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15 January, 2021
The Securities and Futures Commission
54/F One Island East
18 Westlands Road
Quarry Bay, Hong Kong

Re: Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers

To The Securities and Futures Commission ("SFC"):

We are writing to express our support and provide feedback on the proposed Management and Disclosure of Climate-related Risks by Fund Managers (the "Consultation").

Sustainable Finance Initiative (SFi) is a dedicated platform for private investors to learn, connect and invest together as a community, with a mission to mobilise private capital for positive impact and accelerate Hong Kong's transition towards being a hub for sustainable finance. The platform was incubated by RS Group and launched in June 2018. Since launch, SFi has built a community of private investors who believe in the importance of ESG considerations in their wealth management practices and are increasingly active in the deployment of capital for impact.

We applaud the SFC's proposed amendments to the Fund Manager Code of Conduct ("FMCC") and strongly support the management and disclosure of climate-related risks put forth in the Consultation. Enhanced management and disclosure of climate-related risks are a fundamental building block to ensure the resilience of the financial sector and enhance transparency towards investors and combat greenwashing in Hong Kong.

The timely and effective development of management and disclosure of climate-related risks by asset managers is crucial in order to address the growing long-term systemic risks posed by climate change.

Overall, we agree with the proposal set forth in the Consultation. However, as a community of private investors, we want to see Hong Kong take even bolder steps and go beyond just addressing climate-related risks, by proposing further amendments to the FMCC to also include other environmental risks. By doing so, Hong Kong would align itself to international standards and ensure it remains competitive on the global stage.

We have summarised our recommendations to further strengthen the Standards 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? Please explain your view.

We believe the SFC's proposal to focus on climate change represents a good starting point, as climate-related risk is systemic and financially relevant or material to the majority of the asset management industry. The proposal also builds on the good foundation provided by SFC's April 2019 guidance on enhanced disclosures for green or ESG funds. We are of the opinion that this proposal will put Hong Kong on the right trajectory to catch up with other jurisdictions and meet international standards.

However, the proposal is not bold enough and SFi recommends the following additional measures:

- **we suggest that the SFC uses a stronger language throughout the FMCC**, and define the issue as a *climate crisis*, as described by the United Nations Secretary-General Antonio Guterres in September 2019 (source), rather than *climate change*. Language matters, and the suggested wording would be in line with what the Intergovernmental Panel on Climate Change (IPCC) reported, which is that "climate change" is no longer considered to accurately reflect the urgency of the situation.
- **we advocate for adopting a wider focus on environmental and social risk** beyond just climate change throughout the FMCC, given the strong interlinkages between climate change and other environmental and social issues, as well as the inherent risks associated with issues like water risk air/water pollution and deforestation/biodiversity. As examples of good practices adopted by other jurisdictions, we would suggest SFC to look at the following
    - The Energy Transition for Green Growth Act passed into law in France in August 2015 is one of the is often cited as the first regulatory framework on climate-related risk, requiring institutional investors to disclose to clients their climate-related risk and the incorporate environmental, social, and governance parameters into their investment policy. The dual-objective of the French regulator is to improve transparency and increase awareness of risks relating to the energy transition for green growth
    - The Monetary Authority of Singapore (MAS)'s Guidelines on Environmental Risks Management for Asset Managers introduced in December 2020 demonstrate how, while retaining a focus on climate change, regulations on other environmental risks can be introduced (e.g. biodiversity, land and marine conservation)
    - The Network for Greening the Financial System (NGFS)'s Technical document on Overview of Environmental Risk Analysis by Financial Institutions released in September 2020 highlights how environmental risks (including, but not limited to, climate risks) translate into financial risks. The document identifies several sources of environmental risks, and how they affect the financial system through micro- and macro-economic channels.

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?

According to paragraph 31 of the October 2020 SFC "Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers", the

> *"proposed requirements would apply to fund managers which manage collective investment schemes (CISs) but at the initial stage they would not be mandatory for fund managers which manage discretionary accounts (in the form of an investment mandate or a pre-defined model portfolio)."*

However, paragraph 32 of the Consultation Paper states the following about discretionary accounts:

> *"Nevertheless, if a client's climate-related investment preference has been incorporated into the investment mandate of a discretionary account or a pre-defined model investment portfolio, the fund manager should ensure that it acts accordingly."*

SFi view as private investor collective

We believe that eventually the requirements should apply to all portfolios and not only CIS, as:

1. Climate/environmental issues affect all portfolios just the same and their management is consistent with fiduciary duty
2. Asset managers have an opportunity (perhaps even responsibility) to 'educate' asset owners clients about importance of environmental/climate risk management

However, SFi agrees that **at the initial stage** the requirements **could** be applied to CISs but not discretionary accounts, because:

