SECURITIES AND
FUTURES COMMISSION
證券及期貨事務監察委員會

Consultation Conclusions on the Management and Disclosure of Climate-related Risks by Fund Managers

August 2021

Contents

Executive summary

1. On 29 October 2020, the Securities and Futures Commission (SFC) issued a Consultation Paper on the Management and Disclosure of Climate-related Risks by Fund Managers (Consultation Paper), which proposed requiring fund managers to take climate-related risks into consideration in their investment and risk management processes and make appropriate disclosures. The SFC proposed that the Fund Manager Code of Conduct (FMCC) be amended to provide high-level principles and that a circular be issued to set out expected standards for complying with the FMCC (collectively referred to as the SFC's proposed requirements).

2. The consultation ended on 15 January 2021. The SFC received 52 written submissions, including submissions from various industry associations, asset management firms, professional bodies and individuals. A list of respondents is set out in Appendix A.

3. In general, the SFC received positive feedback on the proposed requirements focusing on climate-related risks which would at the initial stage apply to fund managers managing collective investment schemes (CISs). Respondents also agreed with the proposal to make reference to the well-recognised Task Force on Climate-related Financial Disclosures (TCFD) Recommendations[1] in developing the requirements and to implement them using a two-tier approach, ie, with baseline requirements for all fund managers and enhanced standards for fund managers with assets under management (AUM) that equal or exceed certain threshold (Large Fund Managers). The key comments and the SFC's responses are summarised below.

Key comments

Scope and applicability

4. Some respondents suggested further limiting the scope of the requirements to specific types of funds, eg, SFC-authorised funds or environmental, social and governance (ESG) funds. Some sought the SFC's clarification of how the proposed requirements should be applied to fund managers performing different roles such as delegated fund managers, advisors and distributors.

5. At the initial stage, the SFC's proposed requirements focus on climate-related risks. They are intended to help ensure that fund managers properly manage these risks and promote clear, comparable and high-quality disclosures to help investors make more informed decisions. To align with international regulatory developments, such as the approach adopted by the European Union (EU) where no distinction is made between authorised and unauthorised funds, the SFC considers it appropriate to retain the original proposal to apply the requirements to managers of all funds.

6. When determining the applicability of the requirements, fund managers should first consider whether they have discretion over the investment management processes. If so, the SFC's requirements are applicable to the extent of the fund manager's role. Fund managers should apply the principle of proportionality[2], ie, assess the nature, size,

[1] The TCFD's Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures, June 2017.

[2] Paragraph 1.2(d) of the FMCC.

complexity and risk profiles of their firms and the investment strategies adopted by each fund under their management, in determining how to adhere to the requirements accordingly. Where fund managers delegate the investment management function to sub-managers, they shall retain the overall responsibility for complying with the SFC's requirements. If a licensed corporation (LC) is solely providing investment advice to a separate team of an affiliate or acting as a distributor of funds, with no investment management discretion, the LC will not be expected to comply with the SFC's proposed requirements.

Threshold for defining Large Fund Managers

7. A few respondents suggested increasing the threshold for Large Fund Managers from AUM of $4 billion to $8 billion or above as they view that only fund managers with that much AUM would have the appropriate resources to adopt the enhanced standards. Reference was also made to the threshold for climate-related disclosure requirements set by another jurisdiction.

8. After further deliberation, the SFC considers it appropriate to raise the threshold to $8 billion at the initial stage. To align with the scope of the application of the proposed requirements—fund managers managing CISs—the AUM of discretionary accounts will be excluded.

Governance

9. While respondents generally agreed that the board of directors has to exercise oversight, some commented that it would be more appropriate for senior portfolio managers or senior management to handle the role of supervising and monitoring climate-related issues. Respondents also sought the SFC's clarification of whether they can leverage group resources in adhering to the proposed governance requirements.

10. The SFC agrees that the governance requirements should allow flexibility for the roles of the board of directors based on specific circumstances and has amended the baseline requirements to clarify the respective roles of the board and management. The board or the board committees should have overall oversight of climate-related issues and set the tone from the top. Management are required to supervise and monitor the integration of climate-related considerations into the investment and risk management processes.

