The Rise of Sustainable Finance in China: ESG Funds and Regulations

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This article examines the emerging ecosystem of ESG (Environmental, Social, and Governance) funds in China, focusing on their classification, regulation, and policy context. It presents a taxonomy of ESG funds in the Chinese market, including public, private, government-guided, and Public-Private Partnership (PPP) funds. It analyses China's distinctive policy-driven transformation model on ESG, emphasising its top-down design, the pivotal role of Stateowned Enterprises (SOEs), and the use of phased policy implementation. Compared to the European Union's sophisticated disclosure and taxonomy regime, China requires clearer legal definitions, mandatory reporting mechanisms, and a unified classification system on ESG funds. The crucial future task involves balancing government direction with market-based forces to ensure capital is channelled into the real economy's green transformation. This will be essential for establishing an internationally competitive sustainable finance framework and ensuring capital genuinely supports industrial upgrading and sustainable development.

Keywords: Sustainable Investing, Green Fund, ESG, Regulation, China

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Abstract:

This article examines the emerging ecosystem of ESG (Environmental, Social, and Governance) funds in China, focusing on their classification, regulation, and policy context. It presents a taxonomy of ESG funds in the Chinese market, including public, private, government-guided, and Public-Private Partnership (PPP) funds. It analyses China's distinctive policy-driven transformation model on ESG, emphasising its top-down design, the pivotal role of State-owned Enterprises (SOEs), and the use of phased policy implementation. Compared to the European Union's sophisticated disclosure and taxonomy regime, China requires clearer legal definitions, mandatory reporting mechanisms, and a unified classification system on ESG funds. The crucial future task involves balancing government direction with market-based forces to ensure capital is channelled into the real economy's green transformation. This will be essential for establishing an internationally competitive sustainable finance framework and ensuring capital genuinely supports industrial upgrading and sustainable development

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I. Introduction

The integration of Environmental, Social, and Governance (ESG) principles into investment strategies has gained significant traction in China in recent years. Chinese policymakers and financial institutions have increasingly acknowledged that mobilising capital in alignment with ESG objectives can play a critical role in advancing national priorities, including the "dual carbon" targets of peaking carbon emissions by 2030 and achieving carbon neutrality by 2060， promised by President Xi Jinping during the general debate of the 75th session of the United Nations General Assembly in 2020.[1] The growth of ESG-focused, green or sustainable- themed investment funds in China thus reflects both an internal policy imperative to promote green finance and an external response to international sustainability standards.

The origins of the ESG fund landscape in the China can be traced to 2011, when the Industrial Bank of China launched the Xingquan Green Investment Equity Securities Investment Fund,

[1] Chinese President Xi Jinping on Tuesday made a statement at the general debate of the 75th session of the United Nations General Assembly via video, Xinhua, September 23, 2020, <http://english.scio.gov.cn/topnews/2020-09/23/content_76731466.htm> accessed 1 July 2025.

the country's first fund dedicated to investments in energy-saving, new-energy, and environmental-protection enterprises. In October of the same year, the State Council issued the *Opinions of the State Council on Strengthening Major Environmental Protection Work*, which expressly provided the policy goal to "encourage the establishment of various development funds for the environmental protection industry to broaden its financing avenues,"[2] thereby furnishing policy support for the creation of such funds.[3]

Building on this early momentum, the People's Bank of China, the Ministry of Finance, and other competent authorities jointly issued the *Guidelines for Establishing the Green Financial System* in 2016, which explicitly mandated to "support the establishment of all types of green development funds and implement market-oriented operations" and "encourage all types of green development funds to support the relevant programs operated in the Public-Private Partnership (PPP) mode,"[4] among other measures.[5] These successive policy instruments collectively signalled a clear and sustained commitment at the central level to fostering the growth of green investment vehicles.[6]

The development of green financial instruments in China has followed a phased and sequential trajectory. In the early stages, policy and regulatory efforts were primarily concentrated on green credit[7] and green bonds[8]. Within this context, green industrial funds, especially those closely aligned with industrial policy and established under government guidance or participation, began to emerge as important vehicles for promoting specific green sectors. Notably, the establishment of such funds was most active between 2014 and 2016.[9]

As market mechanisms matured and awareness of ESG principles increased, ESG-themed publicly offered funds[10] and market-driven green private equity (PE) and venture capital (VC)

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[2] State Council, Opinions on Strengthening Key Environmental Protection Work (20 October 2011) <https://www.gov.cn/zwgk/2011-10/20/content_1974306.htm> accessed 28 May 2025.

[3] Zhiyan Consulting, 'Green Fund Industry Development Trends (including Industry Development History, Key Enterprise Analysis, Market Competition Landscape Analysis and Market Outlook Forecast)' (6 September 2024) <https://mp.weixin.qq.com/s/9z4MxcDPo_CnIWU0KmjhcQ => accessed 26 February 2025.

[4] People's Bank of China et al., 'Guidelines for Establishing the Green Financial System' (31 August 2016) <https://www.mee.gov.cn/gkml/hbb/gwy/201611/t20161124_368163.htm> accessed 28 August 2024.

[5] Zhiyan Consulting, 'Green Fund Industry Development Trends (including Industry Development History, Key Enterprise Analysis, Market Competition Landscape Analysis and Market Outlook Forecast)' (6 September 2024) <https://mp.weixin.qq.com/s/9z4MxcDPo_CnIWU0KmjhcQ => accessed 26 February 2025

[6] Ibid.

[7] Regarding the regulatory framework governing green credit, see Virginia Harper Ho, 'Sustainable Finance & China's Green Credit Reforms: A Test Case for Bank Monitoring of Environmental Risk' (2018) 51 Cornell International Law Journal 609.

[8] On the development of the Chinese green bond market, see Lin Lin and Yanrong Hong, 'Developing a Green Bonds Market: Lessons from China' (2022) 23 European Business Organization Law Review 143.

[9] Green Finance Committee, 'Development Model and Strategy of Green Industrial Funds' <http://www.greenfinance.org.cn/displaynews.php?id=1220> accessed 20 March 2025.

[10] China's "Publicly Offered Funds" are much like "Mutual Funds" in the United States. Both publicly pool investors' money for professional management and diversified investment in assets like stocks and bonds, aiming to provide shared market returns and risk diversification.

funds began to expand rapidly. This trend accelerated significantly following the introduction of China's "dual carbon" goals in 2020, which triggered substantial growth in both the number and scale of ESG publicly offered funds. By 2022, the assets under the management of ESG publicly offered funds continued to grow steadily. This shift from policy-driven, government-led financial tools to a more diversified and market-oriented product landscape has fundamentally shaped the current structure of China's ESG fund market.

Despite recent progress, ESG funds remain underdeveloped within China's broader green finance policy framework.[11] China's green finance sector has established a prominent global position and exhibits substantial potential for further development. Recent data indicates that, as of early 2024, the outstanding balance of green loans in China reached RMB 36.6 trillion.[12] Furthermore, the domestic green bond market saw significant activity in 2023, with issuance volume surpassing RMB 940 billion.[13] By early 2024, the cumulative issuance of green bonds had exceeded RMB 4.1 trillion.[14] As of 2024, debt financing instruments (primarily green credit and green bonds) accounted for as much as 97% of total green finance, while equity financing comprised less than 3%.[15] This structural imbalance is likely to slow progress towards achieving the "dual carbon" objectives.

While China's ESG funds have demonstrated substantial progress in market scale, nascent regulatory development, and notably through the practical experience of government guidance funds, a significant gap remains in dedicated legal scholarship analysing this domain. This article seeks to fill the literature gap by addressing the following key research questions:

1. How are different types of ESG funds operated and regulated in China and what legal reforms are needed to ensure the sustainable growth of ESG funds?
2. What are the regulatory approaches of ESG funds in China, and how do they compare with those in the European Union (EU)?
3. What insights and lessons can be drawn from China's legislative and regulatory experience in the development of ESG funds?

[11] On the overall development and distinctive models of green finance in China, see Wenting Cheng and Peter Drahos, 'China's Regulatory Pathway to Green Finance' (2021) 14 Tsinghua China Law Review 195; Virginia Harper Ho, 'China, the Environment, & the Global Green Finance Transition' (15 April 2025) <https://papers.ssrn.com/abstract=4890303> accessed 15 May 2025.

[12] Financial Times, 'Credit Supply Continues to Increase, 'Green Content' of Financial Services Constantly Improves' (29 April 2025) <https://gu.qq.com/resources/shy/news/detail-v2/index.html?t=1#/index?_tentrees_trans=0&id=SN2025042910265597495e9d> accessed 20 May 2025.

[13] Caixin, Liangtao Zhu, 'Climate Bonds Initiative Report: China's Green Bond Issuance Reaches 9400 Billion Yuan in 2023, Ranking Second Globally' (21 May 2024) <https://finance.caixin.com/2024-05-21/102198485.html> accessed 28 May 2025.

[14] Xinhua Net, 'Investment and Financing Service System Gradually Enriched: "Green Content" of Financial Industry Boosts "Gold Content" of Development' (23 April 2025) <https://www.news.cn/money/20250423/e98d4397790e45ac9c232f8532ebb92e/c.html> accessed 20 May 2025.

[15] Lan Hong, 'Green Equity Financing Accounts for Only 3% of Green Funds, Green Funds Urgently Needed to Make up the Shortfall' <http://www.greenfinance.org.cn/displaynews.php?id=4264> accessed 28 May 2025.

Given the EU's established leadership in green finance regulation and the ongoing close cooperation between China and Europe on sustainable finance standard-setting, exemplified by initiatives like the Common Ground Taxonomy (CGT), a comparative approach offers valuable insights. Therefore, this article, in its examination of China's ESG fund ecosystem, will make comparative references to the regulatory frameworks and prevailing practices of the EU where such comparisons help illuminate potential pathways for enhancing China's own legal and regulatory architecture.

The forthcoming sections of this article are structured as follows: Part II discusses the concept and classification of ESG funds in China, including types such as public, private, government-guided, and PPP funds. Part III outlines the regulatory framework for ESG funds in China, covering relevant policies, fund establishment, labelling, standard-setting, investment operations, industry guidelines, local legislation, information disclosure, ESG ratings, and requirements for fund managers. Part IV analyses China's policy-driven transformation model in the sustainable investment sector, highlighting its top-down approach, the role of State-owned Enterprises (SOEs), and characteristics such as a phased focus. Part V explores current challenges and proposes paths for future development, suggesting improvements in conceptual guidelines, incentive mechanisms, information disclosure, and the cultivation of active shareholders.

II. The Emergence of ESG Funds in China[16]

a. Defining Green and ESG Funds in China

To establish a clear analytical framework, this article begins by defining the key concepts of "ESG funds", "green investment", and "green funds" as they pertain to the Chinese context.[17] This definitional exercise is made necessary by the complex and often ambiguous relationship between these terms in both market practice and China's fragmented regulatory environment, a reality which presents a non-trivial challenge for market participants and regulators alike.

ESG funds, drawing upon the elucidation of responsible investment by the United Nations Principles for Responsible Investment (PRI), are generally understood to denote investment funds that systematically integrate ESG criteria and factors into their investment analysis, decision-making processes, and ownership practices, particularly encompassing active ownership and stewardship activities. A key feature of this model is its sector neutrality. Such funds may invest in non-green industries provided that the investee companies are evaluated through a rigorous ESG lens.

[16] There are no specific laws or policies in China targeting ESG funds exclusively, aside from certain regulations and documents related to ESG information disclosure by companies.