1. By focusing the requirements on CISs at the initial stage, the SFC makes sure to capture a significant proportion of the AUM held by LCs (see paragraph 31 of the Consultation Paper)

Given the tailor-made nature of the investment mandates of discretionary accounts, we believe the consideration of climate-related risks and the corresponding disclosure requirements to discretionary mandates could be incorporated into the next stage of development. As a comparison, in the EU:

- the European Securities and Markets Authority ("ESMA") published technical advice to integrate sustainability risks and ESG considerations in relation to investment firms and investment funds into the existing law.
- The EU supervisory bodies also issued a regulation to require financial market participants, including fund managers/pension fund managers to disclose their sustainability risk integration policies (including impact assessments) to investors.
  With regards to the two bullet points above, the terms "Financial Market participants" and "investment firms" may refer to firms providing portfolio management services, which include "managing portfolios in accordance with mandates given by clients on a discretionary client-by-client basis" (ref. Directive 2014/65/EU of the European Parliament and of the Council)

2. We fully support the emphasis that in situations where the client has requested the managed discretionary account to take climate-risks into consideration in the investment mandate, these accounts should not be exempt from the requirements. This is particularly valid in the case where we have seen an increased promotion and adoption of managed discretionary account among private banks to

HNWI/Family offices that have an ESG mandate. Further, it would be useful to clarify what would be considered as a client driven preference on climate-related investments for DAM or model-portfolios, e.g. would the inclusion of negative screens or ESG scoring/integration be sufficient or explicit request for climate thematic investments within portfolios be required.

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 other standard or framework which in your opinion would be appropriate for the SFC to refer to in developing the proposed requirements?

The TCFD Recommendations released in June 2017 are the most endorsed at an international level by the financial industry and other major stakeholders including governments, regulators, and investors. Therefore, SFi strongly supports the SFC making reference to the principle-based TCFD recommendations as the basis for reporting in developing the proposed requirements. We believe this approach to be much more pragmatic than developing a reporting framework from scratch, and has the additional value-add of aligning the Hong Kong marketplace with internationally recognized bodies.

In addition to the TCFD Recommendations, we believe there are other valid reporting frameworks and tools that it could be appropriate to make reference to, such as:

- WWF's Taskforce on Nature-related Financial Disclosure (TNFD): this taskforce is still in development, but since it is supported by major financial institutions and several European governments, it should be taken into consideration. The launch of TNFD is scheduled to happen in early 2021 and a framework to guide nature-related financial disclosure is planned to be launched by the end of 2022.
- AIGCC's Climate Action 100+: backed by major asset owners, asset managers, and other investors, it is an initiative to make sure the world's largest corporate greenhouse gas emitters take action on climate change by engaging with them.

We would also recommend that reference be made to the following:

- WWF's RESPOND (Resilient and Sustainable Portfolios that Protect Nature and Drive Decarbonisation): we believe this tool could be of help as "it reviews asset managers' disclosures about their implementation of responsible investment […] and it is also aligned with the Task Force on Climate-related Financial Disclosures (TCFD) and the Principles for Responsible Investment (PRI)".
- European ESG Disclosure Requirements for Asset Managers: coming into force in March 2021, these rules cover ESG disclosure-based requirements and apply to a wide range of financial industry participants.

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.

SFi view as private investor collective

Observing what has already been successfully implemented in other jurisdictions and applying a similar methodology to Hong Kong is an efficient way of proceeding. We believe that proposing a basis for determining a threshold from scratch would not be as efficient. It is therefore a good approach by the SFC to model its methodology after existing ones such as the EU's AIFMD. We believe the AIFMD is particularly suited to this purpose as it regulates a top fund management jurisdiction, Luxembourg, with trillions of USD of AUM, which is a similar case to Hong Kong.

SFi believes that the proposed basis for determining the HK$4 billion threshold for Large Fund Managers, and the basis for reporting, is meaningful as:

- by applying such threshold, the legislation would cover 80 percent of the AUM in the Hong Kong fund management industry (paragraph 43.b. of the Consultation)
- the SFC Consultation states on paragraph 42 that "this threshold is meant to be an indicative number for reference only and is subject to review from time to time to align with market developments." We believe it is important that the threshold for Large Fund Manager be subject to periodic reviews as it needs to reflect the reality of the asset management industry in Hong Kong
- It respects the principle of proportionality outlined in the FMCC: it would be a disproportionate burden for small fund managers to apply the same standards as Large Fund Managers. Large Fund Managers have more resources to implement enhanced standards, and it would therefore be in line with the principle of proportionality

Moreover, SFi believes that, compared to other jurisdictions, Hong Kong has taken a stricter approach by subjecting *"all"* fund managers (i.e., also the smaller ones) to the baseline requirements. We consider this to be a thorough approach to considering and addressing climate-related risks in the industry.

SFi has therefore no objections to the proposed threshold of HK$4 billion for Large Fund Managers.

