

Submission to Securities and Futures Commission on the Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers

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For inquiries on this submission, please contact Josephine Chung at ichung@complianceplus.hk. CompliancePlus Consulting Limited understands and agrees that our name and/or submission may be published to the public.

Introduction

The Securities and Futures Commission (The “SFC”) issued a Consultation Paper in October 2020 on the proposed amendments to Fund Manager Code of Conduct in relation to climate-related risk disclosures (“Consultation Paper”). CompliancePlus is pleased to provide feedback on the Consultation Paper per the below:

Question 1: Do you have any comments on the SFC’s proposal to focus on climate change or should a broader spectrum of sustainable finance should be considered in developing the requirements?

We welcome the SFC’s efforts to build Hong Kong as a hub for green and sustainable finance in the Asia-Pacific region. Whilst we understand that the current proposal is focused on climate change, we are supportive that a broader spectrum of sustainable finance should be considered in developing the requirements in the next phase.

In requiring fund managers to consider climate-related risks in its investment and risks management processes, it is inevitable that fund managers would also touch on the broader scope of ESG factors. Hence, it makes sense that a broader spectrum of sustainable finance and/or ESG reporting should be considered in the future (not just for ESG-themed funds). This would also allow investors and asset owners to easily compare and consider environmental and social factors in their investments. However, in light of the additional broader spectrum of sustainable finance factors, the SFC may consider further amending the Fund Manager Code of Conduct (“FMCC”) to and consult the industry further.

Stock Exchange of Hong Kong Limited has taken the lead in publishing its enhanced Environmental Social Governance (“ESG”) reporting framework including the need to disclose requirements in relation to environmental and social factors (e.g., requiring disclosure of climate-related issues which have impacted and may impact the issuer and require listed companies to publish ESG reports).

We note that overseas jurisdictions such as Singapore has recently issued guidelines in December 2020 for environmental risk management for asset managers¹ to integrate environmental considerations into the asset managers' strategies, business plan and products. Similar with Hong Kong, Singapore Exchange also requires listed companies to produce annual sustainability reports on a comply-or-explain basis.

We are rather concerned on the implementation and readiness of the industry on climate-related risk disclosures for fund managers, especially for smaller sized fund managers which may have less resources to implement the new changes. We recently conducted a survey interviewing our clients, we attach our survey results in Appendix for SFC's reference.

Question 2: Do you agree that at the initial stage, the SFC's proposed requirements should apply to the management of CISs but not discretionary accounts?

We have no issue with the scope that the proposed requirements should apply to the management of collective investment schemes only and not to discretionary accounts (in the form of an investment mandate or a pre-defined model portfolio).

However, we think that it will be helpful to clarify the scope of the proposed guidelines given the diversity of business activities and roles carried out by asset managers. The proposed requirements propose exclusion from applicability where the asset manager has discretionary authority over the investment funds or mandates.

We would like to check if the SFC can clarify whether fund managers with passive mandates or strategies linked to benchmarks and indices will be included or excluded and whether asset managers who delegate the investment management to sub-managers or advisors would still be required to consider climate-related risks.

The SFC should consider scoping out funds or mandates where the client does not expect the fund manager to integrate ESG characteristics and climate-related risks in the investment decision-making process. We want to know the position of the SFC that they will expect the fund manager to unilaterally impose the guidelines even if the client does not view environmental and climate-related risk as an

¹ <https://www.mas.gov.sg/regulation/guidelines/guidelines-on-environmental-risk-management-for-asset-managers>

important consideration in conjunction with investment performance or on funds that do not claim to be 'Green' or 'ESG-themed or not as that may provide more clarity to the industry on this matter.

Question 3: Do you agree that the SFC should make reference to the TCFD Recommendations in developing the proposed requirements so as to minimise fund managers' compliance burden and foster the development of a more consistent disclosure framework? Other than the TCFD reporting framework, is there any standard or framework which in your opinion would be appropriate for the SFC to refer to in developing the proposed requirements?

We welcome the proposed recommendations by the SFC in referring to the TCFD Recommendations in developing proposed requirements. However, apart from the TCFD framework, the SFC should take reference from other international standards and frameworks including but not limited to the Global Reporting Initiative ("GRI"), CDP (formerly Carbon Disclosure Project), and Sustainable Accounting Standards Board ("SASB") to foster development of a more consistent disclosure framework.