[17] For discussion on the concepts of ESG, CSR and Sustainable Finance, see Lin Lin, "Venture Capital in the Rise of Sustianble Investment" (2022) 23 (1) European Business Organization Law Review 187.

In contrast, "green investment" in China is a more ambiguous and highly contextualised concept, better understood as a flexible, policy-shaped framework rather than a rigid category. While its primary focus is on environmental objectives, it does not strictly exclude social or governance factors. This built-in flexibility is clearly evident in the Asset Management Association of China's *Green Investment Guidelines (for Trial Implementation)*: while Article 3 defines green investment in environmental terms, Article 4 simultaneously encourages fund managers to integrate broader ESG factors into so-called "green investments". As a result, the term "green fund" has in practice become an umbrella descriptor for a wide range of products, many of which incorporate ESG elements, thereby blurring the conceptual lines between funds explicitly labelled "green" and those labelled "ESG".

China's distinct preference for the term "green" is closely linked to its policy trajectory. Initially, "green finance" referred exclusively to financial policies with environmental objectives, while social ("S") goals were addressed through separate policy channels, such as inclusive finance (e.g., poverty alleviation) or pension finance.[18] However, from a broader perspective, because green finance's emphasis on the environmental dimension offers the closest parallel to international ESG trends, it has served as the natural policy channel for integrating broader ESG-related institutional frameworks, particularly information disclosure regimes, thereby guiding its evolution towards a more encompassing ESG model.

It is crucial to recognise, however, that this entire process—from the preference for "green" to the gradual inclusion of broader ESG concepts—is a characteristic of the market's nascent stage. In the absence of a unified, official definition for these evolving terms, a fragmented regulatory landscape has emerged, creating uncertainty for investors and impeding effective data analysis.[19]

b. Types of ESG Funds

Although China's ESG fund landscape, akin to that of the EU, comprises both publicly offered and privately offered fund structures, its developmental trajectory and current composition exhibit distinct national characteristics. Notably, government guidance funds assume a principal catalysing function, and green funds structured via PPP mechanisms are significant, reflecting a more state-influenced approach in China compared to the predominantly bottom-up, market-driven evolution of such funds in the EU and the UK.

1) Publicly Offered Funds

[18] Sci-tech finance, green finance, inclusive finance, pension finance, and digital finance are referred to as the 'five major articles' of building China into a financial powerhouse, see General Office of the State Council, 'Guidance on Doing a Good Job in the "Five Major Articles" of Finance' (Guo Ban Fa [2024] No 8, 29 January 2024) <https://www.gov.cn/zhengce/content/202401/29/content_6928825.htm> accessed 9 June 2024.

[19] International Institute of Green Finance (IIGF) and Zhou Zhou, Yuxin Xia, 'IIGF Annual Report | 2023 Green Fund Progress Report' (6 September 2024) <https://mp.weixin.qq.com/s/ijl9293cumKCUsxDlN3KSw> accessed 20 February 2025.

China's ESG publicly offered funds can be broadly classified into two categories: "general ESG funds" and "pure ESG funds". General ESG funds typically concentrate on a single aspect of the ESG criteria without adopting a fully integrated ESG investment philosophy. In contrast, pure ESG funds implement a comprehensive ESG investment strategy that systematically incorporates all three ESG dimensions.[20]

As of 24 March 2025, data from Wind indicates that the total assets under management (AUM) for outstanding ESG publicly offered funds amounted to RMB 818.229 billion. Of this, funds employing explicit ESG strategies accounted for 36.42 percent of the total, environmental-theme funds comprised 22.72 percent, social-responsibility-theme funds comprised 15.94 percent, and all other thematic funds comprised approximately 24.92 percent.[21] According to the *Self-Assessment Report on Green Investment by Fund Managers* (2024) (the Self-Assessment Report) issued by the Asset Management Association of China, over half of the surveyed Chinese fund management companies have integrated green investment into their corporate strategies and governance, primarily to support the "dual carbon" goals, meet market demands, and address foreign shareholder requirements, with many establishing specific structures for oversight and environmental risk management.[22]

2) Private Securities Investment Funds

China's ESG private securities investment funds refer to privately offered funds that engage in ESG investing and primarily allocate capital to publicly traded equity securities, bonds, futures, options, and other securities and derivatives recognised by the China Securities Regulatory Commission.[23]

Nevertheless, sustainable investment practices within these funds often remain superficial. Relevant data indicates that while most Chinese private securities fund managers have appointed executives or established firm-level committees to oversee such matters, actual implementation in terms of product launches, performance evaluation, and environmental risk management remains limited across the industry.[24]

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[20] CICC Quantitative and ESG and Liu Junwei, Qi Xing, et al., 'CICC ESG Fund Research (1): ESG Funds, The Next Important Position in the Asset Management Industry' (8 October 2023) <https://mp.weixin.qq.com/s/v-qbWwxPZa0s0rYyF6WX0w> accessed 28 May 2025.

[21] Securities Times, 'ESG Investment Map Clarified, Green Bonds and ESG Funds Significantly Grow in Scale' <https://www.stcn.com/article/detail/1606373.html> accessed 28 May 2025.

[22] Asset Management Association of China, 'Green Investment Self-Assessment Report by Fund Managers (2024)' <https://www.amac.org.cn/hyyj/esgtz/esgyj/202412/P020241219611533021140.pdf> accessed 20 March 2025.

[23] Asset Management Association of China, 'Explanation on "Fund Type" and "Product Type" of Private Investment Funds' <https://ambers.amac.org.cn/web/app/static/publicTemplate/productInfo.html> accessed 26 February 2025.

[24] The Self-Assessment Report (n 22).

3) Private Equity Investment Funds

A "green private equity investment fund" is defined as one that aims to improve corporate environmental performance, develop green industries, and mitigate environmental risks.[25] The Self-Assessment Report reveals that while many PE institutions are incorporating green investment into their strategies and governance structures, the integration of ESG considerations into decision-making processes and disclosure of progress remain at an early stage.[26]

4) Government Guidance Funds

Government guidance funds have played a prominent role in promoting sustainable development in China, particularly in emerging sectors such as new energy and carbon capture.[27] These funds are primarily funded by the central and local governments, which collectively contribute more than 50% of the capital.[28] Financial institutions provide approximately 30% of the capital, with the remaining contributions split almost equally between enterprises and privately offered funds.[29]

Among the major green industrial guidance funds in China,[30] the National Green Development Fund ("NGDF") stands out as China's first national-level mother fund dedicated to green development. Jointly initiated in 2020 by the Ministry of Finance, the Ministry of Ecology and Environment, and the Shanghai Municipal Government, NGDF adopts a diversified investment approach encompassing project investment, equity investment, and sub-fund investment.

A representative project investment by NGDF is the Dali City Huan'erhai Lakeside Buffer Zone Ecological Restoration and Wetland Construction PPP Project ("Dali PPP Project"). In partnership with Yunnan Construction Infrastructure Investment Co., Ltd. and Yunnan YIG Fund Private Equity Management Co., Ltd., NGDF invested approximately RMB 180 million as a limited partner (LP), acquiring a 9% equity stake in Dali Cang'er Investment and Construction Co., Ltd. to support the regulation of ecological spaces, improvement of the

[25] China Securities Regulatory Commission, 'Basic Requirements for Green Private Equity Investment Funds (Draft for Comments)' <https://www.csisc.cn/zbscbzw/c100133/202009/27d7181ea42f4181a837adf2f5fe85e4.shtml> accessed 1 June 2025.

[26] The Self-Assessment Report (n 22).

[27] China Government Guidance Fund Channel, 'Government Guidance Funds: A New Engine for Industrial Development' (2 January 2025) <http://mp.weixin.qq.com/s?__biz=MzI4MDc5NjI0OQ==&mid=2247500423&idx=1&sn=9277fd0e3e72084433c549d621b694ea&chksm=ead76b64a44ca9278db7ecb1f2822ab2f8241062f93a0e1ca67101da07be249b8d34107db458#rd> accessed 28 February 2025.

[28] Hainan Green Finance Research Institute and HGFR, 'How Many Times Can the Green Industrial Guidance Fund Leverage Social Capital?' (Hainan Green Finance Research Institute, 7 September 2021) <https://mp.weixin.qq.com/s/0063rveWnqKyNLy2MR4R5g> accessed 29 May 2025.

[29] Ibid.

[30] Ibid.

ecological structure of the lakeside zone, and building of ecological barriers in core buffer areas to significantly enhance the ecological health of the lakeside region.[31]

As part of its equity investment strategy, the fund injected RMB 1 billion of capital into Huadian Fuxin Energy Co., Ltd. to support the Huadian Group in its deployment of clean energy power stations. This investment contributes substantially to reducing standard coal consumption and carbon dioxide emissions, thereby advancing China's "double carbon" goals, and promoting low-carbon transformation in the energy sector and green development across the Yangtze River Economic Belt.[32]

In addition, NGDF invests through sub-funds. For example, it collaborated with China Baowu Steel Group and CCB Financial Asset Investment Co., Ltd. for the 2021 launch of the *Baowu Green Carbon Private Equity Fund*, committing RMB 1 Billion of an initial RMB 5.625 billion. By its closure in December 2023, this fund, one of China's largest carbon neutrality-themed funds, had raised over RMB 10 billion in commitments and completed nearly RMB 3 billion in green low-carbon equity investments across 13 projects by January 2024.[33]

Government industrial guidance funds leverage fiscal capital to promote social capital participation via two main mechanisms (see Diagram 1): (i) directly attracting social capital at the guidance fund level, and (ii) expanding fund scale as LPs in downstream investments to draw more social capital into the field.[34]

Diagram 1: Structure of the Green Industrial Guidance Fund[35]

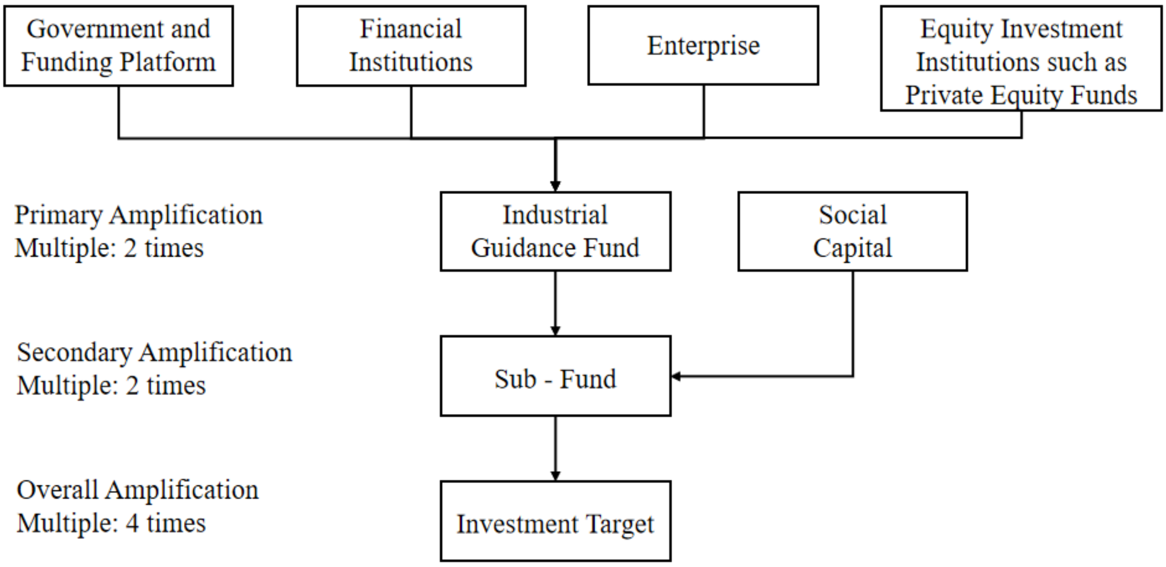
[31] NGFD, 'Beautiful China, Green Development' <https://www.ngd-fund.com/case> accessed 25 February 2025.