Specific actions

Regarding smaller fund managers of less than HK$4billion AUM (1600 firms representing 20% of total AUM – ref. 43.(b) consultation), we believe they form an important part of the asset management industry that should not be exempt from baseline reporting. Climate risk being a long-term systemic factor is expected to increase overtime, ensuring all fund managers have a basic form of reporting will avoid a divergence of standards over time and enable Hong Kong to stay competitive in the industry.

Referring to the SFC's "Survey on Integrating Environmental, Social and Governance Factors and Climate Risks, in Asset Management 16 December 2019", pg. 10 (no. 24) – "Survey results also show that asset management firms of various sizes, including small firms in terms of AUM, have ESG investment processes relating to research and portfolio management. This is contrary to the general perception that developing ESG practices is resource-intensive and only large players can afford the cost." We believe along the same lines, incorporating climate related Governance, Investment Management and Risk Management processes and disclosures can be done in a pragmatic manner.

For instance, CDP's Climetrics is an independent climate rating for funds provided by CDP (a not-for-profit charity that runs a global disclosure system on environmental impacts) which so far scored over 15,000 funds across the globe. Their rating integrates TCFD-aligned scores and measures how well companies in a fund's portfolio disclose and manage material risks and opportunities linked to climate change and other environmental risks.

In support of smaller fund managers to comply with baseline requirements, we suggest SFC to also provide a list of resources (including external consultants).

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

We have the following comments with regards to the proposed amendments to the FMCC requirements, baseline requirements and enhanced standards on Governance, Investment Management, Risk Management, and Disclosures:

<u>Governance</u>

a. The board/board committees should have the role of overseeing the incorporation of all environmental and social material issues, not just climate-related considerations, into investment/risk management, as well as tracking the progress made against achieving environmental-related goals, in addition to climate risk specifically (in line with suggestion for the requirements to cover environmental and social issues more generally)

b. Along with procedures to ensure compliance with policies and requirements on the management of climate-related risks, it is important to also implement processes that ensure that these risk management processes/policies are reviewed and updated on a regular basis.

<u>Investment management</u>

Overall, we are of the opinion that the importance of stewardship (i.e. engagement and voting) should be made more prominent throughout the Consultation Paper as it represents a key pillar of best practice that fund managers should undertake to support investee companies' transitions towards more sustainable practices.

a. SFi is supportive of the amendment to mention climate risks specifically. However, we believe that, in addition to climate change, this amendment should also mention environmental and social risks more generally. The title of paragraph 2.1 should therefore satate "Identifying climate *and other environmental and social*-related risks)

b. Paragraph 52 states that "all fund managers should adopt processes to identify the relevance and materiality of climate-related risks", and "to look beyond their usual investment horizon because portfolio assets will in most cases be reinvested in similar investments". We believe that in order to be able to assess the extent to which a fund manager has integrated sustainability risks into their investment decision processes, the manager showcase how investment due diligence and risk management policies have been enhanced to account for sustainability aspects.

c. Paragraph 55: SFi completely supports the importance of assessing the materiality of the impact of climate-related risks, and that the approach chosen to do so should be appropriate and proportionate. Additionally, due to the dynamic nature of materiality, we believe fund managers should be required to perform their assessments regularly.

d. We recommend referring to the concept of double materiality as outlined by the Sustainability Accounting Standards Board (SASB), because how a business interacts with society and the environment can create negative and/or positive impacts, and these should be taken into accounts as they may translate into risks and/or opportunities that are financially material.

Risk management

Overall, we are supportive of the amendment to mention climate-related risks specifically, but also environmental and social risks should be mentioned more generally.

a. Paragraph 62: the use of ESG benchmarks should be explicitly mentioned as another tool for managing climate risk

b. Paragraphs 62 and 66: It is important to emphasise the limitations to GHG data for assessing climate risk, as these data are historical and backward looking by definition. Hence it is important that forward-looking data are elaborated for this purpose, e.g. capital expenditure plans and emissions reductions targets/goals

c. Paragraph 64: SFi supports the importance of monitoring materiality of climate, environmental, and social risks over time in case they do become material. Certain financial impacts may only materialize in the long term, often over a period much longer than what is considered in traditional financial reporting. It is therefore important to maintain a long-term perspective and regularly monitor potentially material risks.

Disclosure

SFi fully applaud the proposal for Paragraph 6.2A of the FMCC to require fund managers to disclose governance and management of climate-related risks and how these are taken into account in the investment/risk management process. We are of the opinion that also social and other environmental risks should be included though.

a. Paragraph 71: we support the requirement for large fund managers to disclose engagement policy, and we would like the wording to include the following:
    i. Policies or expectations for companies in high-risk sectors (e.g. coal, oil & gas, mining, etc.), as well as any sectors or activities that they do not support (exclusion principles)
    ii. Policies covering their approaches to engagement and voting (including voting records)
    iii. Progress on engagements made across their portfolios

b. Paragraphs 76: we support the recommendation to encourage disclosure of other relevant metrics besides WACI, for instance we would recommend to include the Global Real Estate Sustainability Benchmark (GRESB) for real estate/infrastructure as it is a globally adopted framework/standard

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?