We note in the SFC Consultation where the fund manager is already subject to or has implemented group policies and practices, then the environmental or climate-risk framework implemented at group level can be cross-referenced and used to meet the requirements of the guidelines expected of fund managers in Hong Kong, provided that it fulfils SFC's requirements. Typically these group policies would refer to globally accepted environmental risk standards and frameworks such as GRI and SASB.

We would also like fund managers in Hong Kong to be allowed to choose the appropriate framework and metrics and not be required to adopt any specified tools and metrics.

We note that the area of environmental and sustainability risk reporting is evolving, as five leading organizations, CDP, Climate Disclosure Standards Board ("CDSB"), GRI, the International Integrated Reporting Council ("IIRC") and SASB have published a joint statement of intent to IOSCO in September 2020 to reiterate their shared commitment to achieve a globally accepted corporate reporting system. In December 2020, the five organizations co-authored an illustration of how their current frameworks, standards along with the elements set out by TCFD can be used together to provide a running start for development of global standards that enable disclosure of how sustainability matters create or erode enterprise value.

To determine the materiality of climate-related risks, we encourage references to be made to sector specific guides such as the Global Industry Classification (“GIC”) Sector Reports, and the TCFD Implementation Guide developed by the CDBS and SASB. We would request that the SFC refer to global standards when considering material risk, but also allow flexibility, especially in the context of multi-asset portfolios, where climate-related risks may be material for a portion of the portfolio only. We would also like to see SFC giving more examples on assessing materiality of climate-related risks relevant to fund managers.

Question 4: Do you have any comments on the proposed basis for determining the threshold for Large Fund Managers, i.e. HK\$4 billion, and the basis for reporting? Please explain your view.

CompliancePlus agrees with the proposed basis for determining the threshold for Large Fund Managers (i.e., fund managers with AUM of HK\$4 billion or above) to be expected to adopt a more robust approach and make more detailed disclosures.

We would like SFC to clarify how the calculation of AUM of HK\$4 billion is considered when fund managers manage a mixed portfolio. For example, a fund manager may be managing a quantitative fund (HK\$2 billion) and long/short equity fund (HK\$2 billion). Will they be considered as a ‘Large Fund Manager’ or not in the abovementioned example?

Question 5: Do you have any comments on the proposed amendment to the FMCC requirements, baseline requirements and enhanced standards? Please explain your view.

FMCC Amendments

Paragraph 3.1A of the FMCC

We would suggest that short, medium and long-term risks and opportunities should also be taken into account in its investment management process for funds that we suggest amendment below:

“A Fund Manager should ensure that climate-related risks and opportunities are taken into account in its investment management process for funds over the short, medium and long term (as appropriate).”

New Paragraph in FMCC

We would suggest that an additional paragraph be added in the FMCC (whether as part of Paragraph 3.1A, or New Paragraph E under Appendix 2 of the FMCC, or elsewhere) to clarify that international standards and frameworks can be used to assess the materiality of climate-related risks:

“In assessing materiality of climate-related risks, a Fund Manager should adopt an approach which is appropriate and proportionate to their circumstances. The approach can be qualitative and/or quantitative. Fund managers may consider adopting methodologies suggested by international reporting frameworks in assessing the materiality of climate-related risks.”

General Comment:

- We would like to point out that almost all (if not all) the examples given in the Practice notes in the Consultation Paper are not applicable to many smaller fund managers that may not have the scale and resources that a larger fund manager or global fund manager may have. Examples given for incorporating climate related risks in governance processes (see Practices 5 – 7) seem not that very practical.
- For example, it is not feasible and impracticable for a hedge fund/ fund manager of smaller scale to establish ESG Strategy Committee, ESG Rating Committee, Social Impact Committee and Voting Committees at the same time; neither would there be any in-house ESG ratings available to integrate into its investment strategies.
- As such, we would suggest the SFC to provide Practice examples for smaller scale fund managers for each element (governance, investment management, risk management and disclosure) that will help them on compliance.
- We suggest the SFC may issue disclosure templates (where applicable) for governance, investment management, risk management and disclosure to assist fund managers to comply with the newly proposed requirements.