[32] Ibid.

[33] 'Green Credit, Green Bonds and Green Funds: Development Path and Latest Practices in the Chinese Market | MHP Junyue Commentary' <https://mp.weixin.qq.com/s/0pdP1oTMyPueUOHMYHiaIQ> accessed 25 February 2025.

[34] Hainan Green Finance Research Institute and HGFR (n 30)

[35] Ibid.



5) PPP Funds

PPP green project funds represent another important component of green equity funds in China. These funds are designed to attract private capital throughout the full life cycle of project investment, construction, operation, and exit.[36] Rather than adopting a "fund-of-funds plus direct investment" model common to green industrial funds, PPP green project funds operate through mechanisms such as concession arrangements and viability gap subsidies.

These mechanisms combine the government's credit enhancement with the efficiency of private enterprises, thereby addressing initial capital bottlenecks in project financing. This dual mechanism of government guidance and implicit government guarantees significantly increases the attractiveness of green funds to private capital. At present, PPP green project funds have primarily been implemented in sectors with high market maturity, stable cash flows, and established operational models, such as wastewater treatment, waste incineration, and ecological restoration.

PPP green project funds are not mutually exclusive from other types of green funds. For instance, the aforementioned Dali PPP Project received investment from the NGDF. After the selection of private capital parties (led by Yunnan Construction Infrastructure Investment Co., Ltd. and Yunnan Construction Investment Holding Group Co., Ltd.) through a public tender in 2019, the Dali municipal government introduced the NGDF in 2021 to supplement market-based financing for environmental capital expenditures. This made the Dali PPP Project the first project-based investment by NGDF nationwide.

[36] For a more detailed discussion on PPP funds, see Lin Lin, (n **Error! Bookmark not defined.**).

PPP green project funds also serve as underlying assets for Green Real Estate Investment Trusts (REITs)[37] in China. In 2021, Capital Water REIT became the first infrastructure REIT issued in China with a green PPP project as its underlying asset. The REIT was backed by wastewater treatment infrastructure operated by Beijing Capital Eco-Environment Protection Group Co., Ltd. (known as "Capital Environment") and incorporated a PPP project model. This financing structure enabled the monetisation of illiquid assets and long-term capital tied up in Capital Environment's PPP and BOT projects, effectively reducing its debt ratio and improving cash flow.[38]

6) Corporate PE/VC Funds

There are PE/VC funds initiated by industrial enterprises (large enterprise groups) and PE/VC funds initiated by financial institutions or private entities in China.[39] Although both types of funds operate within market mechanisms, their functional orientations differ considerably. The former, often referred to as corporate venture capital funds (CVC), is primarily established by large enterprise groups to advance industrial development. Their focus is predominantly on aligning with the parent company's strategic objectives and facilitating business expansion, often through incubation or mergers and acquisitions.[40] The latter category comprises funds that adhere to fully market-oriented models of fundraising, investment, management, and exit, targeting returns predominantly from green industry projects with robust commercial prospects.[41]

This divergence endows CVCs with significant advantages in industrial consolidation and capital structuring, rendering them more amenable to official endorsement. A representative example is the *Everbright Belt and Road Green Equity Investment Fund*. Launched as an official outcome of the second "Belt and Road" International Cooperation Forum in 2019, it is China's first domestic equity investment fund to fully adopt ESG investment standards.[42]

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[37] For an introduction to Chinese REITs, see L Lin, 'C-REITs and Investor Protection' (2023) 39 Banking & Finance Law Review 159.

[38] In January 2023, Vice Chairman Li Chao of the China Securities Regulatory Commission announced plans to further expand the pilot scope of infrastructure REITs, with an aim to soon include new infrastructure sectors such as renewable energy, water conservancy, and digital infrastructure. As of the end of 2022, wind and solar power station projects had already been accepted for review by the stock exchanges.

[39] Zhiyan Consulting (n 5).

[40] Ibid.

[41] Ibid.

[42] Everbright Holdings, 'Everbright Belt and Road Green Equity Investment Fund Successfully Raises First Round of 3 Billion Yuan' <https://www.everbright.com/zh-hans/news/%E5%85%89%E5%A4%A7%E4%B8%80%E5%B8%A6%E4%B8%80%E8%B7%AF%E7%BB%BF%E8%82%A1%E6%9D%83%E6%8A%95%E8%B5%84%E5%9F%BA%E9%87%91%E5%AE%9E%E7%8E%B0%E9%A6%96%E8%BD%AE30%E4%BA%BF%E5%85%83%E5%8B%9F%E9%9B%86%E6%88%90%E5%8A%9F> accessed 26 February 2025; 'First Phase 10 Billion Everbright "Belt and Road" Green Equity Investment Fund Launched', Belt and Road Portal (22 April 2020) <http://mp.weixin.qq.com/s?__biz=MzAxMTQ5NjgyMw==&mid=2650053212&idx=1&sn=0b9f0b94a5e22a1deb8740a822521edc&chksm=8253d553b9a77c284a3cadc0e4d06bfa817ae031acd4665621e19ad83f378b6031d2af8f39a8#rd> accessed 26 February 2025.

Pioneering fund ESG evaluation, the fund deploys a multi-tiered indicator library designed for exhaustive coverage. Its sophisticated framework, encompassing 31 to 36 primary and 120 to 180 context-specific secondary indicators, draws criteria meticulously from international best practices and current policy directives.[43] Distinct from conventional "negative screening", the investment target methodology leverages an innovative "green positive list", a prescriptive model mandating project alignment with four delineated green industrial sectors: environment, energy, manufacturing, and living.[44]

III. Regulating ESG Funds in China

a. Policy and Regulatory Framework

China is actively refining its ESG policy framework to facilitate the integration of ESG principles into funds.[45] At both national and local levels, regulatory bodies, including the State Council, local governments, national and local development and reform commissions, financial regulatory agencies, state-owned assets management institutions, and stock exchanges, have issued various regulatory documents addressing areas such as top-level design, implementation rules, asset classification, statistical standards, information disclosure requirements, and performance evaluation criteria.[46]

Diagram 2: Regulatory Framework of ESG Funds in China

[43] Everbright Holding, 'Everbright Belt and Road Green Fund: Strategizing Carbon Neutrality and Practicing ESG' <https://www.everbright.com/zh-hans/news/%E5%85%89%E5%A4%A7%E4%B8%80%E5%B8%A6%E4%B8%80%E8%B7%AF%E7%BB%BF%E8%89%B2%E5%9F%BA%E9%87%91%EF%BC%9A%E8%B0%8B%E5%B1%80%E7%A2%B3%E4%B8%AD%E5%92%8C%EF%BC%8C%E8%B7%B5%E8%A1%8Cesg> accessed 24 June 2025.

[44] Everbright Holdings, 'Everbright Belt and Road Green Fund Establishes an Equity Investment "Flagship" Fully Adopting ESG Investment Standards' <https://www.everbright.com/zh-hans/news/%E5%85%89%E5%A4%A7%E4%B8%80%E5%B8%A6%E4%B8%80%E8%B7%AF%E7%BB%BF%E8%89%B2%E5%9F%BA%E9%87%91%E6%89%93%E9%80%A0%E5%AE%8C%E6%95%B4%E9%87%87%E7%94%A8esg%E6%8A%95%E8%B5%84%E6%A0%87%E5%87%86%E7%9A%84%E8%82%A1%E6%8A%95%E8%B5%84%E2%80%9C%E6%97%97%E8%88%B0%E2%80%9D> accessed 26 February 2025.

[45] PwC, 'China Private Equity Fund Survey Report 2023 – ESG Chapter' (Dec 2023) <https://www.pwccn.com/zh/industries/private-equity/publications/china-pe-fund-research-report-esg-dec2023.html> accessed 28 February 2025.

[46] KPMG China, 'Rising Sun, Promising Future - White Paper on Insights into the Development of Sustainable Finance in China' (21 August 2023) <https://kpmg.com/cn/zh/home/insights/2023/05/sustainable-financial-development-in-china-white-paper.html> accessed 26 February 2025.

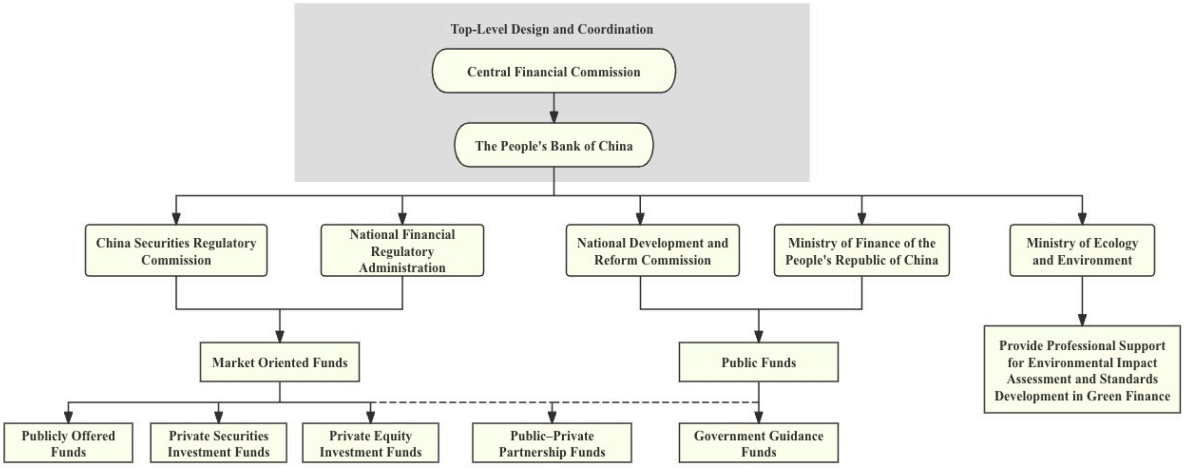

Diagram 2 reveals the hierarchical and division-of-labor framework for the regulation of ESG funds in China. This system combines vertical hierarchy with horizontal coordination to ensure comprehensive supervision of different types of green funds. Supervision of green finance, including sustainable funds, involves multiple regulators — the People's Bank of China, the China Securities Regulatory Commission, the Ministry of Ecology and Environment, the National Development and Reform Commission, and the National Financial Regulatory Administration.

At the top of the structure are the Central Financial Commission and the People's Bank of China, which play a central coordinating role by formulating macro-level policies and overseeing the overall regulatory framework. The next level includes the China Securities Regulatory Commission and the National Financial Regulatory Administration, both primarily responsible for the oversight of market-based financial instruments. Additionally, the National Development and Reform Commission and the Ministry of Finance are entrusted with the management of government guidance funds and other green funds with public attributes. These two agencies also hold certain supervisory responsibilities for PPP funds, which feature both public and private sector collaboration.

The Ministry of Ecology and Environment plays a specialised and supportive role in this regulatory system. It is mainly responsible for conducting environmental impact assessments related to green finance and for researching and setting relevant standards. This provides essential technical support for the compliant development of various types of funds.

