentially facilitating greater access to Chinese green securities for international investors.

Establishing such an eligible universe of securities requires screening the outstanding Chinese labelled green bond universe against the CGT. It requires a screening methodology based on which a binary decision can be made on the securities to determine their index eligibility, with a clear definition of what it means by CGT alignment at the activity/project level.

Given that the CGT is based on an in-depth comparison exercise between the EU and China taxonomies, it offers granular, activity-level guidance on the comparability and interoperability of green definitions between the two jurisdictions. However, it is not a readily implementable screening tool. The creation of a screening methodology for the CGT-alignment index would require further adaptations and specifications, so that binary decisions would be possible from the assessment, especially in absence of metrics disclosure. For example, there may be lack of information and data from the Chinese issuers to justify alignment. Examples of such metrics include the Primary Energy Demand (PED), a numerical indicator of total primary energy use in kWh/m^2, as displayed on the Energy Performance Certificate (EPC) in Europe for constructions of new buildings activity. In such a case, a proxy or derived metrics using available disclosure in Chinese context may be adopted and clearly spelled out in the screening methodology document.

While the CGT has received plenty of attention from international capital markets and policymakers as a potential useful tool to identify alignment across jurisdictions, it is not a taxonomy covering all environmental objectives. Nor is it recognized by the EU or China as a legal document. Nevertheless, it offers the best interoperable approach available, even though there are still operational challenges derived from differing regulatory and governance regimes, and lack of eligibility measures based on outstanding areas such as DNSH considerations and Minimum Safeguards - this may hinder the CGT's recognition as strictly EU Taxonomy-aligned.

Several factors may further constrain the number of eligible securities, limiting the size of the pool to begin with: 1) The current version of the CGT covers 72 activities that fall into the climate mitigation area only. Chinese green bonds that address environmental improvement and more efficient resource utilisation objectives are not considered; 2) The Chinese green bonds whose use of proceeds are not 100% used for green projects will need to be excluded to meet the international standard. Although for the forthcoming issuances, the challenges brought forth by the discrepancy of use of proceeds requirements will be significantly alleviated with the recent introduction of China's inaugural **China Green Bond Principles**, which requires all green company bonds to allocate 100% of their proceeds to green projects.

Despite the aforesaid challenges, a pilot screening exercise is needed to assess the practicality and develop an adaptive methodology based on the CGT for index creation purposes.

The Chinese green bond market has evolved to be the second largest in the world. As the nation further opens up its capital market and integrates renminbi (RMB) into the global economy, international investors may look for better access to the RMB-denominated assets and tap into investment opportunities to fund China's transition to low carbon economy. A Chinese CGT-aligned Green Bond Index or index family offers the market a benchmarking point on the performance of Chinese onshore green bonds that are generally aligned with both EU and Chinese green definitions. It offers opportunities to create index funds or ETFs, that may lead to greater cross-border investment flow due to enhanced comparability and transparency for international investors.

3.2.2 International examples

Several series of green bond indexes have been created using Climate Bonds Initiative (Climate Bonds)'s Green Bond Database (GBDB) as a starting point to assess the index eligibility of prospective constituents. Examples included the S&P Green Bond Indices, FTSE Green Impact Bond Index Series, and the FTSE Chinese (Onshore CNY) Green Bond Index Series. Inclusion into the GBDB indicates the securities' general alignment with the Climate Bonds Taxonomy (the Taxonomy), an internationally recognised standard for green projects and activities. By doing so, it removes the noise from labelling standard differences amongst various geographies, allowing cross-market analysis and comparison by applying the same 'green' standard and screening methodology globally.

Climate Bonds screens self-labelled debt instruments from over 80 jurisdictions against the Methodology. Though based on the Climate Bonds Taxonomy and Sector Criteria, the Methodology has historically been adapted to allow assessment in the absence of metrics disclosure and/or third-party verification of metrics in various jurisdictions. For example, for some sectors where measurement is less of an issue (e.g., solar, wind) or metrics are typically met, the Methodology follows the Taxonomy closely; whereas for sectors where metrics are not readily available and/or reported metrics need further assessment, the Methodology uses adapted pragmatic approaches. The Methodology also tightens and converges disclosure requirement to the Sector Criteria periodically as data become more available. For example, screening criteria in buildings and transport have been tightened in the latest July 2022 version of the Methodology as the green bond market in these sectors becomes mature and the need to decarbonise becomes more pressing.

Overall, this practical approach has allowed effective assessment of eligibility when the data environment remained nascent and inconsistent across jurisdictions.

