Commentary by Paula DiPerna, Civic Exchange Visiting Fellow

HONG KONG, 3 April 2018 — On a recent Sunday along Victoria Harbour, smog and haze hung so thickly that the spectacular skyline seemed like stage scenery veiled in shadowy disguise. Gone were the gleaming spires and the excitement they proclaim — instead, the dull thudding message of dirty air.

But history is catching up and the public is tiring of wearing face masks. As an affluent financial centre that nevertheless has quality of life problems, Hong Kong can epitomize the opportunities of embracing new opportunities in the emerging and transformational field of green finance, based on the need to address serious environmental challenges in Hong Kong and beyond.

China Looking to Global Carbon Market

Take bad air. Sulphur dioxide is the main culprit in smog, but SO_2 clean-up comes along with clean-up of carbon dioxide, a main greenhouse gas and culprit in climate change. To get at both problems, in 2018 China announced its national Emissions Trading Scheme (ETS) to control greenhouse gas emissions from the power sector. China's national market will gradually become the keystone of an inevitable global carbon market, an environmental commodities market that will channel investment to low-carbon alternatives, while helping emitters hedge and manage high-carbon costs.

But Hong Kong has let its expertise in carbon market trading lapse. Now is the time to ramp it

up again. A 2017 report by the Hong Kong Productivity Council on options for Hong Kong as a financial center for China's ETS said, "Currently, action from Hong Kong's financial sector is alarmingly low, as many consider this market as lacking short-term financial gains."

The Mainstreaming of ESG

Two decades ago, capital investment focused mostly on financial returns and no one blinked an eye. The role of money was to make more money as fast as possible. Today, that fierce exclusive focus is out of date. Capital investment has taken on a new job — betterment of the world. Quietly and globally, new thinking has become mainstream in the financial services sector as it takes so-called "non-financial" considerations more into account, without sacrifice to financial performance.

This mainstreaming of environmental, social and governance (ESG) considerations means that, according to the U.S. Sustainable Investment Forum, "The total U.S. domiciled assets under management using SRI strategies grew to $8.72 trillion at the start of 2016, an increase of 33% since 2014" – meaning that one in five dollars invested in the U.S. is screened or analyzed for ESG impact. In Asia, according to the Global Sustainable Investment Alliance, as of 2016, "$52.1 billion in assets were managed using one or more sustainable investment strategies, an increase of 16 percent since 2014." The Asian trend is clear, even if it lags behind the global average of 25 percent increase.

The "5 Ps"

When does this shift mean, especially in Hong Kong and Asia, the current world hub of capital accumulation, where social and environmental problems are also accumulating? Today, as Hong Kong seeks its place in a changing world, the city could be uniquely motivated to catch what I call the "5P" wave – products, practitioners, performance, policy and purpose.

First, **products.** The mainstreaming of "capital for good" tends to be narrowly described as "green finance," itself also at times narrowly focused on products intended for explicitly green purposes, such as green bonds. But green-ness is only one factor, and bonds only one tool. The trend is expressed in many product types: ESG indices, equity funds, green funds, social performance bonds, impact funds and, especially in China, "carbon credits"—all types of new products that involve entrepreneurs and high flyers, but also venerables, such as the MSCI KLD 400 Social Index and the S&P Carbon Efficient index. Products, of course, do not create themselves. Their creation is a response to demand — active, latent and presumed.

Of course, neither do products sell themselves, which leads to **practitioners** — the cadre of financial managers and thinkers increasingly drawn to these new ways to deploy capital. Many cities are now vying to be "capitals of green finance," and the winners, even legendary Hong Kong, will need to retain and attract the next generation of skilled, committed and seasoned practitioner talent who can maximize the field.

Neither products nor practitioners matter much if "**performance**" is inadequate, but ESG products are now shown to yield not only acceptable but often better financial returns. A recent landmark review of 2,000 studies of return trends published in the Journal of Sustainable Finance and Investment in 2015 that concluded: "Roughly 90% of studies find a nonnegative ESG–CFP relation. More importantly, the large majority of studies reports positive findings… Promising results are obtained when differentiating for portfolio and non-portfolio studies, regions, and young asset classes for ESG investing such as emerging markets, corporate bonds, and green real estate."

Increasingly, too, asset owners and managers are taking corporate social behavior into consideration. The CEO of Blackrock, which has US $6.28 trillion under management across asset classes, Larry Fink, wrote in a much publicized letter to CEOs earlier this year, "To prosper over time, every company must not only deliver financial performance but also show how it makes a positive contribution to society. Companies must benefit all of their stakeholders, including shareholders, employees, customers and the communities in which they operate."

In that society's concerns are public policy concerns, new **policies** of course must evolve. To avoid "greenwashing" so to speak, Hong Kong Exchanges and Clearing (HKEX) stepped up its scrutiny of listed companies on their ESG reporting with its "comply or explain" rules. These policies will keep evolving, and accountability is now reaching clearly up to the corporate Board of Directors.

But, after all is said and done, so what? What do these trends truly mean and why are they moving slowly relative to their importance? Because ultimately, shifts in products, practitioners, performance and policy all reflect a deep and not yet fully expressed reconsideration of **purpose**. Money is either a means or an end, and to catch the 5P wave requires subjective and philosophical reflection on why we do business.

Catching this exciting new wave should be easy for a city like Hong Kong, with such impeccable financial tradition, special status, and global zest . But time is passing.

The article was also published on Harbour Times.

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