Global Witness's recommendations on the proposed revisions to the Law of the People's Republic of China on the People's Bank of China and the Law of the People's Republic of China on Commercial Banks by the Bank of People's Republic of China

At the United Nations General Assembly in late September, the Chinese President Xi Jinping made an important commitment to the world – that China would reach a carbon emissions peak by 2030 and be carbon neutral by 2060. To meet such ambitious targets, every level of China's economy and society will need to undergo structural change.

The People's Bank of China together with financial regulators from many different countries have jointly initiated the establishment of the Central Banks and Supervisors Network for Greening the Financial System (NGFS). NGFS clearly states that the risks brought about by climate change will have lasting effects on important economic and financial variables, and that central banks and financial regulators must respond to the major risk of climate change influencing financial stability.[i]

At the close of the fifth plenary session of the 19th Central Committee of the Communist Party of China this October, it was announced that one of China's next focus points would be the "advancement of a complete green transformation of the economy and society".[ii] The Central Committee and Government have already identified the pivotal role that the financial sector, and banking in particular, plays towards green transformation. Over the years, China has adopted many practices within the green finance sphere, with policies and regulations that form a world-leading green finance system. China has recently issued guidance on climate change investment and financing that correspond to the climate commitments made by the top leadership,[iii] providing the financial sector with a clear policy direction.

However, at present, China's green finance system is mainly reflected at the soft law level – e.g. departmental rules and policies – which often lack corresponding legal responsibility provisions. Some of the policies or rules contain prohibitive clauses, but no liability provisions if the clause is violated, or provisions that are vague. To advance the establishment of the rule of law for green finance, it is necessary to go further and – on the basis of existing policies and regulations – improve the role of hard law, define the legal responsibilities of financial institutions and propose targeted disciplinary measures.

To achieve this, the "Law of the People's Republic of China on the People's Bank of China" (People's Bank of China Law) and the "Law of the People's Republic of China on Commercial Banks" (Commercial Bank Law), as major components of the top-level

design of the financial rule of law, should have the concept of green finance integrated in from the macro level; climate and environmental risks should be incorporated into macroprudential management and risk supervision; and the responsibilities and obligations banks must undertake to implement ecological civilisation and adhere to the ecological redline policy should be specified.

<u>Exploration within China</u>

Currently, practical steps are being taken within China with regard to the environmental liability of banks. In 2018, after the environmental NGO Green Home of Fujian brought an environmental civil public interest litigation case against a polluting enterprise in Hubei's intermediate court, they brought charges against the Yicheng (Hubei) branches of the Agricultural Bank of China and the Rural Commercial Bank too. In an interview, the lawyer representing Green Home of Fujian brought up the concept of "the lender's environmental legal responsibility": namely, if lenders such as commercial banks fail to fulfil compliance reviews – deliberately or not – which result in funds being lent to polluting companies that go on to cause environmental damage, the lender will bear the related liability.

This lawyer pointed out that the reason the abovementioned legal case attracted such wide national interest was because Chinese banks tend to disregard environmental laws and regulations, regularly granting loans to polluting companies. The fundamental reasons banks have overlooked environmental liability for such a long time is a lack of robust corresponding laws. For example, both "Opinions on implementing environmental protection policies and rules and preventing credit risks[iv]", issued in 2007 by three government departments including the former State Environmental Protection Administration, and "Notice on issuing green credit guidelines[v]", issued in 2012 by the China Banking Regulatory Commission, contain provisions about the banking sector's environmental liability. However, the above opinions and notices serve as guidance documents rather than the legislative law of department rules, have a low level of effectiveness, are unenforceable, and are unable to act as a basis for directly issuing administrative punishments to banks.

Therefore, the representing lawyer recommended that content regarding "resource conservation and environmental protection" be added to the Commercial Bank Law by amending Article 8 of its General provisions to read "When commercial banks conduct business, it should be advantageous to conserving resources and protecting the environment; it should comply with the law and to related provisions of administrative regulations, and should not be harmful to national or public interests." To paragraph 1 of Article 35 of Basic rules governing loans and other businesses, he recommended including: "Loans shall not be granted to clients with uncompliant environmental and social conduct." Alongside this, relevant legal responsibilities should be included under administrative responsibilities for the Commercial Banking Law and the Banking Supervision Law.[vi]

<u>Relevant international experience</u>

Globally, it is a growing trend to regulate the financial sector's impacts on the climate, the environment and society, to guide the sector to play an active role in green and sustainable development worldwide.

In recent years, there has been a rise in the number of cases where legal practise has been used to explore the boundaries of environmental liability of the banking sector. In 2017, the shareholders of Australia's Commonwealth Bank filed a lawsuit against the bank in federal court, claiming it had failed to properly disclose how climate risks would affect business. The Commonwealth Bank immediately published in its annual report that climate risks had a substantial impact on its corporate strategy and promised to carry out a climate change scenario analysis, following which, its shareholders withdrew their lawsuit[vii]. This is the world's first example of a lawsuit being raised against a bank for not carrying out adequate climate risk management. Since then, analysis carried out by London School of Economics and Political Science has shown that there was more climate litigation against banks worldwide in 2018 than in any previous year. Some cases were directly to do with fossil fuel, some were similar to Australia's Commonwealth Bank case, where shareholders filed lawsuits against financial institutions such as banks for failing to put climate risks at the core of their decision-making mechanism and failing to making truthful climate disclosures to associated parties.[viii]