USE CASE 4: CORPORATE DISCLOSURES

4.1 USE CASE OVERVIEW

The first phase of the CGT maps the basic commonalities and differences between the green classification system adopted by the Chinese and EU jurisdictions. It will serve as a tool to guide interoperability between the two taxonomies and serve as a foundation to build on tailored criteria to factor in regional nuances. While there are clear limitations for the practical use of CGT in corporate disclosure, we expect some of the limitations to be addressed in the next development phase.

4.2 DETAILING OF USE CASE

4.2.1 Taxonomy-alignment in corporate disclosure

The green taxonomy has been primarily used for the assessment of green activities and investments, specifically, the alignment of the green bonds and green loans to green standards. Recently, an extension of the use of green taxonomy to potentially cover the corporate disclosure of individual companies has been observed in the EU region. Through integration of green taxonomy into corporate disclosure, corporates and the markets that they operate in could reap the benefits of:

A standardization of taxonomy-aligned disclosures: Reporting on activities that align with the CGT could improve transparency and comparability of corporate sustainability efforts through alignment with a common set of criteria. It would also support the mitigation of greenwashing activities by preventing unsupported claims due to lack of a common definition, rallying behind a lower standard, unproven claims, or green by association etc. The taxonomy will act as the fundamental cornerstone of a suite of future regulation to be launched by the regulators to improve and standardize sustainability reporting.

Sustainability strategy development: A standardized definition could provide clearer guidance to businesses assessing their own alignment to increase climate resilience and drive transition towards more environmentally sustainable activities and investments. Corporates can develop sustainability strategies that focus on increasing alignment to a common taxonomy to improve capital allocation to sustainable activities. It is an opportunity for corporates to develop in house expertise to understand how their business model fits into the local and regional taxonomies that they operate in, and for investors to understand their exposure to sustainable activities.

Attracting cross-border investment: Improve data availability, usability and credibility for information sharing in capital markets due to increased transparency, consistency and comparability of common definition, and justifying first-mover advantage for forward-looking companies. As other regions begin to enact regulations to integrate green taxonomy into corporate disclosure, businesses within regions with limited data availability to comply with foreign regulations will become less attractive.

4.2.2 Global example of taxonomy-aligned corporate disclosure – EU

In 2013, European Parliament first acknowledged the importance of businesses divulging information on sustainability, such as social and environmental factors. Development of corporate disclosure requirement accelerated with a view to promote "accountable, transparent and responsible business behaviour and sustainable growth.

Table 4:
Taxonomy-Aligned Corporate Disclosure Timeline

Release Date	In Effect	Main Context
2014	December 2016	The European Supervisory Authorities (ESA) first released the Non-Financial Reporting Directive (NFRD), requiring listed companies of more than 500 employees in the EU to release ESG reports and "mandatory disclose" environmental information.
2020	July 2020	European Parliament and of the Council published the Taxonomy Regulation (EU TR), setting out all financial entities, non-financial entities and market participants subjected to the original NFRD, shall report information on the proportion of the turnover, capital expenditure (CapEx) or operating expenditure (OpEx) that is associated with environmentally sustainable activities.
2021	March 2022	EU Commission adopted a proposal for a Corporate Sustainability Reporting Directive (CSRD) that amends the existing reporting requirements of the NFRD, and which all companies issuing securities on a regulated market (including SMEs) will be subjected to, as well as large companies meeting at least 2 of the following criteria: • More than 250 employees • Total balance sheet exceeding €20M • Total turnover exceeding €40M

EU Taxonomy will be integrated into mandatory sustainability reporting over a course of two years from 2022 to 2024. The EU TR and CSRD are the two main regulations to facilitate taxonomy-alignment. EU TR clearly states that all financial entities, non-financial entities and market participants subjected to the original NFRD, shall report on certain climate-related key performance indicators that is associated with environmentally sustainable economic activities. In 2021, the EU Commission further amends the NFRD to include more companies that the EU TR will be applicable to and introduces more detailed reporting requirements over the sustainability risks and opportunities for the remainder of the economy and sectors which are not directly covered by the Taxonomy.

4.2.3 Potential use of CGT in Hong Kong

Corporate disclosure for listed companies in Hong Kong has quickly stepped up in recent years. In 2012, 2015 and 2019, HKEX issued three versions of "Environmental, Social and Governance Reporting Guidelines", which gradually changed the requirements of key indicators in environmental, social and governance levels from "Voluntary Disclosure" to "Comply or Explain", and is expected to continue to shift towards "Mandatory Disclosure".