11. The SFC wishes to clarify that local fund managers may leverage group resources in managing climate-related risks. Nevertheless, the local management should retain the responsibility to ensure that the LC is in compliance with the SFC's requirements.

Data availability

12. Many respondents raised concerns about the availability and quality of climate-related data, which may cause difficulties for fund managers in adhering to the proposed requirements.

13. The SFC noted respondents' concerns about data availability and the lack of common standards among disclosures by investee companies, though metrics and standards are globally converging. However, the SFC would like to clarify that:

(i) Fund managers have the flexibility to adopt the type of tools and metrics they consider appropriate to assess climate-related risks for risk management purposes using either a qualitative or quantitative approach, or a combination of both. They are encouraged to take reference to new standards and metrics which are emerging.

(ii) In complying with the greenhouse gas (GHG) emissions disclosure requirement, Large Fund Managers are expected to make a reasonable effort, where data is available or can be reasonably estimated.

(iii) Fund managers can make reference to the standards or approaches of international organisations such as the Partnership for Carbon Accounting Financials (PCAF)[3] in estimating the GHG emissions of investments in different asset classes.

(iv) At the initial stage we only expect Large Fund Managers to assess if scenario analysis will be relevant and useful for them in evaluating the resilience of investment strategies to climate-related risks under different pathways. If so, Large Fund Managers are expected to develop a plan to implement scenario analysis within a reasonable timeframe. Hence, there is time for Large Fund Managers to plan for the adoption of scenario analysis, if required.

Disclosure of GHG emissions

14. While many respondents supported the quantitative disclosure requirement under the enhanced standards, some suggested that the SFC allow Large Fund Managers to choose which metric to report instead of mandating disclosure of weighted average carbon intensity (WACI). A number of respondents asked the SFC to consider allowing the use of enterprise value-based metrics, which are more commonly used by fund managers in the EU, rather than WACI, which is revenue-based.

15. Acknowledging the efforts needed in making quantitative disclosures, the Consultation Paper proposed to mandate a single metric as a starting point to provide investors with comparable information across different size portfolios. Taking industry feedback and all material factors into consideration, including the TCFD's latest view as set out in the consultation paper issued by the TCFD in June 2021[4], the SFC has decided to revise the proposed requirements to require Large Fund Managers to take reasonable steps to identify the portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions of funds' underlying investments and to disclose them as enterprise value-based metrics (Appendix E). Large Fund Managers could supplement the quantitative disclosures with additional metrics as they consider appropriate, such as other enterprise value-based, revenue-based, asset class-specific or forward-looking metrics, to provide more decision-useful information to investors.

[3] Partnership for Carbon Accounting Financials, an industry-led partnership, was launched in 2015 to harmonise GHG accounting methods and enable financial institutions to consistently measure and disclose GHG emissions financed by their loans and investments.

[4] The TCFD's Proposed Guidance on Climate-related Metrics, Targets, and Transition Plans, June 2021.

Implementation timeline

16. While respondents generally accepted the proposed phased approach which would allow more time for relatively smaller fund managers to prepare, a number of respondents suggested extending the transition periods as the proposals concern climate-related risks which are new to the industry and additional workload is expected for fund managers to enhance their systems, policies and procedures.

17. Having considered this suggestion, the SFC has decided to amend the transition periods, commencing from the date of publication of this Consultation Conclusions Paper and circular, as follows:

    (a) Large Fund Managers are given 12 months as the transition period for complying with the baseline requirements and 15 months for the enhanced standards; and

    (b) other fund managers are given 15 months as a transition period for complying with the baseline requirements.

18. For the reasons set out in this paper, the SFC will adopt the amendments to the FMCC and issue a circular to set out the baseline requirements and enhanced standards with certain modifications. The final version of the amendments to the FMCC and the baseline requirements and enhanced standards are included in Appendix B and Appendix C, respectively.

19. The circular will include practical examples for fund managers' reference when considering how to adhere to the requirements. Fund managers should note that these sample practices are for illustrative purposes only and not intended to be exhaustive. Fund managers should develop governance structures, policies and procedures which are commensurate with the nature, size, complexity and risk profiles of their firms and the investment strategies adopted by each fund under their management.

20. The SFC would like to thank all who responded for their time and effort in reviewing the proposals and for their detailed and thoughtful comments.