Governance:

- In general, we agree that it is key to enforce the Board's oversight of the accountability and incorporation of climate-related considerations into the investment and risk management processes. This is in line with good practices such as the Network for Greening the Financial System ("NGFS") Guide for Supervisors published in May 2020.
- In light of the proposed requirements for board and senior management to have oversight and management of climate-related risks, the SFC should consider, particularly for "Large Fund Manager" whether the Manager-in-Charge responsible for the Risk Management function covering Climate-Related Risks matters should be required to receive specific training and possession of knowledge of environmental risks or provide information to the SFC as supporting of their relevant knowledge in their resume to the SFC on ESG matters that SFC may SFC specify this as well in FAQ for the industry to comply with such requirements.
- For Management's role in devoting sufficient human and technical resources to manage climate-related risks, we note that one of example is providing training to staff. It will be helpful if SFC can provide guidance materials on training for staff soon after the amendments to the FMCC are finalized to set out best practices for Licensed Corporations ("LC") given that this area is new to Hong Kong.

Investment Management:

- We note that in Paragraph 55 of the SFC Consultation, fund managers will need to assess the materiality of the impact of climate-related risks on an investment strategy or a fund and the approach can be qualitative and/or quantitative. We also note that under Para 55 of the SFC Consultation, SFC has made it a suggestion to consider international frameworks such as SASB, GRI, PRI, etc to assess materiality. As such, we suggest including reference to international standards in the amended Fund Manager Code of Conduct so that the industry can easily follow the international standard for compliance.
- It will also be helpful if the SFC give relevant examples to fund managers on the assessment of material climate-risks. For example, what material climate-risk factors should fund managers consider with respect to different asset classes such as equity, fixed income, real estate/ infrastructure.

Risk Management & Tools and Metrics:

- We would like to ask the SFC to provide guidance as to (1) the level of detail of incorporating climate-risks into risk management processes, procedures, actions, goals and targets; (2) how will fund managers be expected to evaluate their performance against such climate-related goals and targets.
- We suggest that the proposed requirements give flexibility to fund managers so that quantitative assessment be optional.

Question 6: To provide a clear picture to investors on whether a fund manager has integrated climate-related considerations into its investment strategies or funds, do you agree that if the fund manager considers that climate-related risks are irrelevant to certain investment strategies or funds, it should make disclosures and maintain appropriate records to explain the rationale for its assessment?

We are open to the proposed requirement that if the fund manager considers that the climate-related risks are irrelevant to certain investment strategies or funds, it should make disclosures and maintain appropriate records to explain the rationale for its assessment.

However, given the nature of the proposed amendments to the FMCC as principles or best practice standards, as opposed to legally binding requirements, we would like clarity on the expectations around explaining and documenting the irrelevancy of the climate-related risks and the 'materiality assessment'. We suggest that SFC will consider issuing a template disclosure document for this requirement.

Question 7: Do you agree that climate-related disclosures (except for the disclosure of WACI) to investors should be made at an entity level at a minimum and supplemented with disclosures at a strategy or fund level to reduce burden on fund managers?

We would like to seek clarification from the SFC what it means by climate-related disclosure at an entity level that whether it is expected for an LC to consider climate-related disclosures at their entity level or refers to climate-related risks relating to assets under management of that entity.

For a logical deduction, it should refer to assets under management by that entity level that they can then disclose their practice and process in monitoring Climate-related Risks for assets under their management that unless requires the other wise, they can further disclose any other practice at fund level.

Question 8: Do you agree that disclosures of quantitative climate-related data such as WACI should only be applicable to Large Fund Managers having regard to the resources required and the size of assets covered? Do you agree that at the initial stage the disclosure of the WACI should be made at the fund level instead of the entity level?

We have suggested above in answer to Question 5 that the proposed requirements give flexibility to fund managers so that quantitative assessment be optional.

We would suggest that disclosures of climate-related data such as WACI should be made as an option for Large Fund Managers in case they would like to disclose climate-related risks quantitatively in this manner. Nonetheless, we agree that at the initial stage the disclosure of the WACI should be made at the fund level only if such disclosure would be made mandatory.