As of today, we have yet to see an attempt for the integration of a green taxonomy into the corporate disclosure processes. This situation could prevail till the development of a domestic taxonomy that aligns with CGT has been complete and could likely be part of the disclosure requirement revision in the next phase. However, we do expect Hong Kong to gradually progress towards taxonomy-alignment disclosure in the future as Hong Kong regulators step up to match international standards. In time, CGT could be a useful tool for companies with cross-border business operations to understand the differences across the two regions. Hong Kong businesses could also remain attractive to EU investors if they can refer to the CGT as a tool to assess if their GBA investments are EU taxonomy-aligned when the EU TR comes into total effect.

4.2.4 Potential use of CGT in GBA

A significant milestone took place in May 2020, where the People's Bank of China, together with the National Development and Reform Commission and the Securities and Supervision Commission, drafted the Catalogue of Green Bond Endorsed Projects (2020 Version).
The Mainland China continues to adopt the principle of "Voluntary Disclosure" for listed companies in terms of the publication sustainability or corporate social responsibility reports, and the industry expects the "Mandatory Disclosure" standards to be released in near future. As disclosure requirements step up locally, we also expect to see further integration of the Chinese Green Bond Catalogue or CGT into the corporate disclosure processes to meet international standards

USE CASE 5: INVESTORS DISCLOSURES

5.1 USE CASE OVERVIEW

The growth of ESG Investing in recent years have also brought about increasing investors' concerns on greenwashing risks and increasing regulatory policies and activities. Globally, Morningstar removed the sustainable label from more than 1,200 European funds totaling $1.4T USD in assets after an internal review of the fund's legal documents and disclosures[21]. Within Asia, this has been a topic raised by governments and regulators including PBOC Governor Yi Gang raising about "moral hazards" of greenwashing[22], SFC's Ashley Alder mentioning on "mounting concerns on greenwashing"[23] and Singapore Deputy Prime Minister Heng Sweet Keat commenting on the "magnitude of greenwashing"[24].

Against this backdrop, taxonomies could potentially play an interesting role in ESG Fund Disclosures and regulations on investors and financial institutions by serving as a reference standard on defining sustainable investments and business activities and help with:

- **Standardization:** Standardized definitions of what can be considered as sustainable can be fed into requirements on ESG fund labelling and ESG disclosures (metrics and content); allowing for more consistent standards in ESG investments
- **Comparability:** Having the same reference standard allows better comparability across both individual issuers or holdings as well as at an investment funds or portfolio level.
- **Greenwashing:** Address greenwashing risks related to investments in sustainable funds or products by having clear disclosure requirements backed by the taxonomy

5.2 DETAILING OF USE CASES

In line with objectives detailed, a CGT-based Taxonomy in Hong Kong can then feed into corresponding investor related disclosures in both Hong Kong and other regions in GBA. As a caveat, taxonomies are just one way or approach that can be used in the following investor disclosures; there are also other ways to define sustainable investments.

5.2.1 Use Cases in Hong Kong

5.2.1.1 ESG Labelled Funds Disclosures:

- **Scope:** Investment funds in Hong Kong marketed as "ESG Funds", such as those defined in SFC's existing Circular on ESG Funds[25] as funds "which incorporates ESG factors as their key investment focus and reflect such in the investment objective and/ or strategy". Given the various fund regulators in Hong Kong (including but not limited to SFC, MPFA), adoption would have to be embedded within each regulator's ESG regulations or guideline.

21. FT Morningstar cuts 1,200 funds from sustainable list https://www.ft.com/content/9cf8c788-6cad-4737-bc2a-2e85ac4aef7d
22. PBC Governor Yi Gang CGTN Interview http://www.pbc.gov.cn/en/3688110/3688172/4437084/4587509/index.html
23. SFC Ashley Alder PRI Speech https://www.sfc.hk/-/media/files/ER/PDF/Speeches/Speech-27-May-2022.pdf
24. MAS Heng Swee Keat Speech https://www.mas.gov.sg/news/speeches/2022/speech-by-mr-heng-swee-keat-deputy-prime-minister-and-coordinating-minister-for-economic-policies-at-the-opening-of-point-zero-forum-on-22-june-2022
25. SFC Circular on ESG Funds https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/products/product-authorization/doc?refNo=21EC27

- **Requirements:** Generally, the key parts to ESG Fund Disclosures include
  – **I. ESG Fund Name or Label:** For a fund to market itself as an ESG fund in its fund name, there are minimal requirements in how the fund's holdings should be aligned to that in which it's marketed for. Typically as seen in some jurisdictions regulations, a quantitative criteria might be applied, where a minimum % of a fund's holdings must be in certain ESG or sustainable investments based on the fund's ESG focus. Taxonomies thus become a potential reference standard in defining what can be constituted as sustainable investments.