21. The Consultation Paper, the responses (other than those from respondents who requested their submissions be withheld from publication) and this paper are available on the SFC's website at www.sfc.hk.

Comments received and the SFC's responses

Section I – Proposed area of focus

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 be considered in developing the requirements? Please explain your view.

Public comments

22. There was broad support for the SFC's proposal to focus initially on climate change which is at the top of the regulatory agenda globally and needs to be urgently addressed. Some respondents were of the view that the proposal would encourage the industry to strive to achieve carbon neutrality which is consistent with Hong Kong's and mainland China's commitments to achieve net-zero carbon emissions by 2050 and 2060, respectively.

23. A few respondents suggested that in view of international developments, such as those in the EU[5], the proposal should be bolder and cover more ESG factors, or all of them.

24. Among those who supported initially focusing on climate change, a number, including a few industry associations, also requested that the SFC provide a clear roadmap by setting out a timeline for broadening the regulatory scope to address other ESG factors.

25. Separately, a respondent suggested expanding the proposal to require fund managers to take climate-related opportunities into consideration in order to direct capital to fund the climate transition. Another respondent suggested that the SFC, along with other authorities, develop a taxonomy to help incentivise the movement of capital towards sustainable investments.

The SFC's responses

26. The SFC welcomes the respondents' general support for the proposal to focus on climate change at the initial stage and it will proceed to do so in the amendments to the FMCC.

27. As some respondents also recognised, commencing with an initial focus on climate change will make the implementation process more manageable, especially as metrics are generally more developed in this area at present. Yet, as mentioned in the Consultation Paper, the SFC acknowledges the importance of ESG factors and

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[5] Starting from 10 March 2021, financial market participants in the EU are subject to the Sustainable Finance Disclosure Regulation (SFDR) which requires them to disclose how sustainability risks are integrated into their investment decision-making processes and how they consider principal adverse impacts in their portfolios. It also specifies pre-contractual disclosure of the integration of sustainability risks for various investment products. Furthermore, on 21 April 2021, the European Commission adopted a number of sustainability initiatives to improve the flow of money towards sustainable activities including the requirement that EU fund managers take sustainability risks into consideration in their investment processes.

encourages fund managers to consider integrating a broader spectrum of sustainability risks into their investment management and risk management processes. Fund managers have the flexibility to establish proper policies and procedures in compliance with other international guidelines, standards and regulations, alongside satisfying the SFC's proposed requirements.

28. For example, the SFC understands that some fund managers may already have group policies or frameworks covering other ESG factors in addition to climate change. These fund managers could follow their group policies to take sustainability risks into account in their investment and risk management processes.

29. Further, many areas relating to ESG are still developing. Instead of setting a definite roadmap and timeline for expanding the regulatory scope and mandating that fund managers cover other aspects of ESG in their investment and risk management processes, the SFC will remain abreast of international and market developments and explore expanding regulatory coverage to other aspects of ESG over the longer term.

30. Given that the primary focus of the SFC's proposed requirements is on the management of climate-related risks, we do not intend to impose any regulatory requirements in relation to climate-related opportunities. But fund managers have the flexibility to determine whether they wish to incorporate climate-related opportunities into their investment management processes and disclose them.

31. The SFC has been working on the taxonomy issue through its participation in the Green and Sustainable Finance Cross-Agency Steering Group (CASG) which aims to strengthen Hong Kong's financial ecosystem to support a greener and more sustainable future in the longer term. The CASG announced in December 2020 that one of its five key action points is joining the International Platform on Sustainable Finance (IPSF) Working Group, co-led by mainland China and the EU, which is developing a Common Ground Taxonomy[6].

[6] Taxonomy in this context generally refers to a system for classifying economic activities which are considered environmentally sustainable. The Common Ground Taxonomy will provide transparency to all investors and companies by constituting a unique common reference point across IPSF jurisdictions for defining environmentally sustainable investments.

Section II – Proposed requirements for climate-related risks

I. Proposed scope

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?

(a) Application of requirements to CISs but not discretionary accounts

Public comments

32. Respondents generally supported our phased approach to apply the SFC's proposed requirements to the management of CISs but not discretionary accounts at the initial stage as discretionary account holders are generally considered to have greater influence over the investment and risk management processes for their portfolios and could always request additional information from the fund managers.