It would be helpful for the SFC to clarify the frequency of the WACI calculations disclosures required at the fund level. We note that many companies publish their carbon footprints predominately on a yearly basis in conjunction with annual reporting.

To calculate the WACI, carbon data needs to be identified. As there are various sources of carbon data from third parties, data providers, climate research organizations and NGOs, it would also be preferable if SFC can specify which providers of carbon measures would be considered as widely accepted by SFC. For example, we note that MSCI Inc is a leading provider for Equities, and ISS Ethix is a leading provider for Fixed Income.

Question 9: Do you think the following transition periods are appropriate?

- ***A nine-month and a 12-month transition period for Large Fund Managers to comply with the baseline requirements and enhanced standards respectively; and***
- ***A 12-month transition period for other fund managers to comply with the baseline requirements***

If not, what do you think would be an appropriate transition period? Please set out your reasons.

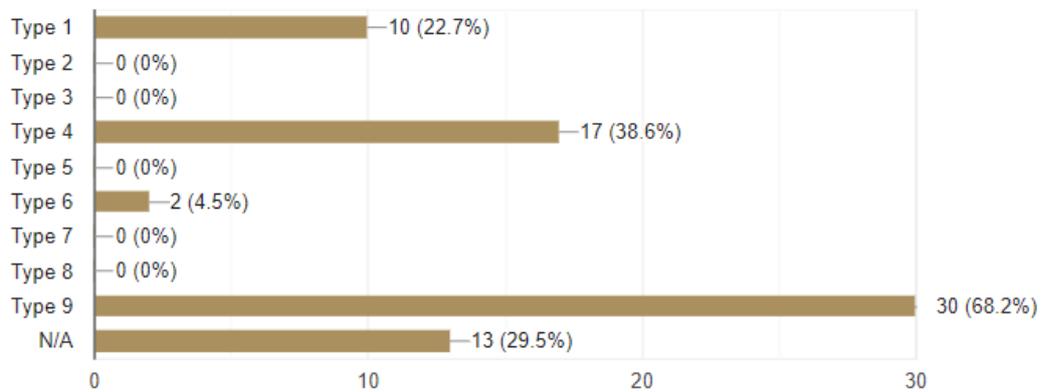
CompliancePlus suggests that the industry be given more time to fulfil the newly proposed requirements. We would suggest a of 12-month and an 18-month transition for Large Fund Managers to comply with baseline and enhanced standards respectively. For other fund managers to comply with the baseline requirements, we suggest an 18-month transition would be more appropriate to establish the processes to fulfil the requirements required in the amended FMCC.

Appendix

We have conducted a webinar on this SFC Consultation on 7 Jan 2021 for our clients and industry that over 150 guests joining us virtually and we conducted survey below with 44 response below that we extracted the responses for easy reference of the SFC for information exchange only.

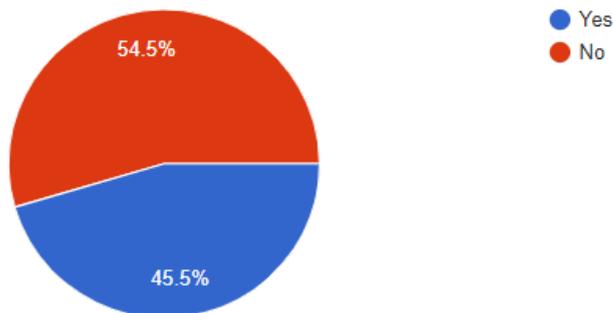
Which SFC license type do you currently hold as an individual?

44 responses



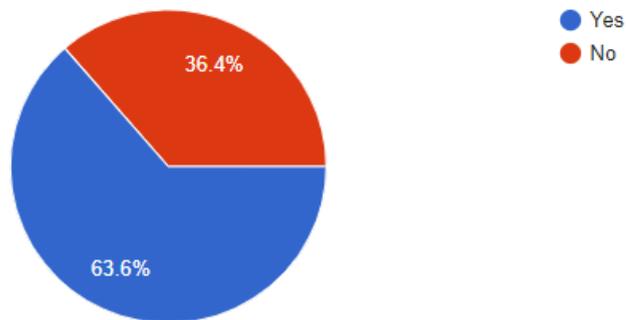
Have you read the SFC Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers issued in October 2020?

