

Original Paper

Research on the Review and Supervision Mechanism of Green Credit

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Received: January 21, 2024

Accepted: March 07, 2024

Online Published: March 23, 2024

doi:10.22158/ibes.v6n2p43

URL: <http://dx.doi.org/10.22158/ibes.v6n2p43>

Abstract

Green credit involves the government, enterprises and commercial banks, among which commercial banks are not only the executors of the government's macro-control functions, but also the lenders of credit business, which are both public and commercial, and are the core subjects of green credit. Due to the different classification standards of green credit, the low availability of environmental information and the lack of third-party auxiliary institutions, commercial banks are left without resources when auditing green credit enterprises and projects, but the necessary supervision mechanism is lacking because of the ambiguous division of supervision subjects and their responsibilities. In order to prevent the phenomenon that commercial banks neglect the audit, which virtually helps enterprises to cause environmental and resource damage accidents, we should improve the review and supervision mechanism of green credit from two aspects: unifying the classification standards of green credit and establishing the legal system of green credit supervision.

Keywords

Green credit, commercial banks, supervision mechanism

1. Introduction

Green credit policy is a kind of green financial means to support the development of environmentally friendly enterprises or environmental protection-related industries by treating environmentally friendly enterprises and enterprises that damage the environment differently in the process of credit granting, limiting the financing of enterprises with high energy consumption, high pollution and environmental protection standards. The implementation of green credit financial policy shows that environmental protection is gradually changing from over-reliance on administrative means to full use of economic means. However, judging from the published policies, the guiding opinions and plans formulated by relevant institutions are relatively sketchy, not operational enough, and some do not have the legal basis

for enforcement.

2. Weak Green Credit Review

Green credit review is mainly reflected in the review of credit projects by commercial banks, which verifies whether credit projects meet the requirements of relevant environmental laws and regulations. The obligation of environmental review of commercial banks begins with the provision of credit and ends with the recovery of credit funds, covering the whole process of pre-loan investigation, loan review and post-loan inspection. In the pre-lending credit review, commercial banks should review whether the environmental impact report and report form of the loan project have passed the examination and approval of the environmental protection department. In the process of granting credit, if commercial banks find signs or warning signals of environmental risks in some links of lending, they should adjust their credit decisions in time and report to the competent department of ecological environment administration. After the loan is issued, the commercial bank shall have the obligation to check the environmental protection compliance of the borrowing enterprise. Its scope of review mainly includes; Whether the loan project carries out environmental protection engineering construction; If the loan project has built an environmental protection project, it shall examine whether the environmental protection project meets the design and construction requirements; Whether there are significant environmental and social risks in the loan project.

2.1 Different Review Standards

The planning and management of commercial banks' green credit in China's laws and regulations covers four stages: identifying access, environmental risk assessment, lending standard procedures and post-lending monitoring. However, most of the green credit standards involved are comprehensive and principled, lacking specific green credit guidance catalogue and environmental risk rating standards. It is difficult for commercial banks to formulate relevant internal implementation rules and internal supervision measures, which reduces the operability of green credit policies. And because of the lack of uniform standards, each commercial bank will distinguish the control scales of different links of green credit according to its own characteristics when implementing and operating, and understand and implement it independently. All major banks have their own credit audit standards, and even different regions of the same banking system will have different standards. This undoubtedly seriously endangers the fairness of credit issuance. At present, the implementation rules of green credit in China are obviously too scattered, and each law and regulation has its own requirements and specific provisions. Whether the implementation scale is strict or lenient often depends on the consciousness of commercial banks to fulfill their environmental responsibilities, so it has great uncertainty and is not conducive to the improvement of the overall level of green credit. Therefore, it is urgent to formulate practical implementation standards and standardize bank operations. Formulate and improve the review standards related to green credit, and conduct strict and unified loan review for each loan enterprise according to the specific green credit guidance catalogue, environmental risk evaluation standards and

performance evaluation guidelines to ensure that each loan meets the green credit standards and the national development direction, and avoid the inconsistency and arbitrariness of bank loan review standards.