33. Moreover, given that CISs account for a significant proportion of the total assets managed by LCs, a few respondents agreed that CISs are a good starting point to guarantee a broader reach and deeper penetration into the asset management industry.

34. However, some respondents maintained that climate issues affected almost all portfolios and suggested that the proposed requirements should also apply to the management of discretionary accounts in order to provide better investor protection and avoid segmenting the market.

35. A few respondents sought clarification of whether a fund manager would be expected to comply with the proposed requirements if discretionary account holders have indicated ESG or climate-related investment preferences in the investment mandates.

The SFC's responses

36. In light of the respondents' general support, the SFC will retain the original proposal and at the initial stage apply the requirements to fund managers which manage a CIS, irrespective of whether they have delegated their investment management function to other intermediaries.

37. We may expand the requirements to uniformly cover the management of all discretionary accounts at a later stage. To do so, additional assessments and further consultations may be required in light of the bespoke nature of the investment mandates in discretionary accounts.

38. For the purpose of the initial roll-out, if a client has requested that a discretionary account manager take climate-related risks into consideration in the investment mandate, the fund manager is expected to do so in accordance with the client's preference. The SFC's proposed requirements are not mandatory in this case.

(b) Implications for private funds and green or ESG funds

Public comments

39. A few respondents suggested applying the SFC's proposed requirements only to certain types of funds at the initial phase, depending on whether they are SFC-authorised, their size and investor base and whether the investment strategy has an ESG or climate focus. For other funds, the requirements should be relaxed or they should be exempt.

40. A respondent noted that the SFC has published disclosure guidance for SFC-authorised ESG funds and enquired about the difference between the fund disclosure guidance and the proposed requirements. Another respondent sought clarification of whether a fund would be subject to the proposed requirements if its investors do not view ESG risks as an important consideration and it is not a green or ESG-themed fund.

The SFC's responses

41. To align with international regulatory developments, such as the approach adopted by the EU where no distinction is made between authorised and unauthorised funds, the SFC considers it appropriate to retain the original proposal to apply the requirements to managers of all funds. This is also in line with the FMCC requirements, which do not make any distinction between authorised and unauthorised funds.

42. Furthermore, following the existing approach in the FMCC, we would not impose requirements specific to a fund's nature, size or client base. Instead, we would like to draw fund managers' attention to the principle of proportionality as mentioned in paragraph 40 of the Consultation Paper where fund managers are expected to maintain a risk management governance structure and procedures which are commensurate with the nature, size, complexity and risk profiles of their firms and the investment strategies adopted by each fund under management[7].

43. The SFC's proposed requirements focus on managing the climate-related risks of CISs, regardless of a fund's investment theme or focus. The disclosure guidance for SFC-authorised ESG funds[8] is a separate set of product-level requirements which applies to SFC-authorised funds incorporating ESG factors as a key investment focus.

(c) Applicability to fund managers performing different roles

Public comments

44. A number of respondents sought clarification of how, in practice, the proposed requirements would apply to fund managers appointed to perform different roles, for example:

    (a) A fund manager as a delegate with full investment discretion for a CIS, while the fund is being distributed outside Hong Kong.

[7] Paragraph 1.2(d) of the FMCC.

[8] See the circular to management companies of SFC-authorised unit trusts and mutual funds - ESG funds, 29 June 2021.

(b) A fund manager delegated with investment discretion and subject to the risk management framework, process and parameters implemented at the delegating entity.

(c) A fund manager is delegated with investment discretion for a portion of assets of a CIS and has no discretion over other parts of the CIS.

(d) The local licensed firm is an investment advisor or a distributor of a CIS in Hong Kong, while the investment and risk management functions are borne by an overseas affiliate or third-party.

The SFC's responses

Investment and risk management requirements

45. As illustrated in the flowchart shown in Appendix D, in determining the applicability of the proposed conduct requirements (ie, governance, investment management and risk management), fund managers should first consider whether they have discretion over the investment management processes. If the answer is affirmative, the SFC's proposed requirements are applicable to the extent of a fund manager's role.