44 responses



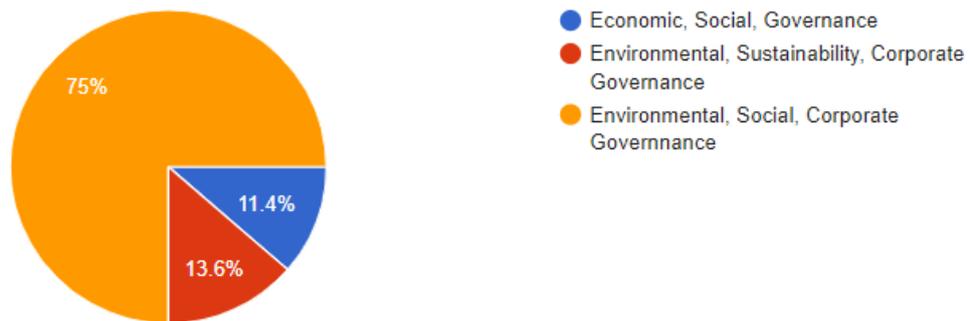
Are you aware of the SFC Consultation deadline will be on 15 January 2021?

44 responses



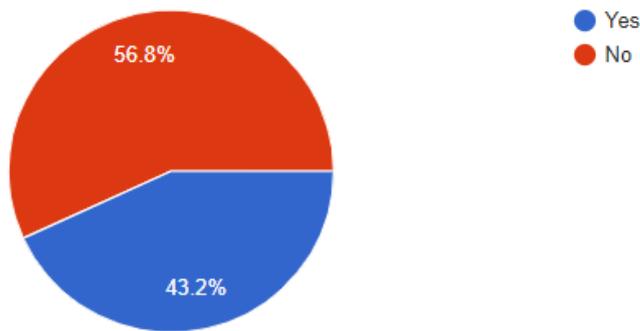
Which of the following is the full name for ESG?

44 responses



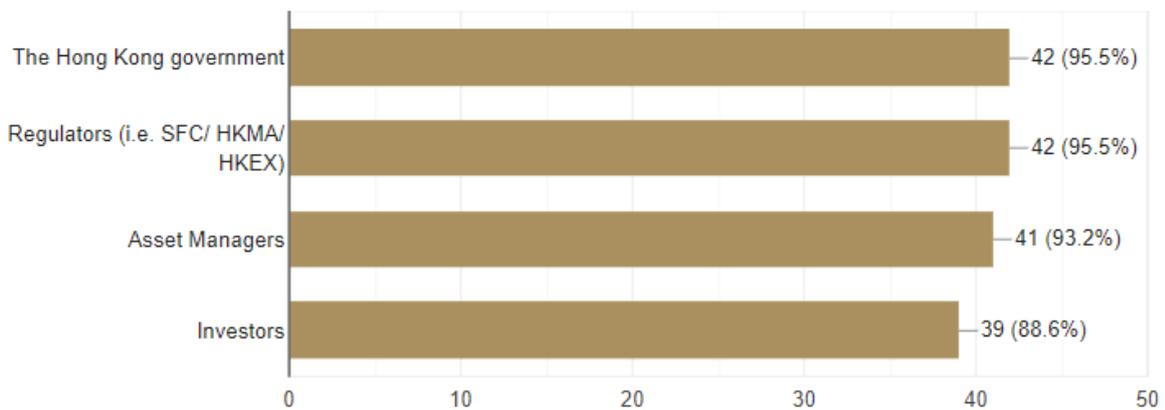
Have you heard of the Financial Stability Board's Task Force on Climate-related Financial Disclosures (TCFD)?