<u>SFi view as private investor collective</u>

SFi believes that the approach suggested by the SFC helps to provide a clear picture to investors on whether a fund manager has integrated climate-related considerations into its investment strategies or funds. This is important given the increasing international focus on climate change, and the resulting requirements for more information about how climate-related risks affect the performance of assets and how these risks are managed.

In particular, the following arguments brought forward by the SFC are worth mentioning:

1. We applaud the fact that the SFC requires all fund managers to adopt processes to identify the relevance and materiality of climate-related risks, as this requirement further strengthens the resilience of the financial system in Hong Kong
2. We believe it is important that if a fund manager considers a climate risk to be irrelevant to its investment and risk management processes, it provides justifications and maintains records to back this assessment, above all given the cross-cutting nature of climate change and its wide-ranging effects. This ultimately creates accountability on the fund managers side, allows all investors to make a well-informed investment decision, and addresses growing concerns of greenwashing
3. It is fundamental that fund managers review their assessments on climate risks on a regular basis, as their investment strategies and risk management processes might change over time

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?

<u>SFi view as private investor collective</u>

The SFC argues that with the exception of the Weighted Average Carbon Intensity (WACI), which should be disclosed at the fund level, the **SFC proposes that at a minimum, fund managers should make appropriate disclosures at an entity level regarding**

- Governance
- Investment management
- Risk management

If different investment and risk management approaches are adopted by different strategies and funds, fund managers should supplement the strategy or fund disclosures accordingly. Hereafter a graphic summary:

4. Disclosure – entity/fund level
- To comply with ALL disclosure requirements ✓
- Entity level disclosures
  - Governance, investment management and risk management-related requirements✓
  - Engagement policy (enhanced standards) ✓
- Fund level disclosures
  - WACI of Scope 1 and Scope 2 GHG emissions (enhanced standards) ✓

SFi agrees with the SFC's proposed approach to disclosures as we believe that

- Governance functions would be performed at an entity level
- If the same Investment management and Risk management are adopted by different strategies and funds, then disclosing them at an entity level would reduce burden on the fund managers.
- If different Investment management and Risk management are adopted by different strategies and funds, it would be important that these differences would be further supplemented and highlighted

However, the SFC should make clear the degree of applicability of entity-level disclosures, i.e. in terms of geography and asset classes (SFi believes that ideally disclosures should me made applicable across all asset classes). Eventually, exceptions to the applicability of the disclosures should be noted and explained according to requirements proposed in question 6.

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?

As it pertains to the WACI: we are of the opinion that it should be disclosed at a fund/strategy level and not at an entity level. However, taking into account the resources required to obtain the information to disclose this metric, to require smaller fund managers to disclose WACI would not respect the principle of proportionality outlined in the FMCC. As proposed by the SFC, we believe Large Fund Managers would have the resources to disclose the WACI, and it should therefore be required by the enhanced standards for Large Fund Managers at the initial stage to provide decision-useful information about a fund's exposures to potential climate-related risks.

Moreover, WACI is calculated based on current portfolio value (see formula in Appendix A of the Consultation Paper) and would not be meaningful to aggregate it and disclose it at an entity level.

As investors who are increasingly concerned about climate risks as well as green washing in the industry, we have engaged with and are beginning to see a number of larger fund managers that have gone beyond Carbon Footprint related reporting and risk management in their practices. These forerunners have included benchmarking, attribution and forward-looking risk metrics as well as scenario analysis into their risk and investment strategies.

We would highly encourage fund managers that already have Baseline and Enhanced requirements in place, to continue to advance their internal practices as a way to elevate overall standards as well as differentiate themselves with their peers.

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

a. a nine-month and a 12-month transition period for Large Fund Managers to comply with the baseline requirements and enhanced standards respectively;
b. 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.

SFi has the following opinions with regards to the proposed timelines for transition:

a. Even though these represent reasonable timelines to comply with the new requirements, the proposed transitions periods are not ambitious enough. Based on a survey conducted with asset owners, large fund managers stated that it is definitely doable for them to adhere to the transition periods
b. We believe the proposed transition period to comply with baseline requirements are appropriate and ambitious enough for other (i.e. smaller) fund managers, as they can count on less resources to transition.

Yours sincerely,

Sustainable Finance initiative (SFi)

We the following family offices, foundations and private investors endorse and support the views presented by SFi in this submission, and also take this opportunity to express our perspectives for further refinement of the SFC proposals.

Signed (in alphabetical order):

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