46. If a fund manager is delegated with the overall investment management function of a CIS, it shall observe the proposed governance, investment and risk management requirements irrespective of whether the fund is distributed in Hong Kong.

47. If a fund manager is delegated with investment discretion but subject to the risk management framework, process and parameters implemented at the delegating entity, it would only need to adhere to the governance and investment management requirements, but not the risk management requirements.

48. In the event a fund manager is delegated with investment discretion for a portion of a CIS, it should comply with the proposed requirements proportionate to its circumstances, ie, limited to the portion of assets under its management and the role assigned to it. Hence, in a situation where a fund manager only has discretion to manage a portion of the fund and is not responsible for the entire fund's investment and risk management functions, that fund manager is required to comply with the SFC's proposed requirements only for the portion of assets under its management and it will not be expected to be responsible for managing climate-related risks at the fund level.

49. If an LC acts as an investment advisor for a CIS without having any investment management discretion, then the LC will not be expected to comply with the SFC's proposed requirements. The same applies to situations where an LC only acts as the distributor of a CIS.

50. The SFC wishes to reiterate that if a fund manager has overall investment management discretion for a CIS and it has subsequently delegated its investment management or risk management function to its group entities or third-party delegates, the fund manager shall retain the responsibility for ongoing monitoring of the competence of

group entities or delegates to ensure that the principles of the proposed requirements are followed[9].

Disclosure requirements

51. The proposed disclosure requirements will be applicable to those fund managers who are responsible for the overall operation of funds[10], but will not be applicable to those who manage only part of a fund.

II. Proposed approach

(a) Alignment with international developments

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?

Making reference to the TCFD Recommendations

Public comments

52. A majority of the respondents agreed with our proposal to make reference to the TCFD Recommendations in developing our requirements as the TCFD Recommendations are principles-based, widely endorsed international standards. These respondents recognised that consistent and harmonised requirements would minimise fund managers' compliance burden and foster the development of a more internationally-consistent conduct and disclosures framework. This approach would also aid in achieving comparability across different fund managers and avoid fragmenting requirements or standards and duplicating competing frameworks.

53. Some supporters also recommended that the SFC stay flexible in incorporating the TCFD reporting framework and avoid automatically adopting any future iterations.

54. Two other respondents suggested that the SFC require full alignment with the four pillars of the TCFD Recommendations, ie, governance, strategy, risk management and metrics and targets, so as to avoid inconsistency or the unintended consequences of fund managers adopting a broad-brush approach which may increase the risk of greenwashing.

[9] Paragraph 1.10 of the FMCC.

[10] For the meaning of a fund manager responsible for the overall operation of a fund, please see answer to Question 1 of the FAQs on the FMCC.

The SFC's responses

55. The SFC agrees that flexibility is needed. In referring to the TCFD Recommendations, which are mainly principles-based, when drafting the proposed requirements, the SFC adopted a balanced approach. This provides flexibility for fund managers to apply different approaches having regard to their specific circumstances.

<u>*Other international standards or frameworks*</u>

Public comments

56. While two respondents suggested that the SFC should only make reference to the TCFD reporting framework and it is unnecessary to refer to other standards at this point in time, other supporters welcomed the SFC making reference to other international regulations or standards including:

(a) the EU SFDR;

(b) global standards such as the Taskforce on Nature-related Financial Disclosure and the Climate Action 100+; and

(c) the prototype for climate-related financial disclosure standards proposed by the CDP, the Climate Disclosure Standards Board (CDSB), the Global Reporting Initiative (GRI), the International Integrated Reporting Council (IIRC) and the Sustainability Accounting Standards Board.

57. Furthermore, some respondents suggested that the SFC should allow flexibility for fund managers to adopt a framework or approach which is commensurate with their respective circumstances such as their investment strategies and firm size.

The SFC's responses

58. To foster the development of a more consistent framework and minimise the industry's compliance burden, the SFC has mainly made reference to the TCFD Recommendations when developing the proposed requirements for the initial roll-out. We recognise that other international regulations and standards are also evolving at a rapid pace, and that these may be relevant for fund managers. For example, the International Financial Reporting Standards Foundation intends to establish an International Sustainability Standards Board for setting sustainability reporting standards. In addition to adopting our proposed requirements, fund managers are welcome to incorporate elements from other regulations or standards into their processes, where appropriate.