44 responses



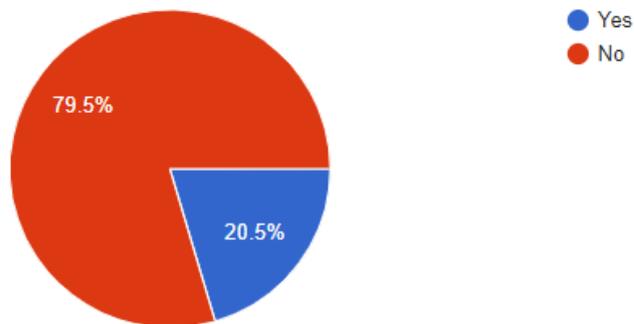
Which of the following stakeholders should consider ESG factors? (can tick more than one if applicable)

44 responses



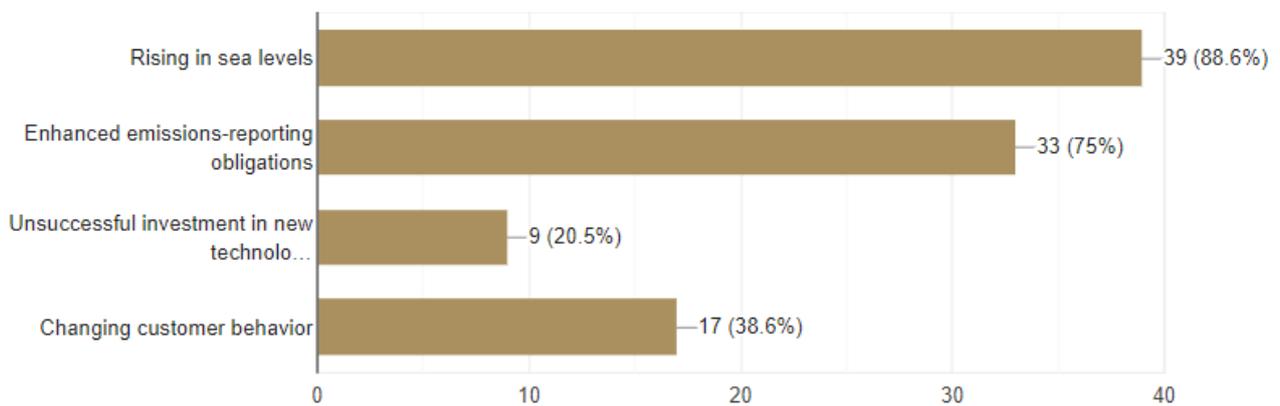
Does your firm currently have any ESG funds or manage any ESG related portfolios?

44 responses



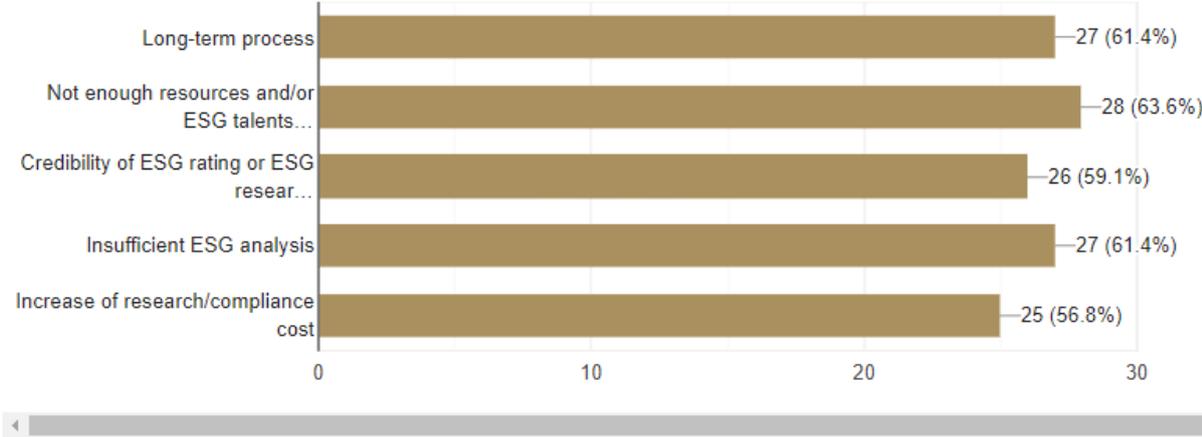
Which of the following is/are considered as climate-related risk? (can tick more than one if applicable)

44 responses



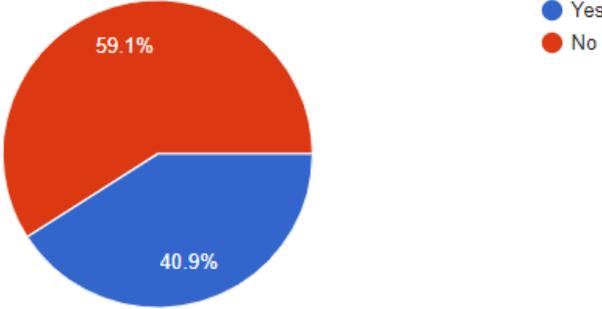
What is/are your concern(s) when considering ESG factors in your investment and/or risk management processes?