  – **II. ESG Fund Disclosures:** Typical ESG Fund would then be required to disclose on items such as ESG Fund Focus, ESG Investment Strategy, asset allocation in the fund and reference benchmarks[26]. Taxonomy could again serve as a helpful standard in each of these applications:
    - <u>ESG Fund Focus and Strategy</u>: Funds would normally have a clear ESG objective or characteristics that in turn translates into the actual strategy (where issuers are selected or excluded based on these ESG criteria).
    - <u>Asset Allocation</u>: Proportion of portfolio holdings aligned with taxonomy can also be a proxy indicator to evaluate minimum amount of asset allocation in support of the ESG focus of the fund.
    - <u>Reference benchmarks</u>: Index selected as reference benchmarks for the fund can also use taxonomy as part of the index construction methodology.

5.2.1.2 General Taxonomy-alignment Disclosures

- **Scope:** All investment funds regulated by different regulators in Hong Kong. For example, SFC's management and disclosure of climate-related risks applies to all fund managers managing collective investment schemes.

- **Requirements:**
  – **Taxonomy Alignment Disclosures:** This basically requires all funds in scope to disclose the degree of taxonomy alignment within the existing fund's holdings.

5.2.1.3 Marketing of ESG Products

- **Scope:** Typically such regulations apply to fund managers and advisors and their clients

- **Requirements:** Managers would need to obtain a client's sustainability preferences and only investments that meet sustainability criteria can be recommended to clients. Taxonomy can be a way to meet definition of sustainable investments.

5.2.2 Use Cases in GBA

ESG Labelled Funds in GBA

Similar application as that in Hong Kong, taxonomy can help become a standard for ESG fund labelling and ESG fund disclosures.

26. SFC Circular on ESG Funds https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/products/product-authorization/doc?refNo=21EC27

Global Examples

European Regulations

Regulation	Scope	Requirements	Evaluation for GBA
Taxonomy-aligned disclosures	All investors and funds	Report % of current alignment of investments to taxonomy Issuer A - 20% · Issuer B - 5% · Issuer C - 10% Aggregated Fund Portfolio Alignment - X%	More applicable for corporate disclosures; for investors addressed through ESG Fund disclosures
Sustainable Investments	All funds marketed as ESG Funds	• Define sustainability objectives with taxonomy as framework • Criterias to meet to term as "sustainable" - Contribute to taxonomy objectives - DNSH - Minimum ESG Safeguards - Technical screening criteria • Report % of investments aligned to taxonomy **Objectives investments contribute to** Fund objectives: objectives A, objectives B → Taxonomy Objectives **Proportion of investments aligned** Issuer A - 20%, Issuer B - 20% → Fund - X% **Additional Criterias**: DNSH · Min Safeguards	Applications for ESG Fund Disclosures would be an important priority though the exact approach (i.e. whether to use taxonomy or other reference standards) and factors (DNSH, minimum safeguards) require discussion
Sustainability Preferences	All clients	Incorporate "sustainability preferences" in investors suitability rules **One of 3 approaches:** **EU Taxonomy** minimum proportion be invested in environmentally sustainable investments as defined in Taxonomy Regulation **Sustainable Investments** minimum proportion shall be invested in sustainable investments as defined in SFDR **Principal Adverse Impacts** considers principal adverse impacts on sustainability factors	Requires fitting into existing suitability regulations

Regulations from other regions

Region	Key Regulations
Hong Kong	**SFC Circular on ESG Funds**[27] • Scope: SFC authorized funds which incorporate ESG factors as key investment focus as reflected in investment objective/ strategy • Requirements: - Fund Name should accurately reflect ESG features of the fund - Fund disclosures should include ESG focus of fund, ESG investment strategy, asset allocation commensurate with fund's ESG focus, reference benchmark • Note: Taxonomies not explicitly referenced in current guidelines but can be used to meet requirements such as on defining asset allocation criteria
Singapore	**MAS Disclosure and Reporting Guidelines for Retail ESG Funds**[28] • Scope: ESG Retail Funds registered with MAS • Requirements: - Fund Name used should be reflected in investment portfolio if name includes ESG related terms - Minimum portfolio threshold should be at least 2/3 of scheme's NAV - Additional disclosures on prospectus, annual reports and additional information • Note: Singapore or ASEAN taxonomy is not explicitly referenced in the guidelines; however such taxonomies can be one way to meet some of the disclosure requirements
US	**SEC new proposals:**[29] • ESG in Fund Names: Propose to amend "Names Rules" to ensure fund reflects investment strategy; fund manager need to invest at least 80% of portfolio in particular type of investment • ESG Fund Disclosures: Disclosure requirements for 3 types of ESG Funds – Integration Funds, ESG-Focused Funds, Impact Funds • Note: There's again no specific references to taxonomies but taxonomies can be an approach that feeds into defining sustainable investments for fund labelling and fund disclosure purposes.