59. The SFC stays abreast of the development of the TCFD Recommendations, as well as other local and international regulations and standards. When necessary, we will refine our requirements and guidance to improve the management and disclosure of climate-related risks by fund managers and combat green-washing.

"Comply or explain"

Public comments

60. Some respondents sought clarification of whether a "comply or explain" approach is allowed for compliance with the SFC's proposed requirements to retain flexibility in configuring approaches to climate-related risk management.

The SFC's responses

61. To ensure consistency with our ongoing regulatory approach and avoid singling out climate-related risks, a "comply or explain" approach will not be considered for the purpose of the proposed requirements.

62. However, providing flexibility for fund managers is important. Fund managers could adopt the principle of proportionality when developing their policies and procedures for complying with the SFC's proposed requirements.

Other related comments

Public comments

63. Two respondents opined that the proposed requirements are more extensive and prescriptive than those in other jurisdictions. Mandating a new investment criteria which may differ from investors' expectations may restrict the ability to choose suitable investments and lead to fiduciary duty issues.

64. A few respondents commented that liability risks are a potential consequence of physical and transition risks and should not be categorised as standalone climate-related risks.

The SFC's responses

65. In relation to the concern about fiduciary duties, the SFC's proposed requirements are intended to be principles-based to allow fund managers the flexibility to determine the most appropriate approach to comply with our requirements. While we are mandating that fund managers take climate-related risks into consideration in their investment management processes if the risks are relevant and material, the proposed requirements do not prohibit or restrict fund managers from considering other factors when making investment decisions in accordance with a fund's stated investment strategy, objectives, investment restrictions and guidelines. Hence, fund managers are not restricted from discharging their fiduciary duties to their clients under the proposed requirements. The SFC will make this clear in the circular.

66. Having considered the public comments, the new paragraph F in Appendix 2 to the FMCC has been revised to make it clear that liability risks may be triggered by physical or transition risks.

(b) Threshold for defining Large Fund Managers

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

<u>*Threshold limit*</u>

Public comments

67. In general, respondents supported the two-tier approach with Large Fund Managers being required to adopt a more robust approach and make more detailed disclosures, given that it would prevent a disproportionate burden falling on small fund managers.

68. Some respondents suggested that the AUM threshold for Large Fund Managers should be increased from $4 billion to $8 billion or above or that the application of the requirements be limited to those funds with ESG or climate-related investment strategies.

69. Some respondents also commented that the AUM of discretionary accounts should be excluded from the calculation since at the initial stage it would not be mandatory for fund managers to apply the requirements to discretionary accounts.

70. Some respondents suggested that the SFC should also consider other factors such as firm size when setting the threshold. One of them commented that the AUM does not necessarily correlate with the monetary resources available for a fund manager to hire additional staff and engage service providers in order to meet the enhanced standards.

71. Separately, two respondents suggested that the SFC should uniformly apply high-level, principles-based requirements across all fund managers irrespective of their size and activities and may impose different implementation timelines for large and other fund managers.

The SFC's responses

72. The SFC appreciates that respondents generally support the proposed two-tier approach with all fund managers complying with the baseline requirements and Large Fund Managers adopting the enhanced standards as well.

73. The SFC has engaged in further discussions with some industry stakeholders to better understand the concerns about the proposed threshold for defining Large Fund Managers. An industry association explained that based on a statistical analysis of its members, fund managers with AUM of $8 billion (ie, US$1 billion) or above generally have more resources and capital. Referring to the proposed New Zealand law which aims to mandate climate-related disclosures for fund managers with AUM over NZ$1

billion[11], this industry association considered that fund managers with AUM of $8 billion are better equipped to adopt the enhanced standards.

74. One of the SFC's key objectives at the initial stage is that fund managers take the first step in addressing climate-related risks. Taking into account the respondents' comments and the fact that a higher threshold would still bring into scope fund managers responsible for a substantial portion of all asset management firms' total AUM, the SFC has decided to increase the threshold to $8 billion or above.

75. The SFC concurs with the suggestion to exclude the AUM of discretionary accounts as this aligns with the initial scope where the proposed requirements would apply to fund managers managing a CIS. Please refer to Appendix C for the amendments made for this purpose.