2.2 Environmental Information Has Poor Pertinence and Timeliness

At present, most commercial banks have not yet established a sound environmental management system, and still do not have the ability to carry out substantive environmental review, mainly relying on information provided by environmental administrative departments. In 2006, the Central Bank and the former State Environmental Protection Administration issued the Notice on Issues Related to Sharing Environmental Protection Information of Enterprises, which required that environmental protection information of enterprises should be gradually incorporated into the central bank's enterprise credit information system. However, in practice, the corporate pollution information held by governments at all levels is not systematic and comprehensive, and the corporate environmental violation information released by local environmental protection departments is not targeted and has a serious lag. Among many loan enterprises, the environmental protection department only informs the list of seriously polluting enterprises, and a large number of environmental violation information of "two high" enterprises is not fully reflected in the credit information system in time, which cannot meet the specific needs of commercial banks' credit review. In addition, some scholars believe that the authenticity of environmental information is also questioned. Ye (2008) pointed out that the State Environmental Protection Administration, as the chief steward of environmental supervision, is limited by material and human resources, so it is impossible to specifically grasp the original data of pollution status of all enterprises nationwide, and a considerable part of it needs local support and transportation. However, for the purpose of local protection or under the pressure of local governments, local environmental protection bureaus often block out some unfavorable information, which puts forward a test for the authenticity of the data provided by local governments. How to ensure the authenticity of data has become a threshold in reality.

2.3 Lack of Third-Party Independent Institutions

Article 24 of Green Credit Guidelines (2012) clearly states that banking financial institutions should strengthen credit due diligence, and define the content of environmental and social risk due diligence according to the characteristics of customers and the industries and regions where their projects are located, so as to ensure that the investigation is comprehensive, in-depth and meticulous. When necessary, you can seek the support of qualified and independent third parties and relevant competent departments. Because the third-party organization has professional advantages, its supplementary evaluation report is more professional than the general enterprise annual report, and it has the following three advantages: first, it can effectively collect environmental information, making the whole process of environmental information disclosure standardized and compliant; Second, help the regulatory authorities to share data and reduce the problems of repeated disclosure of environmental information and waste of resources; Third, use the data obtained from environmental information disclosure to

conduct big data analysis, help regulatory authorities to perform regulatory functions, manage, assess, reward and punish commercial banks, and provide reference for policies and systems. Therefore, the relevant investigation report of independent third-party institutions or organizations is an important part of the credit approval process of commercial banks. However, after investigating 40 listed banks in China, some scholars pointed out that the overall score of information disclosure quality of external supervision intensity of green credit is not ideal, which shows that listed banks have a weak sense of voluntary supervision, and the scores of information disclosure including third-party verification reports have a small annual increase and a downward trend.

3. Lack of Green Credit Monitoring Mechanisms

The competent authority of environmental resources destruction is the administrative department of environmental protection, while the competent department of banking financial institutions is the Banking Insurance Regulatory Commission and its subordinate departments. As a green credit spanning environmental protection and financial credit, it should be subject to double supervision. However, in practice, it seems that the implementation of the green credit supervision responsibility of commercial banks has become the exclusive function of the financial supervision department, that is, the Banking and Insurance Supervision Committee and its subordinate institutions, and the current green credit supervision mechanism is far from achieving the “clear responsibilities, reasonable division of labor and mutual cooperation” required by the financial supervision principle.

3.1 Fuzzy Supervision Subject

The fuzzy supervision subject is the primary problem in the current green credit supervision mechanism of commercial banks. According to the existing policy arrangements, it is not clear what role the State Financial Supervision and Administration, the People’s Bank of China and the environmental protection departments should play in the supervision mechanism. The Guiding Opinions on Credit Work for Energy Conservation and Emission Reduction and the Guidelines on Green Credit have granted the supervision authority to the State Financial Supervision and Administration Bureau; The Opinions on Implementing Environmental Protection Policies and Regulations to Prevent Credit Risks also mentions the management authority of the People’s Bank of China. According to the existing policy documents, it seems that both the State Financial Supervision and Administration Bureau and the People’s Bank of China have the authority to manage green credit, which reflects the trend that the State Financial Supervision and Administration Bureau plays the leading role and the People’s Bank of China assists. However, all the above provisions are in principle, and the supervision subjects of specific matters are not divided in detail, which is easy to lead to regulatory vacuum and overlapping.