44 responses



Does your firm have sufficient resources to implement changes to consider climate-related risks in your investment and/or risk management processes?

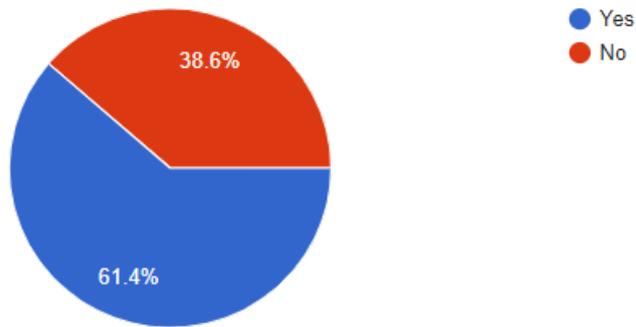
44 responses



Does your Company have/ intent to have any board-level oversight of climate-related risks and opportunities?

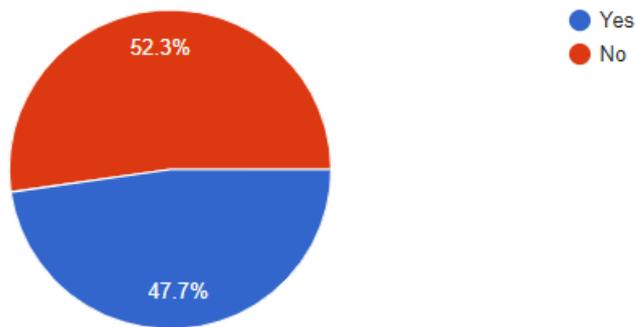


44 responses



Does your company have/ intent to have incentives in place for the management of climate-related issues, including the attainment of targets?

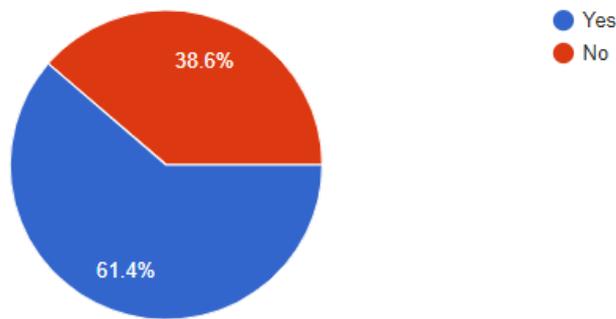
44 responses



Does your company use/ intent to use climate-related scenario analysis as a strategic planning tool to explore the resilience of your business strategy?

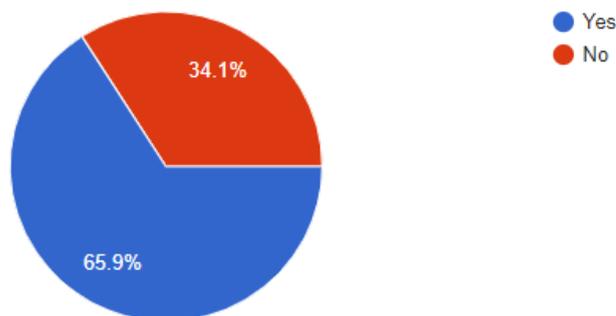


44 responses



Do you integrate/ intent to integrate climate-related risks into multi-disciplinary company-wide risk identification, assessment and management processes?

44 responses



Do you have any comments/ concerns relating to ESG?

9 responses

Nil

Detailed scopes of ESG yet to be harmonized so as to generate more meaningful and valuable big data to be shared compulsorily by all industries / enterprises globally

I believe ESG is getting out of hand.

concerns over the various rating agencies differing opinions on the same company

not now

n/a

Limited information / rating on China A shares

-END-