27. SFC Circular on ESG Funds https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/products/product-authorization/doc?refNo=21EC27
28. MAS Disclosure and Reporting Guidelines for Retail ESG Funds https://www.mas.gov.sg/-/media/MAS/Regulations-and-Financial-Stability/Regulations-Guidance-and-Licensing/Securities-Futures-and-Fund-Management/Regulations-Guidance-and-Licensing/Circulars/CFC-02-2022-Disclosure-and-Reporting-Guidelines-for-Retail-ESG-Funds.pdf
29. SEC Proposed Enhanced Disclosures SEC.gov I SEC Proposes to Enhance Disclosures by Certain Investment Advisers and Investment Companies About ESG Investment Practices

USE CASE 6: POLICY SETTING

6.1 USE CASE OVERVIEW

Policy decisions are critical for incentivizing markets to move toward green and sustainable financing and the realization of sustainable development goals (SDGs). In general, referencing CGT in policy setting is expected to produce outcomes in two dimensions: 1) formulating integrated incentive mechanism for CGT adoption across GBA, and 2) accelerating mutual recognition of regional regulatory and supervisory practices regarding sustainable finance-related activities in Hong Kong, Mainland China, and the broader global market.

6.2 DETAILING OF USE CASES

6.2.1 The EU Taxonomy Regulation and Delegate Acts

The European Union (EU)'s experience in formulating the Taxonomy Regulation[30] framework is a critical reference for other jurisdiction to explore about how CGT can be incorporated into policy initiatives for incentivizing and regulating sustainability-related activities. Beyond providing common definitions for environmentally sustainable activities as a classification system, the EU Taxonomy is linked with supervisory practices and incentive schemes through the delegate acts and incorporation into the existing label frameworks.

In 2021, the European Commission adopted the "the Disclosures Delegated Act"[31] of the Taxonomy Regulation, which mandates large financial and non-financial companies to provide information to investors about the environmental performance of their assets and economic activities. Apart from direct usage in terms of mandatory disclosure, there are ongoing policy initiatives in EU which intend to link developing standards and labels, including EU Ecolabel, EU Green Bond Standards, and EU Climate Benchmarks Regulation, to taxonomy aligned activities[32].

Similarly, regulators in the GBA should also consider utilizing CGT into the ongoing and existing policy frameworks while EU's practice can be a reference for policy-making and implementation.

30. Regulation (EU) 2020/852 of the European Parliament and of the Council of 18 June 2020 on the establishment of a framework to facilitate sustainable investment, and amending Regulation (EU) 2019/2088: https://eur-lex.europa.eu/legal-content/EN/TXT/?uri=CELEX:32020R0852
31. The Delegated Act supplementing Article 8 of the Taxonomy Regulation: https://eur-lex.europa.eu/legal-content/EN/TXT/PDF/?uri=CELEX:32021R2178&from=EN
32. FAQ: What is the EU Taxonomy and how will it work in practice?: https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/sustainable-finance-taxonomy-faq_en.pdf

6.2.2 China – National-Level Initiative

6.2.2.1 The China Green Bond Principles

The China Green Bond Principles[33] ("the Principles") was officially launched by the Green Bond Standards Committee on 29th July 2022. The Principles stress that verification of "Green projects" should be based on the Green Bond Endorsed Project Catalogue (2021 Edition)[34]. Green projects owned by offshored issuers should be verified based on internationally endorsed sustainable taxonomies including the CGT and the EU Taxonomy. The Principles emphasizes its alignment with the global standards, especially with the principles issued by International Capital Market Association (ICMA). Notably, the Principles rule that green bonds must use 100% of proceeds on valid green projects. With consideration of local implementation and coordination with the global markets, the incorporation of CGT criteria into the Principles is a significant step forward for China to provide policy guidelines on CGT adoption.