76. As AUM may fluctuate, the determination of whether a fund manager meets the $8 billion threshold should be made by referencing monthly CIS AUM for any three months in the previous reporting year.

77. The enhanced standards will be applied to Large Fund Managers irrespective of whether they have funds with an ESG or climate-related focus. The SFC believes that the theme of a fund should not affect the need to integrate proper risk management in investment decisions or to assess and manage the impact of these risks on the underlying investments on an ongoing basis. Investors should be protected against exposures to all relevant and material investment risks.

78. The SFC does not intend to add additional factors for defining Large Fund Managers or adopt a uniform approach across all fund managers because we expect fund managers to follow the principle of proportionality and take reasonable steps in developing policies and procedures which are commensurate with the nature, size, complexity and risk profile of the firm and the investment strategy adopted by each fund under management.

<u>Delegation arrangements and relegation</u>

Public comments

79. Two respondents sought clarification of whether AUM under delegating arrangements would be included in the calculation and subject to the requirements.

80. Two respondents sought clarification of whether a firm deemed a Large Fund Manager be relegated to the lower standard if its AUM does not reach the threshold in any three months during the next reporting period.

The SFC's responses

81. Regarding delegation arrangements, the AUM of that portion of the fund for which the fund managers have discretion over the investment management processes should be taken into account in the calculation. This is consistent with the approach used in determining the scope of application set out in paragraphs 45 to 50 above.

[11] In April 2021, the New Zealand Government introduced a Financial Sector (Climate-related Disclosures and Other Matters) Amendment Bill to make climate-related disclosures mandatory for some organisations including all managers of registered investment schemes with greater than NZ$1 billion in total assets under management.

82. A fund manager is regarded as a Large Fund Manager if its monthly CIS AUM equals or exceeds the threshold for any three months in the previous reporting year. If a fund manager no longer meets the threshold, it is not mandatory to comply with the enhanced standards in the following reporting year. However, the fund manager is encouraged to observe the enhanced standards voluntarily to maintain consistency and facilitate comparison.

III. Proposed requirements

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

83. Respondents generally support taking a principles-based approach and adopting the principle of proportionality in formulating the amendments to the FMCC and setting out the baseline requirements and enhanced standards. Specific comments are addressed below.

(a) Governance

General

Public comments

84. Respondents generally agreed that ESG considerations, including climate change, should be integrated into fund managers' investment and risk management processes as well as their governance structures. However, they would have particular concerns if the role of the board is too specific given that the board's role and involvement in operations varies among fund managers. Staff at the management level, such as senior portfolio managers, are better equipped to monitor the integration of climate-related risks into the investment and risk management processes. On the other hand, a few respondents suggested requiring members of the board and management to have the requisite knowledge and expertise to perform their functions appropriately.

85. Furthermore, some respondents commented that for global fund managers, climate-related risks are centrally managed at the group level and handled by overseas affiliates. They asked the SFC to clarify the application of the requirements in these cases and suggested providing flexibility to allow an LC to leverage its group entities in fulfilling the governance requirements.

86. Some respondents sought clarification of whether fund managers are expected to follow the sample industry practices illustrated in the Consultation Paper and establish dedicated governance structures or teams for climate-related issues.

The SFC's responses

<u>The board's role and expertise</u>

87. The SFC appreciates the respondents' recognition of the importance of a proper governance structure for climate-related risk management and their views on the different roles played by the board and management in the operation of a fund. The SFC agrees that the requirements should allow flexibility for the board's role based on specific circumstances. Hence, the SFC will revise the baseline requirements to clarify the roles of the board and the management. In particular, the board or the board committees should have overall oversight of climate change issues for the purpose of setting the tone from the top. Management will be required to supervise and monitor the integration of climate-related considerations into the investment and risk management processes. These include setting goals, developing action plans and establishing controls and procedures as well as overseeing progress against goals for addressing climate-related issues.

88. The SFC is inclined to follow the existing approach[12] to require fund managers to maintain sufficient human and technical resources for the proper performance of their duties, including the management of climate-related risks, rather than imposing on the board or management specific requirements for climate knowledge or expertise.