Overall, this multi-tiered and multi-agency cooperative regulatory framework establishes a comprehensive network for the oversight of ESG funds in China. However, without effective coordination, this fragmented structure risks overlapping responsibilities, inconsistent standards, and regulatory gaps. For ESG funds bearing both financial and environmental-social attributes, such coordination failures may produce acute regulatory challenges.

Diagram 3: Legal Framework Governing ESG Funds in China

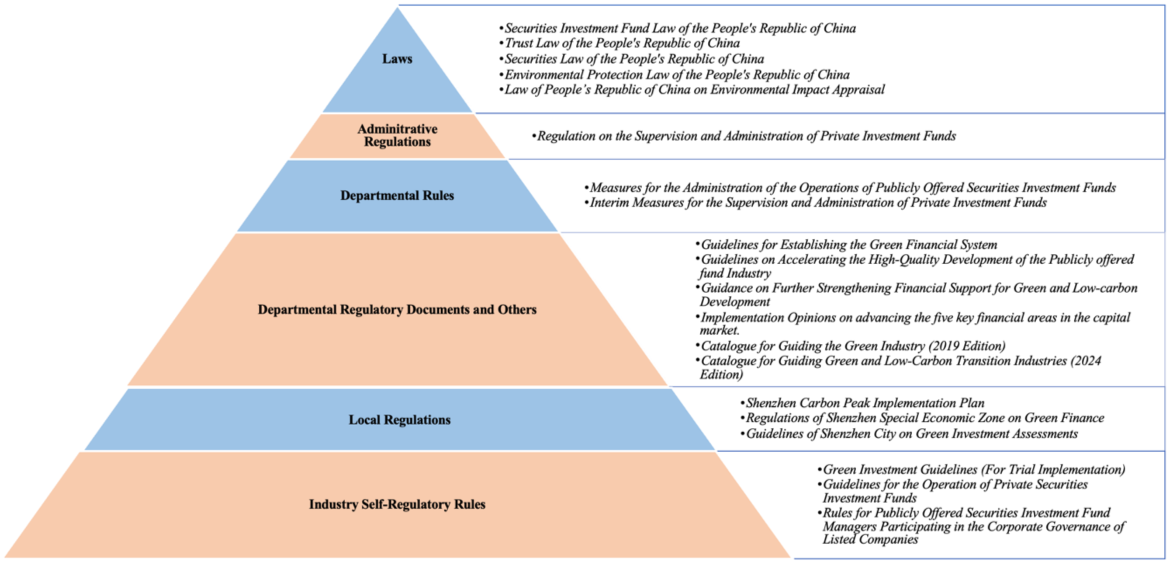

Diagram 3 illustrates the hierarchical structure of laws and regulations related to investment funds and green finance within China's legal framework. This system is organised in a pyramid structure, with the legal authority decreasing from top to bottom, while the regulatory content becomes increasingly detailed at each level.

At the top level are national laws enacted by the National People's Congress and its Standing Committee. Below this are administrative regulations issued by the State Council, departmental rules formulated by State Council ministries. Further down are departmental regulatory documents and others (e.g., *Guidelines on Establishing a Green Financial System*), local regulations (e.g., *Shenzhen's Carbon Peak Implementation plan)*, and industry self-regulatory rules (e.g., *Green Investment Guidelines (for Trial Implementation)*).

Nevertheless, China still lacks a comprehensive and binding regulatory framework that clearly defines ESG fund categories and mandates consistent disclosure requirements for investment targets.[47]

b. Fund Establishment

At present, there are no specific legal provisions tailored to the establishment of ESG funds in China. The establishment and registration of ESG-themed publicly offered funds and private investment funds are primarily governed by existing laws and regulations.[48]

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[47] Han Kun Law Offices, 'ESG Investment Trends and Outlook — Perspectives from Fund Managers and Long-Term Investors' <https://mp.weixin.qq.com/s/NLnFX6mlmrQTiabiZMT9qw> accessed 5 November 2024.

[48] For Publicly Offered Securities Investment Funds, see Securities Investment Fund Law of the People's Republic of China 2015; Measures for the Administration of the Operations of Publicly Offered Securities Investment Funds (CSRC Order No

1) Labelling of Funds

Labelling of funds is on a voluntary basis in China. There are currently no explicit regulatory requirements for including ESG-related keywords in fund names. This regulatory gap heightens the risks of "greenwashing" while simultaneously complicating the process of screening and defining the scope of ESG funds. The China Securities Regulatory Commission promulgated the *Guidelines on Accelerating the High-Quality Development of the Publicly offered fund Industry* in 2022, which emphasise that publicly offered funds must implement responsible investment principles and systematically analyse ESG investment methodologies.[49] However, there is no specific requirement concerning fund registration or labelling in these guidelines.

2) Standard-setting

Unlike the EU which has a unified, binding taxonomy for environmentally sustainable activities, classifying green investments remains fragmented and primarily operates through the policy catalogues in China – *Catalogue for Guiding the Green Industry* (2019 Edition). It has since served as a key reference for the formulation of standards on green credit, green bonds, green enterprises, and green PE funds. The catalogue was formally updated and renamed the *Catalogue for Guiding Green and Low-Carbon Transition Industries* in 2024 (2024 Edition), expanding the scope of green industries to include emerging sectors such as hydrogen energy and green logistics, and the low-carbon upgrading of traditional industries.

Despite certain functional similarities, China's approach contrasts with the regulatory nature of the EU Taxonomy Regulation, which imposes legally binding screening criteria on participants and operates in tandem with disclosure frameworks such as the *Sustainable Finance Disclosure Regulation* (SFDR) and the *Corporate Sustainability Reporting Directive* (CSRD). By comparison, the Chinese catalogue does not carry direct regulatory force over fund naming, classification, or disclosure, and compliance remains voluntary. The fact that the catalogue is issued by key administrative bodies, including the National Development and Reform Commission and relevant industrial and natural resource authorities, underscores its primary function as an instrument of industrial policy rather than financial regulation. Its content is frequently referenced by local governments and financial institutions in designing green credit and subsidy schemes, and therefore indirectly shapes investment behaviour.

104); Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds (CSRC Order No 198); For Private Investment Funds, see Regulation on the Supervision and Administration of Private Investment Funds (State Council Order No 762); Measures for the Registration and Recordation of Private Investment Funds (AMAC Notice No 5 [2023]); Interim Measures for the Supervision and Administration of Privately Offered Investment Funds (CSRC Order [2014] No 105).

[49] National Financial Regulatory Administration, 'Guidelines on Accelerating the High-Quality Development of the Publicly offered fund Industry' (20 April 2024) <https://www.gov.cn/zhengce/zhengceku/202404/content_6947537.htm> accessed 15 May 2025.

Nevertheless, it may exert normative influence over fund investment decisions, particularly those of green funds.

International collaboration has advanced the harmonisation of sustainable investment standards across different jurisdictions.[50] A key initiative in this regard is the CGT, jointly developed by Chinese and EU authorities. The CGT identifies areas of convergence between the EU Taxonomy and China's green finance classifications.[51] Building on this initiative, Singapore joined Phase II of the CGT project in 2023 and launched the Multilateral Common Ground Taxonomy (Multilateral-CGT) in November 2024, thereby introducing new overlapping areas across the jurisdictions of China, Singapore, and the EU.[52]

The CGT's influence is already manifesting in the development of green-labelled financial products. For instance, in December 2024, China approved its first fund explicitly aligned with the CGT: the Morgan Common Classification Catalogue Green Bond Fund.[53] In the same month, Neuberger Berman launched the CFETS 0–5 Year Climate Change High-Grade Bond Composite Index Fund, which integrates CGT-aligned criteria.[54]

These developments suggest a nascent but meaningful shift toward the voluntary adoption of international sustainability standards in China's green fund landscape. While the CGT and Multilateral-CGT does not alter the binding nature of either jurisdiction's existing regulatory rules, they offer a harmonised reference point for ESG fund managers and institutional investors aiming to enhance cross-border compatibility. This initiative also promotes greater transparency and consistency, thereby mitigating greenwashing risks, especially in the absence of a formalised domestic labelling regime.

c. Fund Investment and Operations

Both publicly offered funds and privately offered funds in China operate under strict regulatory supervision governing both their investment and operational activities.[55] Publicly offered funds are largely confined to investing in standardised assets[56] and are regulated accordingly in terms

[50] Ma Jun, Xu Sujiang and Wang Bolu, 'China and the EU Join Hands to Expand the Common Sustainable Finance Taxonomy' (2025) (03) China Finance 46–48.

[51] IPSF Taxonomy Working Group (EU and China co-chairs), 'Common Ground Taxonomy – Climate Change Mitigation: Instruction Report' <https://finance.ec.europa.eu/system/files/2021-12/211104-ipsf-common-ground-taxonomy-instruction-report-2021_en.pdf> accessed 15 March 2025.

[52] 'Common Ground Taxonomy Multi-Jurisdiction Activity Tables' (13 November 2024) <https://finance.ec.europa.eu/document/download/e83394d0-daf1-487e-b1bf-922731767a10_en?filename=241113-common-ground-taxonomy-multi-jurisdiction-activity-tables_en.pdf> accessed 20 March 2025.

[53] See the fund homepage for relevant information <https://www.cifm.com/fund/022618/> accessed 15 March 2025.

[54] See the fund homepage for relevant information < https://www.nbchina.com/nb/products/zhaiquan/023016/index.html> accessed 15 March 2025.

[55] On operational obstacles faced by fund managers, see Luh Luh Lan and Ernest Lim, 'Contextualising ESG Funds' Engagement Strategies in Asia' (15 October 2024) <https://papers.ssrn.com/abstract=4989840> accessed 20 May 2025.

[56] Standardised assets are defined as fixed-income securities lawfully issued, including but not limited to: treasury bonds, central bank bills, local government bonds, government-supported agency bonds, financial bonds, non-financial corporate debt

of their formation, fundraising, and operations[57]. Private fund operations are subject to a parallel framework under regulations governing fundraising activities, fund scale maintenance,[58] impose investment and operational restrictions,[59] information disclosure and filing requirements, as well as supervisory and penalty mechanisms.

In China, ESG public securities investment funds are categorised as thematic funds, necessitating that any ESG-labelled publicly offered fund commits a minimum of 80% of its investable assets to ESG-related sectors or instruments to maintain thematic consistency between its label and portfolio.[60]

Similarly, for privately offered funds, the requirement that the name and product type of a private securities investment fund align with the investment strategy, instruments, and hedging tools outlined in the fund contract, while more broadly stated, also enforces a fundamental principle of coherence between the fund's designation, classification, and its actual investment activities.[61] These regulatory provisions, albeit differing in specificity and enforceability, reflect a broader regulatory intent to ensure that funds' naming conventions do not mislead investors and that thematic funds maintain a meaningful degree of alignment with their stated objectives.

d. Industry Guidelines

The Asset Management Association of China plays a significant role in promoting and regulating green funds, although it is an association under the China Securities Regulatory Commission.[62] The *Green Investment Guidelines (for Trial Implementation)*, issued by the Asset Management Association of China in November 2018, defines the scope of green investment and standardises industry practices to guide fund managers approach to integrating

financing instruments, corporate bonds and enterprise bonds. People's Bank of China. China Banking and Insurance Regulatory Commission, China Securities Regulatory Commission, and State Administration of Foreign Exchange, 'Rules for the Identification of Standardised Credit Assets' (Announcement No 5 [2020]) Art 1.