6.2.2.2 Supervision on Green Lending Performance of Financial Institutions – Mainland China's Practice as Reference

In 2013, the China Banking Regulatory Commissions (CBRC)[35] issued the assessment framework of green lending performance to be applied for mainstream banks with a variety of background in China. The Guideline to Green Lending Performance Information Disclosure (绿色信贷统计信息披露说明)[36] broadly identifies a list of valid green lending-related activities with KPIs covering credit balance, asset quality and the environmental impacts of the funded projects. In July 2021, the People's Bank of China (PBOC) introduced a green finance performance assessment framework[37] specifically applied to the domestic banking financial institutions. The assessment result of green finance performance will be integrated into PBOC's general rating framework applied to the financial institutions to access financial risks.

Both the assessment practices by CBRC and PBOC indicate requirements on the quantity and quality of green finance-related transactions made by the respective entity, powerfully incentivizing the development of green finance market in mainland China. In this sense, for regulators in Mainland China, CGT can be integrated into the existing assessment frameworks as a reliable classification system to accelerate the domestic market's alignment with the global standards. **For regulators in Hong Kong and Macau, similar assessment framework could also be developed with reference to the practices in Mainland China, as a measure to supervising green lending performance of the local financial institutions.**

33. Announcement by the Green Bond Standards Committee [2022, Issue 1]: http://www.nafmii.org.cn/ggtz/gg/202207/P020220729683303814431.pdf
34. China Green Bond Endorsed Project Catalogue (2021 Edition) http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/4342400/2021091617180089879.pdf
35. The CBRC was merged with the China Insurance Regulatory Commission to form the China Banking and Insurance Regulatory Commission (CBIRC) in April 2018.
36. Guideline to Green Lending Performance Information Disclosure: https://www.cnfin.com/upload-xh08/2018/0209/1518175073876.pdf
37. Green Finance Assessment plan for Banking Financial Institutions (銀行業金融機構綠色金融評價方案): http://www.gov.cn/zhengce/zhengceku/2021-06/11/5616962/files/ad23a21fbf414d2facb1dfdb623f560d.pdf

6.2.3 Detailing of Regional Use Case in the GBA

Regional contexts in terms of status of local green finance market development and local industrial structure should be carefully considered when translating the national-level initiatives of CGT adoption into regional implementation.

Potential regional use cases can be detailed in Guangzhou, Shenzhen and Hong Kong which has been active in promoting cross-regional bond issuance, mutual recognition of green finance standards and services and adoption of CGT in the GBA context. Notably, for issuers in Mainland China, policy support should focus on issuance targeting Hong Kong and the global market.

Policy use cases of CGT in the GBA context can be detailed in three dimensions:

- **Incentive mechanisms for CGT-based green and sustainable bond issuance should be introduced.** Policy incentives for CGT adoption could deliver strong signal to the market for pursuing more proactive usage and utilization of the CGT criteria. Cross-regional bond issuance between Mainland China and Hong Kong can also be better facilitated with policy incentives built upon a common language. Notably, for GBA regions such as Shenzhen, Guangzhou and Hong Kong where have already developed decent level of maturity in operating green finance-related incentive mechanisms, the suggested approach to introduce CGT-based incentives is to incorporate the CGT criteria into the existing incentive frameworks rather than creating the standalone CGT-referencing framework. With this approach, administration costs of policy formulation can be lower, and the incentive mechanism can be implemented in a timelier manner.

- **For GBA regions where there has yet developed green finance-related incentive framework**, the local authority may consider incorporating CGT into the existing incentive framework for general financial activities. On the other hand, CGT should be considered as a valid baseline when formulating more specialised incentive framework for green and sustainable finance-related activities.

- **Coordination of policies in Hong Kong, Macau and Mainland is critical.** Regulators in Mainland and Hong Kong should have more active communication when formulating policies supporting the adoption of CGT. An integrated policy framework can be more efficiently facilitated while authorities in Mainland China, Hong Kong and Macau can make full use of the respective regional strengths in regulatory practices.

Specific policy setting use case illustrations where CGT can be referred in different regions of GBA are presented in the table below.