At the same time, increasingly robust research was carried out about the specific role the banking sector plays regarding climate and environmental issues. This is also in light of increased awareness of the sizeable climate-risks associated with land use, biodiversity loss and deforestation – as highlighted in the Intergovernmental Panel on Climate Change 2019 report[ix]. For example, an international non-profit organization Global Witness has dedicated itself in recent years to investigating the forest footprints of global financial institutions. A 2019 report analysed the financial flows into the six large agricultural commodity companies responsible for extensive deforestation within the world's three major rainforests (Amazon, Congo Basin and New Guinea). It revealed that the Bank of America, Deutsche Bank, HSBC, Santander and the Standard Chartered Bank were among the global financial giants that between 2013 and 2019, directly or indirectly, provided tens of billions of US dollars to companies responsible for destroying the world's largest rainforests.[x] The production of agricultural commodities such as soya beans, palm oil and beef is the major driver of global deforestation. Another research shows that between 2010 and 2015 Brazil's soya bean production and exportation alone was responsible for about 223 million tons of carbon emissions[xi], close to Spain's total carbon emissions for 2017.[xii] Brazil exports most of its soy to China. A report released in 2019 finds at least US$2.1 billion of loans made by Chinese financial institutions to Chinese companies in the soy supply chain are exposed to deforestation risks[xiii]. An open database suggests that Chinese banks provide financing to companies involved in palm oil, rubber, paper and beef productions and trade, which are often linked to deforestation globally[xiv].

More importantly, different countries and regions are using legislative measures to more effectively regulate and guide the financial sector. For example, a new European Union regulation obliges the financial sector to make sustainability-related disclosures [xv]. Under this law, from 2021 onwards， European banks need to disclose the principal adverse impacts their investments have on people and planet as well as publish details of their “due diligence” policies to make sure they can systematically identify, prevent, mitigate, and account for those adverse impacts. Another example is the Duty of Vigilance Law, passed by France in 2017. Under the framework of this law, large French companies with over a certain number of employees are held responsible for their damages to human rights and the environment wherever in the world it takes place. This law requires all such companies to establish, issue and effectively implement an annual vigilance (due diligence) plan – the equivalent of requiring companies to adopt a risk management model – in order to identify and avoid potential damage. This law covers all of France's major commercial banks, including BNP Paribas, Natixis and Crédit Agricole.[xvi]

Recommendations

Recommendations for the People's Bank of China Law and the Commercial Bank Law:

1. Under General provisions, **include content relating to "protecting the environment and tackling climate change"**, in a matter that ensures the laws reflects and are compatible with policies related to ecological civilisation and green finance;

2. Under the relevant section, clearly incorporate "environmental and social risks" into the macro prudential management and the supervision and management of risks, for example **clearly stipulate in the text that the macro prudential management and the supervision and management of risks should address environmental and social risks including those where the financial impacts cannot yet be clearly established**.

3. The two laws require both the bank of People’s Republic of China and the commercial banks to enhance its risk management measures when they assess environmental and social high risk sectors and restrict financing into such sectors. **Suggest to include “Relevant regulators set clear definition for the environmental and social high risk sectors, and restrict banks’ financing into these sectors.”** It is advised to refer to the Environmental Protection Law of the People's Republic of China and relevant industrial policies, as well as definitions set by the Asian Infrastructure Investment Bank. In its Environment and Social framework, it defines high risk activities as activities may potentially result in: (i) land acquisition or involuntary resettlement, (ii) risk of adverse

impacts on Indigenous Peoples and/or vulnerable groups, (iii) significant risks to or impacts on the environment, community health and safety, biodiversity, and cultural resources, (iv) significant retrenchment of more than 20% of direct employees and recurrent contractors, and/or (iv) significant occupational health and safety risks[xvii]

Recommendations for the Commercial Bank Law

1. Under the Capital and risk management section of Chapter 4, a standardised risk management mechanism and strategy should be clearly specified to provide guidance to industry, and promote fair competition and effective supervision. **It is recommended that the following be included: "Establish a risk management mechanism which requires banks to carry out due diligence to identify, prevent and mitigate financial, environmental and social risks."**

2. Under the Business operation rules section of Chapter 5, it should be clearly specified that while operating their businesses, banks should support and comply with the macro-strategies of ecological civilisation and green transformation. Before and after granting credit to clients, banks should rigorously investigate the environmental and social conduct of these clients and incorporate this information into their risk management mechanism. **It is recommended that under General business principles, content regarding "environmental protection" be added and, under the Credit review provision, reviewing the client's environmental and social conduct be included and the following specified: "Loans shall not be granted to clients with or are likely exposed to uncompliant environmental and social conduct";**

3. Under the relevant sections, there should be a clear requirement for banks to disclose information, increase business transparency, and promote effective law enforcement and social oversight. **Inclusion of the following is recommended: "Banks should regularly publish information regarding their risk management; this should include publishing policies and details on how they carry out risk management.**

The law should require banks to do enhanced reporting if they are engaging in high risk sectors, and require a further a guidance be developed to guide banks on this, which should require that banks annually and publicly report the names and locations of projects and companies that they finance, and any grievances or complaints filed by affected stakeholders on the basis of environmental or social concerns.

4. Under the Legal responsibility section of Chapter 10, **disciplinary measures should be included for when a bank fails to carry out adequate due diligence or reporting.** Penalties to be sufficiently strong to disincentives bad practice.

5. Banks should be required to publish a clear plan and pathway of how their portfolios will align with net zero emissions – in both their domestic and international exposures - by 2060. This should include clear five-year targets, with clearly articulated consequences if time-bound targets aren't met.

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[i] https://www.ngfs.net/sites/default/files/medias/documents/ngfs_first_comprehensive_report_-_17042019_0.pdf
[ii] http://www.ouhua.info/2020/1030/31957.html
[iii] https://www.mee.gov.cn/xxgk2018/xxgk/xxgk03/202010/t20201026_804792.html
[iv] http://www.lawinfochina.com/display.aspx?lib=law&id=6187&CGid=
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