[57] Since the implementation of the Measures for the Administration of the Operations of Publicly Offered Securities Investment Funds, the "Double Ten" restriction has remained a fundamental regulatory standard governing the investment positions of public funds in China. This restriction stipulates that the market value of securities of any single company held by a single fund shall not exceed ten per cent of the fund's net asset value; moreover, the aggregate holdings of securities of any single company by all funds managed by the same fund manager shall not exceed ten per cent of that company's total securities in issue.

[58] The minimum initial paid-in capital must be no less than RMB 10 million, and specific liquidation requirements are triggered when the daily net asset value or the fund size falls below prescribed thresholds for a designated number of consecutive trading days. Asset Management Association of China, 'Guidelines for the Operation of Private Securities Investment Funds' (AMAC [2024] No 5), Art 4.

[59] For example, the "Double 25% Rule" portfolio investment restriction, prohibitions on certain activities, and constraints on derivatives investments. Guidelines for the Operation of Private Securities Investment Funds, Art 12

[60] Measures for the Administration of the Operations of Publicly Offered Securities Investment Funds, Art 31.

[61] Guidelines for the Operation of Private Securities Investment Funds, Art 10.

[62] Fang Guirong, 'On the Legislative Development and Institutional Construction of Green Finance Regulation' (2020) 6 Economic and Trade Law Review 37.

environmental factors into investment decisions. Article 2 of the Guidelines applies to public and private securities fund managers and their products, while PE funds and institutional investors are encouraged to refer its principles for green investment.

In addition, the *Green Finance Guidelines for the Banking and Insurance Industries* issued by the China Banking and Insurance Regulatory Commission in June 2022 represent another key regulatory initiative. This guideline requires banks and insurance institutions, two major institutional investor groups, to enhance ESG risk management frameworks, set measurable green finance objectives, and gradually reduce the carbon intensity of their asset portfolios to achieve portfolio carbon neutrality. This guideline also specifies key areas for ESG risk due diligence and encourages alignment with international best practices to strengthen information disclosure standards.

e. Local Legislation

While China has yet to implement a comprehensive, targeted national regulation for ESG funds, local regulations on green investment have emerged to guide green investment practices. For example, the *Guidelines of Shenzhen City on Green Investment Assessments* require financial institutions to conduct green investment evaluations for projects meeting specific criteria.[63] Evaluation requirements include a review of environmental impact assessment reports, analysis of environmental risks and benefits, and assessment of the project entity's environmental risk management capabilities. Post-investment, financial institutions must use contractual terms and dynamic tracking to ensure annual environmental risk monitoring reports and implement rectification or exit mechanisms for non-compliant entities. Financial institutions may also appoint third-party professionals for evaluations or conduct joint assessments with other financial institutions.

f. Disclosure and Reporting

1) ESG Information Disclosure by Listed Companies

Effective ESG investing by funds, particularly publicly offered funds that invest significantly in publicly traded equities, is fundamentally dependent on the quality and accessibility of ESG information disclosed by listed companies. Such corporate disclosures are vital for fund managers to assess sustainability-related risks and opportunities, make informed investment decisions, construct ESG-focused portfolios, and meet their own reporting obligations.

[63] Such thresholds include, for instance, total investment exceeding or equal to RMB 50 million, which triggers the requirement for an environmental impact assessment, or annual greenhouse gas emissions reaching or exceeding 3,000 tons of CO_2 equivalent. Guidelines of Shenzhen City on Green Investment Assessments (Shen Jin Jian Gui [2023] No 3), Art 4.

At present, most ESG disclosure norms in China operate under soft law frameworks,[64] which fall into two primary categories: official soft laws issued by regulatory authorities[65] and institutional soft laws promulgated by exchanges[66]. While these soft law norms are not legally enforceable, they exert substantial influence over member companies of the regulating organisations.[67]

Of further significance is the emergence of "soft law within hard law". Article 20 of the *Company Law of the People's Republic of China* (2023 Revision) stipulates that "in operations, a company shall fully consider the interests of its employees, consumers, and other stakeholders and ecological and environmental protection and other public interests, and assume social responsibility". However, the "social responsibility" (S) here lacks corresponding legal consequences, and the governance (G) information disclosure rules remain incomplete.[68]

By 2024, over 2,200 listed companies have disclosed their 2023 sustainable development or corporate social responsibility reports, reflecting an average annual growth rate of 20% over the past three years.[69]

A partial shift occurred in April 2024, when the Shanghai, Shenzhen, and Beijing Stock Exchanges issued the *Guidelines for Sustainability Report of Listed Companies*, mandating that sample companies of the SSE 180, STAR 50, SZSE 100, and ChiNext indices, as well as companies listed both domestically and overseas, disclose their 2025 sustainable development reports. While this marks a step towards mandatory ESG reporting, a comprehensive disclosure regime is still lacking.[70]

Subsequently, on January 17, 2025, under the guidance of the China Securities Regulatory Commission, the three exchanges jointly issued the *Compilation Guidelines for Sustainable Development Reports of Listed Companies* (the "Compilation Guidelines"), which includes specific disclosure rules on "General Requirements and Disclosure Framework" and "Climate

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[64] Factors such as the dominance of state ownership among Chinese listed firms, the weaker role of equity financing in the Chinese market, and the relatively weak demand among Chinese retail investors for ESG information are considered reasons why Chinese securities regulators and stock exchanges have faced less pressing demand for information disclosure, see Virginia Harper Ho (n 9) 8, 9.

[65] For instance, Guidance on Central Enterprises Fulfilling Social Responsibilities (SASAC Ref [2008] No 1); Code of Corporate Governance for Listed Companies (China Securities Regulatory Commission Announcement [2018] No 29); Guidelines for Establishing the Green Financial System (2016).

[66] For instance, Shenzhen Stock Exchange, "Social Responsibility Instructions to Listed Companies" (SZSE [2006] No 115); Shanghai Stock Exchange, "Guidelines for Environmental Information Disclosure by Listed Companies" (2008).

[67] Wang Lan, 'Optimizing ESG Information Disclosure Governance with Soft Law Norms' (February 2024) <https://www.cssn.cn/fx/xr/202402/t20240222_5734274.shtml> accessed 29 May 2025.

[68] Ibid.

[69] Ibid.

[70] Securities Times, 'ESG Mandatory Disclosure Companies Reshuffle: 27 Listed Companies Including Huaxia Bank Newly Included' (26 February 2024) <https://www.stcn.com/article/detail/1534095.html> accessed 26 February 2025.

Change Response" to provide detailed guidance on practical challenges for listed companies.[71] The exchanges have expressed intentions to use the Compilation Guidelines as mandatory standards and to promote the Compilation Guidelines as reference norms. [72]

In March 2025, the China Securities Regulatory Commission promulgated the revised *Measures on Information Disclosure by Listed Companies*. Article 65 of these Measures stipulates that listed companies shall publish sustainability reports in accordance with the rules of the stock exchange. This provision signifies the first instance of mandatory ESG information disclosure requirements being imposed by regulatory authorities at the level of departmental rules, thereby establishing their legal enforceability. Non-compliance with these requirements will subject listed companies to regulatory sanctions.

Diagram 4: The Evolution of China's ESG Disclosure Standards

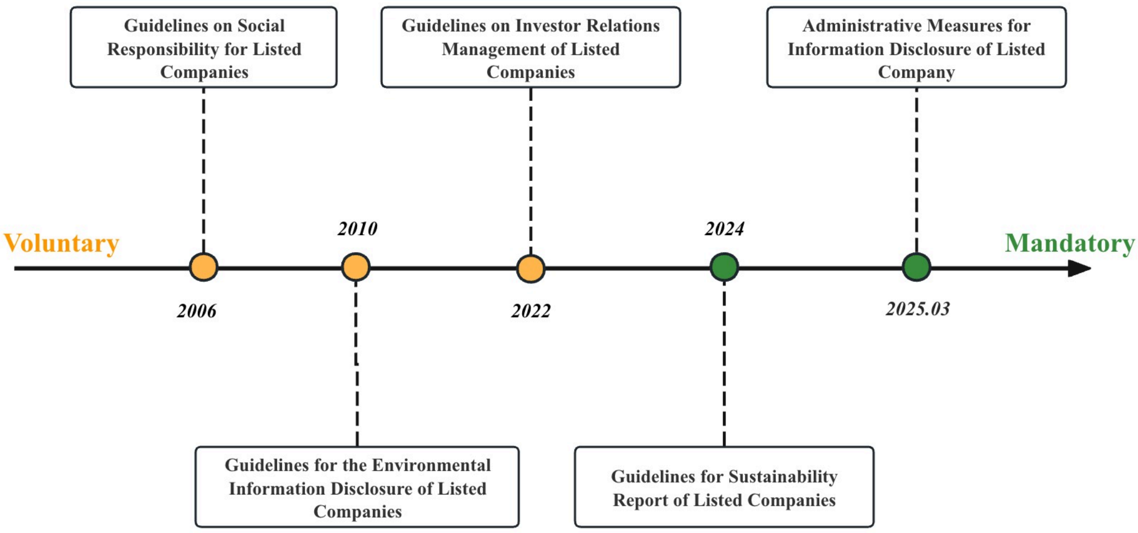

Diagram 4 illustrates the evolution of China's ESG disclosure standards from 2006 to 2025, highlighting the transition from voluntary to mandatory disclosure.

2) Disclosure for ESG Funds

i. Disclosure at Fund Level

China's disclosure framework for ESG funds is evolving. At present, specific regulatory guidance in this domain is primarily confined to the *Green Investment Guidelines (for Trial*

[71] China Fund Journal and Shuchao Li, 'Three Major Stock Exchanges, Latest Release!' (China Fund Journal, 17 January 2025) <https://mp.weixin.qq.com/s/mc3eUNZaSXAsuSl_YLCRQA> accessed 27 February 2025.

[72] Ibid.

Implementation). These Guidelines encourage fund managers to introduce a diversified array of green investment products and mandate that actively managed green funds disclose pertinent information, including green benchmarks, investment strategies, and alterations to their portfolios.

Beyond these specific provisions, both publicly offered funds and private funds conduct their information disclosure in accordance with existing general regulations. They are not, as of yet, subject to supplementary disclosure obligations arising specifically from the ESG attributes of their investments.

Furthermore, even among those funds that voluntarily undertake green investment disclosures, the actual practices observed are not uniformly optimal. Illustratively, in the context of publicly offered funds, most funds only provide high-level descriptions of ESG concepts and investment strategies, with limited details on portfolio composition, asset reallocation, or measurable environmental outcomes such as carbon reduction or environmental protection.[73]

ii. Disclosure at Manager Level

There is no regulatory obligation for ESG disclosure imposed on fund managers, and related regulations remain similarly underdeveloped. However, some leading Chinese fund managers, particularly those signatory to the Principles for Responsible Investment, have voluntarily initiated annual ESG reporting practices. These reports are generally prepared by internal staff and communicated to stakeholders through public or private channels.

According to the Self-Assessment Report, 20 institutions disclosed relevant information to investors or the public via social responsibility reports, environmental disclosures, or corporate statements on official channels. Of these, 21 out of 28 institutions set specific green investment goals, with 13 disclosing goal achievements, including targets for green operations, ESG research systems, investment scale, and product innovation. [74]

Despite such progress, many institutions continue to undervalue the strategic significance of ESG reporting. Over half of the reporting institutions take more than 30 days to prepare their ESG reports, and a comparable proportion of institutions still lack concrete plans to implement ESG disclosures altogether.[75]

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[73] 'How to Press the "Accelerator Key"? Current Situation, Challenges and Prospects for the Development of Domestic ESG Funds in China | Summary of Results' <https://mp.weixin.qq.com/s/1jQFFDC43OWXYQF7CBkDaQ> accessed 28 February 2025.