Guangdong – Provincial-Level	**Notice of Issuing the Implementation Plan for the Green Finance Development in Support of Carbon Dioxide Peaking in Guangdong ("the Action Plan") (关于广东省发展绿色金融支持碳达峰行动实施方案的通知)[38]** Issued in June 2022, the Action Plan proposed establishment of repository for green bond projects and service centre of green bond issuance, so that mainland GBA entities can be better supported to issue green bonds in Macau and Hong Kong. Mutual recognition of environmental disclosure requirements, green finance product framework, green business project verification standards, green credit rating and green bond standards among Mainland, Hong Kong and Macau are regarded as a critical mission. Therefore, CGT as a common language and common classification system is critical for developing the integrated green finance ecosystem.
Guangzhou – Municipal-Level	**Implementing Opinions for Promoting Green Finance Reform and Innovation in Guangzhou ("the Opinion") (关于促进广州绿色金融改革创新发展的实施意见)[39]** Issued in July 2019, the Opinion suggests granting one-time subsidy to 10% of the costs derived from green bond issuance in stock market and interbank market by corporates. Currently, the policy is only applicable for domestic green bond issuance. Subsidy to overseas issuance can be facilitated if CGT can be incorporated into the screening criteria.
Shenzhen – Municipal-Level	**Implementing Opinions for Establishing the Green Financial System ("the Implementing Opinion") (关于构建绿色金融体系的实施意见)[40]** Issued in December 2018, the Implementing Opinion proposes to grant subsidy to local green bond issuers using its financial development budget. The 3-year scheme starting from January 2019 is under ongoing amendment, where internationally endorsed standards like CGT can have a chance to be referred.
Hong Kong – SAR-Level	**The Green and Sustainable Finance Grant Scheme ("GSF Grant Scheme") by Hong Kong Monetary Authority (HKMA)[41]** The GSF Grant Scheme aims at supporting eligible green bond issuance in general issuance costs and external review costs. While green bond issuances are currently verified by the recognized external reviewers, CGT can be considered as one of the baselines for external verification, or explicitly incorporated into the guideline on the grant scheme for better facilitating cross-regional policy coordination and providing a signal to the global market that the eligible issuance under the GSF Grant Scheme is aligned with the global standards. **Government Green Bonds[42]** The Government Green Bond Framework sets the proceeds raised will be credited to the Capital Works Reserve Fund to finance or refinance green projects that provide environmental benefits and support the sustainable development of Hong Kong. Therefore, CGT can be a valid reference for identifying credible projects using fund raised by the Government Retail Green Bonds.

38. https://www.gd.gov.cn/xxts/content/post_3972535.html
39. http://www.zc.gov.cn/zx/ztjj/gaqnlsfzxdjh/content/post_5581425.html
40. http://www.sz.gov.cn/zwgk/zfxxgk/zfwj/szfwj/content/post_6577287.html
41. Guideline on the Green and Sustainable Finance Grant Scheme: https://www.hkma.gov.hk/media/eng/doc/key-information/press-release/2021/20210504e4a1.pdf
42. Hong Kong SAR Government Retail Green Bonds: https://www.hkgb.gov.hk/en/greenbond/retailbackground.html

KEY CONSIDERATIONS

In the implementation of taxonomies into practices and policies, certain key considerations that might pose challenges for the identified users should be considered. These include:

1. **Data Considerations:** Effective adoption of CGT as a basis of a taxonomy will require adequate data availability and standardization.

- **Data availability:** Investors have shown concerns over the availability of ESG data. EU is set to implement mandatory disclosure requirements from 2023 following Corporate Sustainability Reporting Directive including on taxonomy-aligned disclosures, while similar disclosure rules are not mandated in China yet. Investors have observed an overall lower level of ESG information disclosure in China compared to other developed markets, mainly due to an absence of regulation at this front, and a limited understanding from Chinese companies about what and how to disclose. Effective usage of the CGT will require adequate taxonomy disclosures by companies that would be dependent on voluntary adoption in sustainability reporting or disclosures-related regulations.

- **Data standardization:** A lack of standardized metrics and quantitative thresholds is another challenge for cross-region comparison and alignment. Indicators or metrics to measure the green or environmental performances of projects might not be aligned between EU and China. For example, the CGT document mentions the differences in building codes, regulations to measure building energy consumptions. Sectors across different countries are difficult to compare against, and standards tend to vary across regions. This can continue to challenge the data standardization given different local practices. Consistent and comparable metrics across regions will bring clarity to investment decisions.

- **Data capabilities:** Using taxonomy to meet disclosure requirements signify the need for investors to develop data capabilities with taxonomy-aligned data disclosures. Corporates and investors need to develop non-financial data regimes needed for assessing taxonomy-alignment and it is essential that they have data capability or at least a timeline for engaging external stakeholders to build new workflows to accommodate such needs before taxonomy-alignment can be regulated. This requires working with new data providers and developing new technology tools and platforms.

- **Market stage of disclosures:** Actual taxonomy-aligned disclosures or reporting by current issuers might also be low currently. With mandatory taxonomy disclosures in EU for corporates only phasing in later, this might make it difficult for investors to meet taxonomy disclosure requirements initially.