In addition, the supervision status of environmental protection departments and the public is not clear. As an interdisciplinary subject of environmental protection and financial credit, the supervision of green credit should be at least coordinated by the environmental protection department and the

financial supervision department. According to the “Opinions on Implementing Environmental Protection Policies and Regulations to Prevent Credit Risks” jointly issued in 2007, “environmental protection and financial departments at all levels should cooperate closely and establish an information communication mechanism”. Because the information on corporate environmental violations first grasped by the environmental protection department may not be delivered to the regulatory authorities in time for various reasons, thus affecting the regulatory efficiency of the regulatory authorities. However, in practice, it seems that supervising the green credit of commercial banks has become the exclusive responsibility of the State Financial Supervision and Administration, and the interaction between the State Financial Supervision and Administration and the environmental protection department is extremely uncoordinated. In addition, the supervision mechanism established by financial supervision institutions and environmental protection departments such as the People’s Bank of China and the State Financial Supervision and Administration of China is not comprehensive, and there is also a lack of supervision from industry self-discipline and stakeholders. Although the Green Credit Guidelines involve the content of public participation, it proposes that the credit situation involving major environmental and social risks should be supervised by the market and stakeholders, and when necessary, an independent and qualified third-party institution should be hired for evaluation. However, this provision is rarely implemented in practice, and the degree of public participation is not high.

3.2 The Content of Supervision Is Ambiguous

According to the foregoing, although in practice, the State Financial Supervision and Administration has become the only functional department of commercial banks’ green credit supervision responsibility, but its specific supervision content has no legal guidance. At present, China’s State Financial Supervision and Administration Bureau has not issued a special supervision method for green credit business, and the latest Banking Supervision and Administration Law of the People’s Republic of China (revised draft for comments) promulgated in December 2022 does not involve the relevant laws and regulations on green credit. In terms of policy, the Guiding Opinions on Credit Work for Energy Conservation and Emission Reduction requires the State Financial Supervision and Administration to arrange special inspections on the “two high” industries and urge them to make rectification according to the inspection results; The Green Credit Guidelines stipulate that banking supervision institutions at all levels should strengthen off-site supervision, improve the off-site supervision index system, strengthen the monitoring and analysis of environmental and social risks, guide them to strengthen risk management in time, and adjust credit investment; The Opinions on Implementing Environmental Protection Policies and Regulations to Prevent Credit Risks requires the People’s Bank of China and its branches to guide and urge commercial banks to conscientiously implement national industrial policies and environmental protection policies, and incorporate environmental protection information into the basic database of enterprise and individual credit information to prevent possible credit risks. However, the above-mentioned normative documents are mainly based on principles and advocacy, but the

specific types, subjects, reasons, forms and scope of responsibilities are not clear, which impairs their operability and enforceability, so the implementation effect is not ideal. Without the guidance of supervision methods and laws and regulations, the local financial supervision administration can't follow when enforcing the law, which makes the supervision of green credit become a voluntary act called by the government, which leads to the incomplete supervision of green credit lending behavior of commercial banks and easily affects the effective development of commercial green credit activities.

4. Improve the Legal System of Green Credit Review and Supervision

Perfect credit review and supervision mechanism is an important guarantee for the effective operation of green credit. On the one hand, commercial banks should establish and improve their own internal green credit review mechanism and strictly review their own green credit implementation; At the same time, the environmental protection department, the People's Bank of China and the China Banking Regulatory Commission should supervise and verify the implementation of green credit policies by commercial banks, supervise the audit and management mechanism of environmental and social risks of financing projects by commercial banks, and urge commercial banks to strictly follow relevant evaluation standards and implementation rules in the whole process of credit, and establish a sound external supervision system to ensure that green credit can be carried out truly and effectively.