[74] The Self-Assessment Report (n 22).

[75] PwC (n 45).

While regulatory requirements for ESG information disclosure by fund managers and their products are currently in a nascent stage, the above mentioned *Guidelines for Sustainability Reports of Listed Companies*, which expressly mandate disclosure of ESG-related information by listed companies, indicate a regulatory trajectory towards expanding coverage to financial institutions. This suggests that future regulatory frameworks may further encompass ESG disclosure obligations for fund managers and the financial products they oversee.

g. ESG Rating

China's domestic ESG evaluation systems remain underdeveloped.[76] Market rating agencies vary widely in quality, and there is no unified set of metrics for assessing fund managers' philosophies, strategies, and sustainable performance. Compounding this challenge, regulatory authorities have yet to integrate carbon risk assessments with international standards, such as those of the International Sustainability Standards Board (ISSB), which is still at an early stage of domestic implementation.[77]

The aforementioned issues pertaining to ESG ratings in China are not isolated phenomena. They represent not merely a derivative consequence of the previously discussed lacuna in mandatory disclosure requirements, but also a direct repercussion of the intrinsic deficiencies within the ESG rating process itself, namely the absence of standardised assessment criteria and the complexities inherent in its methodologies.

However, it is crucial to note that the most significant potential for greenwashing attributable to these shortcomings is predominantly concentrated among market-driven PE and VC firms. Indeed, government guidance funds demonstrate a superior level of credibility in green investments, whereas investments by PE/VC entities exhibit comparatively weaker green relevance.[78]

The enhanced green credibility of government guidance funds is fundamentally rooted in their pronounced policy-oriented nature and their profound alignment with national green development strategies. Under the impetus of state policy, such funds have adopted ESG principles with greater alacrity and systemic rigour. In 2021, the National Development and Reform Commission, which exercises principal oversight functions concerning government guidance funds, advocated for the assimilation of international best practices, including ESG considerations, into project feasibility assessments. This position was reaffirmed in 2022,

[76] For a detailed examination of recent regulation concerning ESG ratings at the EU level, see Hse-Yu Chiu, 'Regulating ESG Rating and Data Product Providers: Critically Examining EU Regulation through the Lens of Functional Regulatory Consistency' [2024] European Journal of Risk Regulation <https://www.cambridge.org/core/journals/european-journal-of-risk-regulation> accessed 7 September 2024.

[77] IIGF (n 19).

[78] Shanghai Advanced Institute of Finance and Ciguan Qiu, 'Ciguan Qiu: Data Challenges in Green Investment by Private Equity Funds' (14 June 2023) <https://mp.weixin.qq.com/s/_qc37-N2i87Dyt-jdZG81A?poc_token=HDWwtmejj-QNZtbxGAtLm0gEEx3lhkuFUZY1RlXk> accessed 20 February 2025.

thereby signalling a proactive governmental stance towards integrating ESG evaluations into prospective investment undertakings.[79]

Of particular significance, China has recently undertaken a pivotal step towards fostering the institutionalisation of ESG ratings and the concomitant development of market-based mechanisms. In 2024, the People's Bank of China, in conjunction with four other ministries, issued the *Guiding Opinions on Further Strengthening Financial Support for Green and Low-Carbon Development*. This Opinions explicitly supports the integration of ESG factors within the methodological frameworks and analytical models of credit rating agencies, and further champions the institutional entrenchment of ESG ratings throughout the credit rating industry.

h. Fund Manager Requirements

In contrast to the EU, where regulatory frameworks necessitate the incorporation of sustainability risks into organisational arrangements, decision-making processes, and investment due diligence, China does not currently impose specific regulatory requirements upon fund managers with respect to sustainable investment.

It is noteworthy that the role of the "individual portfolio manager", who provides bespoke, discretionary services to independent investors, is not mainstream within China's financial market.[80] Instead, the market for investment funds is largely composed of two predominant groups: on one end, institutional fund managers who provide standardised products to the general public, and on the other end, a vast number of self-directed individual investors accustomed to making their own investment decisions.[81] This structural reality may, in part, explain why the development of ESG funds in China remains in its early stages, as this vast demographic is collectively characterised by short-termism[82] and a limited awareness of and engagement with ESG[83].

[79] National Development and Reform Commission, 'Opinions on Further Improving the Policy Environment and Increasing Support for the Development of Private Investment' (NDRC Investment [2022] No 1652), Part II(4).

[80] In China, the discretionary fund investment advisory business, which is analogous to individual portfolio management, was only introduced on a pilot basis in 2019 and remains in a nascent stage. See Brokerage China, 'Adapting to Client Needs, Fund Investment Advisory Embraces New Business Models', (20 October 2019) <https://mp.weixin.qq.com/s?__biz=MzAwNjA4MTUwNA==&mid=2652736405&idx=5&sn=6d9cee49bc7a00f41a3eb18dac8cb229> accessed 28 June 2025.

[81] A case in point is the market for publicly offered funds in China, where individual investors accounted for 58.93% of total assets in 2024. See Mordor Intelligence, China Mutual Funds Market Size & Share Analysis (2024) <https://www.mordorintelligence.com/industry-reports/china-mutual-funds-market> accessed 28 June 2025.

[82] Qing Wang, 'Report: Investors' Fund Holdings Remain Short-Term in Nature, Particularly Evident in Offline Channels' Economic Observer (20 December 2024) <http://www.eeo.com.cn/2024/1220/703418.shtml> accessed 28 June 2025

[83]Centre for Green Finance Studies, 'Forum Discussions: Zhang Bohui – Is There ESG Awareness? Research on the Asset Management Industry and Retail Investors' (13 February 2025) <https://news.qq.com/rain/a/20250213A01MGE00> accessed 28 June 2025.

While the Asset Management Association of China has identified four key components[84] for the evaluation of green investment, adherence to this aforementioned framework is not statutorily mandated. Consequently, fund managers in China remain predominantly subject to the general regulatory obligations concerning registration, internal controls, risk management, and staffing requirements, as stipulated within pre-existing regulatory provisions.[85]

It is noteworthy, however, that managers of sub-funds operating under the aegis of government guidance funds are additionally obligated to comply with pertinent local regulations. These fund managers must satisfy specific criteria, including an established in-province operational presence, stipulated minimum paid-in capital, requisite private equity investment fund manager qualifications, and relevant prior professional experience.[86]

i. Investors

China's ESG fund landscape is currently dominated by institutional investors.[87] Retail participation remains limited, largely due to the long-term nature of ESG commitments and the complexity of ESG principles, which pose educational and behavioural barriers to entry. Research has also indicated that state-owned institutional investors in China demonstrate a stronger emphasis on ESG considerations compared to their private-sector counterparts, likely due to their dual role in policy implementation and capital allocation aligned with national sustainability objectives.[88]

On the regulatory front, the EU has taken the lead, requiring asset managers, financial advisers, and fund managers with a "MiFID II top-up" to carry out a suitability assessment when providing investment advice or portfolio management.[89] In comparison, China has not yet

[84] See Asset Management Association of China, 'Suggested Framework for Green Investment Self-Assessment by Fund Managers' (31 December 2019) <https://www.amac.org.cn/aboutassociation/gyxh_xhdt/xhdt_xhyw/201912/t20191231_4468.html> accessed 10 May 2025, which outlines the following key areas: (1) Development of green investment philosophy and framework; (2) Operation of green investment products; (3) Control of green investment environmental risks and (4) Disclosures related to green investment.

[85] See Measures for the Supervision and Administration of Managers of Publicly Offered Securities Investment Funds, Measures for the Registration and Recordation of Private Investment Funds, and Regulation on the Supervision and Administration of Private Investment Funds.

[86] For example, the public selection of managers for the NGFD Guizhou Special Fund in Guizhou Province requires compliance with the Interim Measures for the Management of Guizhou New Industrialization Development Fund (Notice No. 26 [2021] of Guizhou Department of Finance), including having an in-province presence, paid-in capital of at least RMB 10 million, qualification requirements for private equity investment fund managers, at least three executives with over three years of experience and three successful investment cases, strong fundraising capabilities (over RMB 300 million in track record), parallel investment of at least 1% of the fund size, industry expertise, and a clean compliance record for the past three years. <https://gxt.guizhou.gov.cn/gxdt/tzgg/202211/t20221104_77009099.html> accessed 20 April 2025.

[87] Eastmoney.com Data Center, 'ESG Literature Commentary: Do State-Owned Institutional Investors Pay More Attention to ESG? — Macroeconomic Research Report' <https://data.eastmoney.com/report/zw_macresearch.jshtml?encodeUrl=HVNJTf2gMQy%2FI7AczrrZEov%2FLsIadbNovNTkLVb8o2Y%3D> accessed 27 April 2025.

[88] Ibid.

[89] Sebastiaan Niels Hooghiemstra, '9. EU 'Rule-Based' ESG Duties for Investment Funds and Their Managers under the European 'Green Deal', Research Handbook on Environmental, Social and Corporate Governance (Edward Elgar Publishing 2024).

established specific eligibility criteria for investors in ESG funds. For both public and private types of ESG funds, ESG factors have not altered their investor qualification requirements or risk classification. Specifically, privately offered funds must still comply with existing regulations to raise capital from qualified investors,[90] whereas public securities investment funds, provided they meet general investor suitability requirements, face no additional restrictions on the number or type of their investors.

IV. Policy-Driven Transformation of Sustainable Investment: The Chinese Approach

Overall, sustainable investment concepts and practices in the EU developed earlier and have since matured, supported by a more advanced market structure and higher levels of investor awareness and demand. While China's sustainable investment market developed at a later stage, it has experienced rapid growth in recent years, driven by strong policy incentives and increasing market interest.

The EU has created a comprehensive disclosure framework for sustainable investment funds through the SFDR and Taxonomy Regulation.[91] This framework emphasises transparency and has advanced sustainable fund development by providing a common definition of "sustainable investment". This concept is embedded in the SFDR and CSRD, aligning corporate and financial product disclosures to enhance data reliability and comparability.

By contrast, China currently lacks a comprehensive and operational regulatory framework governing sustainable investment and related funds. In the early stages of fund development, particularly green funds, regulatory emphasis has been placed on top-down policy promotion rather than the construction of a dedicated supervisory framework.[92] The result is a state-led model of multi-agency coordination characterised by a strategic and flexible approach to policy design, while standard-setting efforts remain ongoing and incomplete.

China's model for ESG fund development is intrinsically linked to its unique market conditions and socio-economic context. While ESG funds are acknowledged as crucial for sustainable

[90] Qualified investors must satisfy requisite asset thresholds—specifically, net assets of not less than RMB 10 million for institutional investors, or for individual investors, financial assets of not less than RMB 3 million or average annual income of not less than RMB 500,000—and make a minimum investment of not less than RMB 1 million per fund. Interim Measures for the Supervision and Administration of Privately Offered Investment Funds, Art 12.