2. **Interoperability:** Interoperability across different taxonomies would also be a key consideration

- **Interfacing with other taxonomies:** when the end universe in question i) discloses with reference to another taxonomy or ii) does not have a taxonomy reporting, there needs to be ways to address interoperability issues

- **Different technical screening criteria:** Technical screening criteria under the two taxonomies may be different, e.g. the EU Taxonomy has CO_2 equivalent emissions as key criteria for many categories while the China Green Bond Catalogue is more focused on "industry-specific green standards" and criteria set by regulatory authorities[43]

- **Interoperability framework:** As CGT per se is not a legal document, interoperable bond issuance framework should be established through policy setting to ensure that verification, planning and issuance of green bonds by the Mainland China entities within the GBA are aligned with CGT as well as regulatory standards and requirements in Hong Kong.

3. **Future developments:** While CGT is a good initial mapping exercise to identify convergence across EU and China's taxonomies, in the longer term there are various potential areas of future developments.

- **Activity areas:** The first stage of the CGT document comprises 79 activities across six sectors that contributes to climate mitigation activities, i.e. carbon emission reduction or sequestration. In future CGT can move towards a wider range of economic activities. The six sectors from CGT are extracted from China Green Bonds Catalogue that primarily focus on climate mitigation, and adaptation activities are not yet included in the document. EU taxonomy already considers climate adaptation as one of the environmental objectives, and Chinese Policy[44] intends to include adaptation activities in future taxonomy development. We expect additional activities and sectors under climate adaptation to be assessed and aligned between EU and China and enhance the usability towards broader investment products.

- **Jurisdiction coverage:** The CGT is currently limited to the Chinese and EU jurisdiction and does not address comparability issue with other regional taxonomies. As other jurisdictions could be added as the CGT develops, the CGT would be capable of multiple comparisons and account for transitional activities of developing economies with slower decarbonization pathways. Regional contexts in terms of local green finance market development and local industrial structure should be carefully considered when translating the higher-level initiatives of CGT adoption into regional implementation. Support from the IPSF in terms of continuous review and consultation on the CGT activities table and methodology will also be critical for the harmonization to ensure usability.

- **Other considerations:**
  - <u>DNSH & Minimum Social Safeguards</u>. Other eligibility features such as DNSH and minimum safeguards could also potentially strengthen comparison and interoperability between jurisdictions. It would be interesting to analyse the alignment of China local environmental regulations with DNSH requirements in the EU.

43. European Commission CGT Update https://ec.europa.eu/info/sites/default/files/business_economy_euro/banking_and_finance/documents/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf
44. https://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202206/W020220613636562919192.pdf

- Considerations on transition activities: The current CGT can also consider transition activities against different regional decarbonization roadmaps. These activities might not significantly contribute to existing environmental objectives, but support a consistent pathway towards decarbonization. Such transition activities are more essential to countries like China where the economic development is still highly fossil-fuel dependent, and could still rely on hard-to-abate sectors in the foreseeable future.

4. **Integration of CGT in the local regulatory regime:** Taxonomies on its own is more of a reference standard, eventual adoption and scaling of usage would often rely on embedding taxonomies into regulations and policy. In the recently announced *China Green Bond Principles*, which is a self regulatory framework introduced by China's green bond standardization committee, the CGT has been stated as one of the standards to identify green projects by panda bond issuers, along with the *EU Taxonomy Climate Delegated Acts*. This reflects one type of recognition of the CGT into the Chinese regulatory frameworks. Future integration of the CGT into the regulatory regime of the local jurisdiction would further enhance the credibility, operability, and the market uptake of CGT-based green indexes.

   In sum, taxonomies are living documents that reflect technological development and coverage expansions. The same applies to the CGT and ongoing review of the standards and eligibility criteria would be critical in the longer-term.

CONCLUSION

In this Phase 2 Report we examine the key potential usage of the CGT in Hong Kong and the rest of GBA, looking specifically at 6 potential use cases based on industry experiences with taxonomies globally. In particular, we also examine key considerations that different users would need to reflect in the adoption and scaling up of the CGT. CGT is a useful analytical tool and significant frame of reference with financing and investment activities, regulation, disclosures and policy setting. On the other hand, jurisdictions may consider developing taxonomies with reference to CGT, to further drive the global harmonization of sustainable finance.

Future research would focus on how these use cases can be carried forward to the market with the potential development of a Hong Kong taxonomy based on CGT and how that can fit into Hong Kong's broader sustainable finance policy and regulatory framework.