4.1 Unified Green Credit Classification Standards

At present, commercial banks' classification of loan risks is based on the Measures for Risk Classification of Financial Assets of Commercial Banks promulgated by the China Banking Insurance Regulatory Commission on February 11, 2023. This method divides loans into five grades: normal, concerned, secondary, doubtful and loss. This classification mainly considers the net assets, the debtor's repayment ability, the debtor's credit rating and guarantee, and does not consider the risks that the loan project may bring to the bank due to its environmental impact. Therefore, it is necessary to increase the classification of different impacts of loan projects on the environment and society in addition to the conventional risk classification, and establish corresponding standards. In this regard, we can learn from the equator principle and classify the financing projects into three categories according to the potential environmental and social risks and the degree of influence: high (a), medium (b) and low (c). That is, class A, projects that seriously change the original state of the environment and the adverse environmental and social consequences are not easy to eliminate; Category B, projects that have adverse environmental and social consequences, but can be easily eliminated by slow-release measures; Class c; Projects that will not have obvious adverse environmental and social consequences. If we can increase the classification of different impacts of loan projects on the environment, then commercial banks can formulate relevant regulatory measures and internal implementation rules on their own. In the process of reviewing green credit, we can give different levels of credit lines to different enterprises to ensure that each loan meets the green credit standards and the national development direction, and avoid the inconsistency and arbitrariness of loan review standards between

banks. And some scholars have suggested that from the perspective of international development, first of all, formulating green credit standards will help to seize the leading role in the formulation of green trade regulations in the international field.

4.2 Establish a Legal System for Green Credit Supervision

The key point of improving the green credit review of commercial banks is to strengthen the supervision of commercial banks, focus on strengthening external constraints, ensure that commercial banks effectively promote green credit policies, conduct environmental impact investigation of project financing and respond to risk prevention mechanisms. As the administrative supervision institution of commercial banks, the China Banking Insurance Regulatory Commission has the function of supervising the operation and risk control of commercial banks, and it is duty-bound to supervise the green credit activities of commercial banks. As the supervisor of environmental pollution and destruction events, the environmental protection department is the main source for commercial banks to obtain environmental information. Therefore, firstly, the laws and regulations on banking supervision should be updated, and the legal status of the State Financial Supervision Administration as the main body of green credit supervision and the environmental protection department as a participant in green credit should be clarified. Secondly, we should also take the existing Banking Supervision Law of the People's Republic of China as the legal basis, and introduce the supervision and management measures specifically for the green credit business of commercial banks, so that the State Financial Supervision and Administration Bureau can have laws to follow when conducting green supervision on banks. Specifically, it can be stipulated to check the pre-loan review, environmental impact assessment results review, basic loan qualification review and post-loan standardized management in the process of handling green credit business. At the same time, a two-way supervision mechanism should be established between the environmental protection department and the State Financial Supervision and Administration. On the basis of improving the self-monitoring mechanism within the regulatory agencies, we should standardize the internal monitoring mechanism and work discipline to guide the standardization of regulatory behavior and earnestly fulfill our regulatory responsibilities in the green credit business. When one of the units violates the regulatory provisions in the process of law enforcement, the other party should promptly report to the superior competent department and ask the superior competent department to correct it. If the regulatory actions of the law enforcement personnel of the two departments violate the laws and regulations related to green credit and cause losses, they should be investigated for legal responsibility. Through the two-way mutual supervision mechanism, we can better regulate the law enforcement behavior of the regulatory authorities, thus promoting the effective development of green credit business of commercial banks.

5. Conclusion

The relationship between the development of green credit and the sustainable development of modern society is getting closer and closer, and it has also begun to gain more and more attention. China has successively issued some normative documents concerning green credit, such as policies and opinions, and commercial banks themselves are constantly in line with the Equator Principles in the international field to jointly improve the implementation level of green credit. However, the problems existing in green credit still need to be solved by constructing a more perfect legal system of review and supervision at the legal level. On the one hand, optimize the classification standard of green credit, establish a unified classification standard of loan risk, complete the combination of loan approval, environmental impact assessment and environmental information disclosure, and realize effective supervision of green credit. On the other hand, by updating the laws and regulations on bank supervision, the main body of supervision and the supervision and management measures for the green credit business of commercial banks are clarified, so that the State Financial Supervision and Administration Bureau can have laws to follow when supervising and managing banks' green credit.

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