[91] For a general overview of EU disclosure requirements, see: Kern Alexander and Aline Darbellay, 'Disclosure Regulation and Sustainability' in Kern Alexander, Matteo Gargantini and Michele Siri (eds), The Cambridge Handbook of EU Sustainable Finance (1st edn, Cambridge University Press 2025); Christos V Gortsos and Dimitrios Kyriazis, 'The Taxonomy Regulation and Its Implementation' in Danny Busch, Guido Ferrarini and Seraina Grünewald (eds), Sustainable Finance in Europe: Corporate Governance, Financial Stability and Financial Markets (Springer International Publishing 2024) accessed 15 September 2024; and Danny Busch, 'EU Sustainable Finance Disclosure Regulation' (2023) 18(3) Capital Markets Law Journal 303, 303–328 <https://academic.oup.com/cmlj/article/18/3/303/7192036> accessed 28 June 2025.

[92] For a comprehensive comparative analysis of green finance development models between the EU and China, see Mathias Lund Larsen, 'Bottom-up Market-Facilitation and Top-down Market-Steering: Comparing and Conceptualizing Green Finance Approaches in the EU and China' (2023) 21 Asia Europe Journal 61.

development, their scale remains modest compared to green credit and bonds.[93] Unlike the EU, China faces distinct challenges: many small and medium-sized enterprises (SMEs) are nascent in their ESG journey from awareness and management systems to data collection and disclosure capabilities, making high ESG standards difficult to implement immediately. Furthermore, the domestic market has a relative scarcity of "patient capital" geared towards long-term investment in the ESG sector, and broad investor adoption of ESG principles is still developing.

This context, marked by a less potent "bottom-up" market demand compared to the EU's interplay with "top-down" regulation, shapes China's primary objective.[94] The fundamental task extends beyond merely channelling finance. It prioritises real economy building. This involves ensuring that financial resources, especially social capital via green funds (the predominant form of ESG funds in the Chinese context), are precisely directed to enterprises, particularly SMEs, that generate tangible environmental benefits and drive industrial green transformation.

Therefore, at the institutional level, China has adopted a step-by-step approach, emphasising the role of government in directing capital flows into green sectors and fostering real economic activities. This strategy aims to gradually shape a uniquely Chinese pathway for the development of ESG funds. The above initiatives are mainly reflected in the following aspects:

a. From the Exemplification of SOEs to Inclusive Transformation

The exemplary effect of SOEs has led to the enhancement of ESG awareness and capacity of the industrial chain as a whole,[95] which is not only a reflection of China's institutional advantages, but also a pragmatic choice to promote ESG development at this stage. As a key force in the national economy, the social functions of central and local SOEs determine that they are not only economic entities, but also important implementers of national strategic goals and their pioneering role in the ESG field has an irreplaceable function of leading and mediating the overall social goals in shaping an ESG ecosystem with Chinese characteristics.[96] Their initiatives include green credit promoted by state-funded banks and the issuance of green bonds by state-funded companies. As for green funds, which have been developing more

[93] Securities Times, 'Looking at the '14th Five-Year Plan' Answer Sheet Through Data: From Systemic Layout to Comprehensive Breakthrough, Building a New Paradigm for Global Green and Low-Carbon Development' <https://stcn.com/article/detail/1842905.html> accessed 29 May 2025.

[94] For an analysis of the interplay between authoritative governance and market mechanisms, see Hse-Yu Chiu, 'Sustainable Finance Regulation – Authoritative Governance or Market-Based Governance for Fund Management?' (2023) 57 Journal of Financial Transformation 48.

[95] For further analysis of the role of government as a controlling shareholder and its implications for climate change management and litigation, see Ernest Lim, 'The Government Controlling Shareholder as a Fiduciary: Implications for Climate Change Management and Litigation' (7 November 2023) <https://papers.ssrn.com/abstract=4625476> accessed 16 May 2025.

[96] State-owned Assets Supervision and Administration Commission of the State Council (SASAC), 'Guiding Opinions on Central Enterprises' High-Standard Fulfilment of Social Responsibility in the New Era' (27 May 2024) <https://www.gov.cn/zhengce/zhengceku/202406/content_6955457.htm> accessed 29 May 2025.

slowly, their development has also been mainly promoted by the centrally-led National Development Fund and local governments.

China's green finance has historically focused more on central and local SOEs while providing limited support for SMEs. The *Catalogue for Guiding the Green Industry* (2019 Edition) prioritised major industries aligned with national strategies, excluding smaller and universal players. In contrast, the updated *Catalogue for Guiding Green and Low-Carbon Transition Industries* (2024 Edition) broadens the scope to include rural revitalisation, SME digital transformation, and supply chain upgrades, signalling a shift towards a more inclusive green finance.

China's export-oriented economy has also bolstered ESG development. The Suzhou Industrial Park (SIP), driven by its export focus, has integrated ESG practices to meet international trade standards and foster industrial upgrading.[97] As an eco-industrial demonstration park, SIP has advanced regional ESG systems with initiatives such as the *White Paper on Sustainable Development* (2024) and the country's first *General Rules for ESG Evaluation in Economic Development Zones* issued by the China Association for Standardization.[98] These efforts aim to enhance regional ESG ecosystems, improve performance, and support sustainable development.

b. The Market Mechanism Centred on Information Disclosure Is in a Backward Trend

Along with the policy development of green finance, which is mainly promoted by Central SOEs (CSOEs), China's ESG disclosure system, which aims to strengthen market mechanisms, is also undergoing a process from voluntary to semi-mandatory, to gradually mandatory, and uniformly regulated. In recent years, regulators such as the China Securities Regulatory Commission, MOE, and stock exchanges have begun to impose more explicit ESG disclosure requirements on listed companies. For example, at the end of 2024, the Ministry of Finance issued the *Corporate Sustainability Disclosure Guidelines – Basic Guidelines (for Trial Implementation),* which aims to align with the International Sustainability Standards Board (ISSB) guidelines while reflecting Chinese characteristics, and plans to gradually establish a unified and mandatory system of sustainability disclosure standards.

It is worth noting that CSOEs have also played a leading role in promoting disclosure. In 2022, listed holding companies of CSOEs were explicitly required to establish and improve their ESG systems, aiming to enhance the exemplary role of CSOEs in the field of sustainability

[97] Suzhou Daily, 'Suzhou Industrial Park Builds a Global ESG Development High Ground' (2024) <https://www.suzhou.gov.cn/szsrmzf/szyw/202407/b197a36b90ef46089968b3d33e03dbc2.shtml> accessed 28 June 2025.

[98] Lei Jin, 'IIGF Viewpoint: A Brief Analysis of the Development Path of ESG Practices in China's Industrial Parks' (18 October 2023) <https://iigf.cufe.edu.cn/info/1012/9502.htm> accessed 28 June 2025.

disclosure.[99] In line with this, China's ESG disclosure framework distinctively incorporates "Chinese characteristic" indicators, such as "rural revitalization" and "beautiful China". These indicators are intentionally designed to connect not only with overarching ESG principles but also directly with the core operational practices of SOEs. This approach underscores SOEs as pioneers in policy implementation and demonstrates how their central socio-economic role fundamentally shapes these national information disclosure standards.

c. Stage-by-Stage Focus on "E before SG" and Long-Term Prospects

In the process of promoting ESG development, China has demonstrated a phased focus on "E before SG". This trend is reflected in a number of policy documents, such as the *Catalogue for Guiding the Green Industry* (2019 Edition) and the *Catalogue for Guiding Green and Low-Carbon Transition Industries* (2024 Edition), whose names and early focus mainly highlight "green" or environmental (E) factors. This phenomenon actually reflects China's early focus on developing green industries and the fact that the concept of "green" is more easily accepted by the public. However, an in-depth analysis of the policy texts reveals that social (S) and governance (G) elements are also reflected in the content.

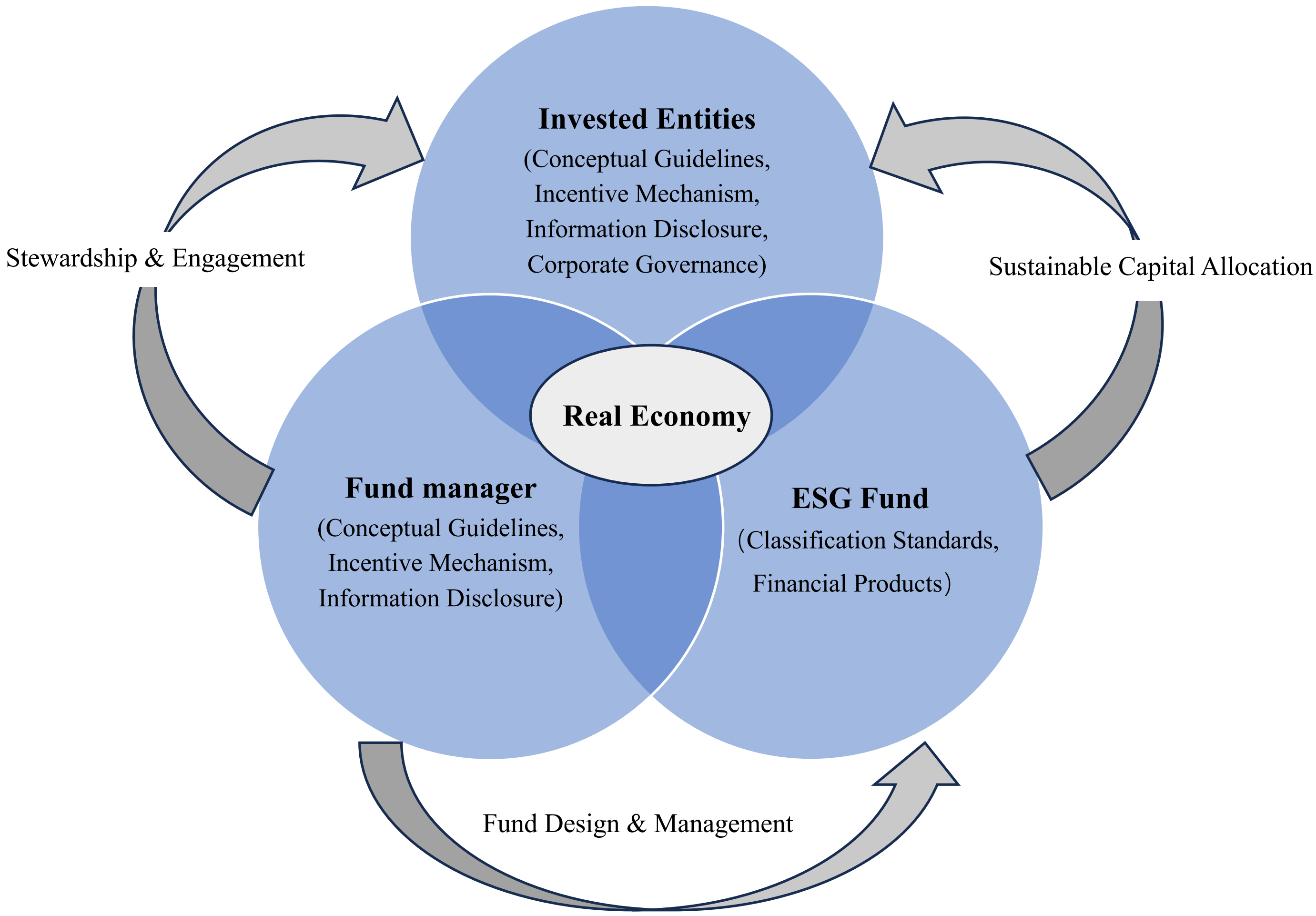
Currently, legislators and policy makers still prefer to use the term "green" when expressing their views. However, in the long run, as society's understanding of the concept of sustainable development grows, terms such as "ESG" or "sustainable development" are expected to be more widely recognised and adopted. It is expected that such concepts will be gradually introduced and strengthened at the legislative level in China in the future.

V. Challenges and the Ways Forward

Against this backdrop, China's green finance policy reveals a foundational tension. The state's priority has been to deploy financial instruments capable of rapidly channelling large volumes of capital into national strategic sectors. However, relatively limited attention has been paid to the design of mechanisms that incentivise the market-based operation of private capital. While this strong top-down mobilisation framework has proven effective in steering capital flows towards key sectors, it may also give rise to concerns of overconcentration of risk and insufficient reliance on market force.

Diagram 5: The ESG Investment Ecosystem — Interplay and Mechanisms Between Invested Entities, Fund Managers, and ESG Funds

[99] SASAC, 'Work Programme for Improving the Quality of Listed Companies Held by Central Enterprises' <https://www.gov.cn/xinwen/2022-05/27/content_5692621.htm> and the accompanying 'Reference Indicator System for ESG Special Reporting of Listed Companies Held by Central Enterprises' <https://32007318.s21i.faiusr.com/61/ABUIABA9GAAg96j5rAYoo_iX6gY.pdf> accessed 19 May 2025.



To address this tension, it is essential to construct a self-sustaining ESG investment ecosystem. As Diagram 5 illustrates, the continuous effectiveness of China's ESG investment ecosystem relies on the distinct yet synergistic interactions among its key participants: invested entities, fund managers, and ESG funds.

In this model, the process begins with the fund manager, who integrates sustainability risks into investment decisions and practices active stewardship to influence the corporate behaviour of invested entities. This relationship is operationalised through a strategically designed ESG fund, which serves as the vehicle for allocating capital towards sustainable activities and directing funds to enterprises that meet verifiable criteria. To maintain integrity and prevent greenwashing, the fund manager is responsible for ensuring the fund's strategy, classification, and marketing are transparent and accountable, ultimately connecting investor capital with companies committed to driving a sustainable transformation in the real economy.

Building this market-based ecosystem in China requires a nuanced approach. A linear progression, whereby the imposition of rigid, prescriptive standards is presumed to precede orderly market growth, is empirically unfounded and risks stifling necessary financial innovation. Therefore, recognising that China's ESG fund market is in its early stages where the marginal utility of government intervention is particularly high,[100] a more foundational strategy is needed. Focused efforts should be directed towards constructing three core enabling pillars: Conceptual Guidelines, Incentive Mechanisms, and Information Disclosure.

a. Conceptual Guidelines: Establishing Clarity and Standards

1) Clear Legal Definition

While the broader sustainable investment concepts continue their evolutionary trajectory, current efforts in China's green finance landscape ought to strategically prioritise the formalisation of green funds. This focused approach, rather than an immediate embrace of the more expansive ESG fund concept, is demonstrably more aligned with China's prevailing emphasis on environmental development and its established regulatory frameworks. A premature, comprehensive shift to ESG might prove untenable given the current stage of development.

The proposed definition should emphasise the fund's primary investment objective, explicitly link its investment scope to officially recognised green classification standards, and clearly distinguish it from funds that merely incorporate ESG factors as part of general investment analysis without a primary green focus.

2) Establishment of Official Classification Standards

The recognition and categorisation of green funds must be firmly grounded in authoritative, state-issued taxonomies for green projects and industries. Core references for this classification should include the *Green Bond Endorsed Project Catalogue (2021 Edition)*, which harmonises green bond standards and incorporates key international principles such as "Do No Significant Harm" (DNSH). Notably, it explicitly excludes fossil fuel-related activities, offering a robust technical foundation for green classification. Additionally, *the Green Industry Guiding Catalogue*, along with its future updates, should serve as a primary basis for assessing whether a fund's investments qualify as "green". Any fund claiming to be "green" must substantiate such claims by referencing official catalogues, ensuring policy alignment and preventing greenwashing.

Building on national classification standards, China should consider developing a tiered green fund classification system aligned with international frameworks such as the EU's SFDR. This system could feature "light green" funds, comparable to SFDR Article 8, which promote environmental or social characteristics. Additionally, it could encompass "dark green" funds,

[100] A similar perspective can be observed in the development of the green bond market, Lin and Hong (n 8).

comparable to SFDR Article 9, designated for financial products with environmentally or socially sustainable investment objectives.

Such a classification would enable investors to discern varying degrees of “greenness”, accommodate diverse investment preferences, facilitate differentiated regulatory oversight, and guide policy incentives. It should also leverage international alignment efforts, including the CGT and Multilateral-CGT, to enhance global comparability and foster cross-border green capital flows.

b. Incentive Mechanisms: Encouraging Genuine Green Investment

A cohesive, nationwide, and enduring incentive architecture is crucial for effectively channelling capital towards ESG objectives. To be effective, these incentive mechanisms should be tailored to the specific characteristics and objectives of different types of funds. Given China’s current stage of development, the recommendations in this article will predominantly focus on the sphere of green investment, that is, environmentally oriented investment.

For public funds, which are either established or led by government capital, the primary objective of policy-oriented green funds lies in their ability to utilise public resources to catalyse private investment within high-risk or long-gestation innovation areas. Instruments such as the “parent-subsidiary fund” structure, subordinated debt tranches, co-investment frameworks, and credit enhancement mechanisms, alongside robust governance frameworks that accommodate early-stage investment failures, are required.

In the context of PPP funds, innovative financing models such as green bonds and credit facilities should be supported by government guarantees or subsidies. However, a critical requirement is the maintenance of policy clarity and contractual enforceability to mitigate project risks for private participants.

Market-oriented Private Fund, especially PE and VC funds, require incentive structures that encourage investments in early-stage, hard technology, and green projects aligned with national development strategies. This includes considering tax incentives and risk compensation mechanisms. Concurrently, it is vital to address fundraising and exit barriers by diversifying exit pathways through dedicated IPO channels, M&A, and the development of secondary markets (S-funds).

c. Information Disclosure: Ensuring Transparency and Accountability

China’s ESG fund ecosystem confronts critical information disclosure deficiencies, hindering environmental accountability and fostering greenwashing. Publicly offered funds, despite general regulations, lack binding quantitative environmental reporting, often relying on inconsistent qualitative narratives. Private funds exhibit even greater opacity. This systemic information asymmetry stems from the absence of a standardised, mandatory fund-level disclosure framework.

However, building on recent progress in corporate-level ESG reporting, a phased strategy should be adopted to construct a tiered, mandatory disclosure framework for ESG funds, drawing inspiration from the EU's SFDR. This regime should compel funds to disclose verifiable, quantitative data on their portfolio's principal adverse impacts on sustainability factors and their alignment with official taxonomies. Furthermore, establishing clear criteria and minimum investment thresholds for different ESG fund categories would be crucial.

Concurrently, greenwashing must be explicitly defined in legislation as any false, misleading, or unsubstantiated claim regarding a fund's green characteristics or impacts. A robust preventative strategy should include compulsory pre-approval label certification linked to taxonomies, strict adherence to recognised green taxonomies, comprehensive quantitative disclosure, and independent verification. While existing laws (e.g., the Securities Law, the Anti-Unfair Competition Law) offer indirect avenues for addressing misleading claims, specific sanctions tailored to greenwashing by funds, such as fines, license suspension, and corrective disclosures, must be instituted.

d. Active Shareholder Cultivation: Fostering Engagement and Participation

Finally, China must continue to strategically cultivate the role of active shareholders,[101] with a particular emphasis on institutional investors such as public mutual funds. These entities are not merely passive investment vehicles. They serve as cornerstone institutions within China's financial architecture, playing a pivotal role in channelling capital to the real economy, supporting national strategic objectives, fostering the reform, stable development, and overall health of the capital markets, and crucially, meeting the burgeoning wealth management demands of the populace.[102] Given their significant shareholdings and systemic importance, it is imperative that publicly offered funds transition towards and embrace a more proactive and influential role in the corporate governance of the listed companies in which they invest. This involves moving beyond passive portfolio management to actively engage with company

[101] Shareholder activism in China is thriving, with 156 major campaigns identified between 2007 and 2023, and more than two-thirds of these occurring in the last five years, see Chun Zhou, Wei Zhang and Dan W Puchniak, 'The Overlooked Reality of Shareholder Activism in China: Defying Western Expectations' (2024) <https://www.ssrn.com/abstract=4853552> accessed 15 July 2024.

[102] National Financial Regulatory Administration, 'Guidelines on Accelerating the High-Quality Development of the Publicly offered fund Industry' (n 49).

management, monitor corporate strategy and risk, advocate for sustainable long-term value creation, and promote sound governance practices.[103]

A landmark development underscoring this strategic direction occurred on May 9, 2025, when *the Rules for Publicly Offered Securities Investment Fund Managers Participating in the Corporate Governance of Listed Companies* was officially released. These rules clearly define the role of publicly offered funds as "active shareholders" and stipulate that if a fund's aggregate holding of a single stock reaches 5% or more of its outstanding shares, the fund manager must actively exercise voting rights on 13 specified matters.[104]

VI. Conclusion

China's ESG fund market is still in its early stages of development, with its primary drivers coming from the government, including central and local SOEs as well as government guidance funds. The investment strategies of these entities typically align closely with national strategic objectives, providing crucial impetus for the nascent stage of China's ESG market. Against the backdrop of the relatively weak foundation of China's current ESG fund market, this government-led development model possesses a certain rationality and demonstrates significant development momentum. The practical trajectory of China's ESG funds indicates that, in an environment where market mechanisms are yet to be fully developed, sustainable financial instruments, particularly funds, can explore feasible development models.

However, over-reliance on a government-driven development model partially explains the relatively lagging development of market-oriented regulatory frameworks specifically for ESG funds (e.g., fund classification standards, information disclosure requirements, etc.). Excessive policy favoring may lead to limitations in the functioning of market force. This not only potentially hinders non-SOEs, particularly SMEs, and the innovative industries they pursue from accessing necessary financial support when they lack policy backing, but it may also give rise to risks such as greenwashing and regulatory arbitrage.

With the continuous development of China's ESG investment regulatory framework, particularly the improvement in company-level ESG disclosure rules in recent years, China has clearly demonstrated its willingness to develop market-driven mechanisms for ESG investment. As China continues to build its ESG ecosystem, policymakers must strike a careful balance between incentivising equity capital to flow into ESG investments, and establishing robust

[103] For a discussion on shareholder stewardship in the context of controlling shareholders, see Ernest Lim and Dan W Puchniak, 'Can a Global Legal Misfit Be Fixed? Shareholder Stewardship in a Controlling Shareholder and ESG World' (3 August 2021) <https://papers.ssrn.com/abstract=3898281> accessed 16 May 2025.

[104] These matters include, but are not limited to, amendments to articles of association and other institutional documents, profit distribution, election or removal of directors, remuneration of directors and senior executives, as well as equity incentive plans and employee stock ownership plans. Rules for Publicly Offered Securities Investment Fund Managers Participating in the Corporate Governance of Listed Companies (AMAC Circular [2025] No 8), Art 7.

standards and disclosures to guard against greenwashing. Clear and enforceable ESG frameworks are essential to protect investor trust and ensure the integrity of sustainable finance. At the same time, it is critical that capital not only circulates within financial markets but is also channelled into the real economy — supporting innovation, entrepreneurship, and the development of genuinely sustainable industries. This dual approach will be key to aligning financial growth with long-term environmental and social goals.

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