<u>Application of group policies</u>

89. The SFC agrees that local fund managers may leverage group resources and staff in managing climate-related risks on a group basis while the local management retains the responsibility to ensure that the policies and practices adopted by the LC are in compliance with local regulatory requirements.

<u>Sample practices</u>

90. The industry practices illustrated in the Consultation Paper are provided for reference only. Fund managers may integrate climate-related risks into existing governance structures and investment and risk management processes which are commensurate with their operations having regard to their circumstances.

91. Some respondents also requested that to reduce uncertainty, the SFC provide comprehensive guidance on governance, investment management and risk management practices which it considers acceptable. The SFC would like to reiterate that it does not intend to endorse any industry practices and the rapidly evolving nature of climate-related risk management methodologies makes it difficult, if not impossible, to provide a single set of practices which are universally applicable. Some respondents mentioned that attempting to do so would also limit the development of new methodologies. We will assess fund managers' compliance with the requirements on a case-by-case basis in a pragmatic and holistic manner.

92. The SFC will keep up with international and market developments and share more practical examples with the industry from time to time. The SFC also welcomes firms to share their experience with us.

[12] Paragraph 1.2(b) of the FMCC.

(b) Investment management

Relevance and materiality assessments of climate-related risks

Public comments

93. A majority of the respondents agreed to the proposed principles-based requirements in the FMCC which require fund managers to identify relevant and material climate-related risks and factor material risks into their portfolio construction processes. Some respondents sought clarification and guidance on how fund managers could identify the relevance and assess the materiality of climate-related risks, especially across different asset classes such as equity, fixed income, real estate and infrastructure, as well as the frequency with which reviews or assessments should be performed.

94. A respondent commented that climate-related risks are not relevant to some specialised funds, eg, managed futures, macro, quant, high frequency trading and index tracking funds.

The SFC's responses

95. The SFC is aware that climate-related risks are relatively new to the industry and the methodologies and practices in this area are evolving. Fund managers can refer to paragraphs 50 to 55 of the Consultation Paper for guidance on identifying climate-related risks and assessing their relevance and materiality. Given the broad spectrum of climate-related risks and the wide range of financial assets and investment strategies in the market, the SFC considers that it is more appropriate to take a pragmatic approach and allow fund managers the flexibility to determine whether climate-related risks are relevant and material based on their investment strategies.

96. Fund managers can also make reference to the publications and standards of international organisations[13] which focus on climate change or sustainability in developing their policies and procedures. When incorporating climate-related risks into investment management processes, a fund manager should not only focus on green-related investments but also monitor and manage the climate-related risks associated with high carbon intensity assets in order to properly manage the fund's overall risk exposures.

97. We would require that reviews or assessments be made on a regular basis and when triggered by any major changes such as to a fund's investment strategy.

Passive strategies

Public comments

98. Some respondents agreed that passive funds should not be automatically carved out from the requirement to take climate-related risks into consideration in investment management processes but pointed out that passive fund managers have a fiduciary responsibility to follow the stated investment objectives and are expected to minimise

[13] Apart from those mentioned in paragraph 55 of the Consultation Paper, fund managers can also refer to the CDSB, GRI, IIRC and PCAF.

tracking errors. Hence, they sought clarification of how the requirements should apply to passive funds.

99. In the case of partial replication or enhanced passive funds, some respondents commented that there may be obstacles to deviating from or excluding certain benchmark constituents based on climate-related considerations unless clearly specified in the fund documents. Respondents generally supported exempting full replication funds from the requirements.

100. Some respondents sought clarification of the expectation that passive fund managers would exercise stewardship responsibilities such as voting and collaboration with other stakeholders if their investment discretion is limited to rebalancing portfolios to match the index compositions.

The SFC's responses

101. The SFC recognises passive fund managers' limitations in exercising investment discretion over index funds or funds with specific investment objectives. Paragraph 54 of the Consultation Paper provides suggestions passive fund managers can consider when incorporating climate-related risks into their investment and risk management processes. Fund managers can adopt these suggestions to the extent they are permissible according to the fund's mandates and restrictions.

102. While fund managers may be constrained from deviating from a reference benchmark or index in their investment processes, they can manage the material climate-related risks of the underlying investments in various ways such as through exercising stewardship (eg, proxy voting) or engaging with index providers to enhance ESG considerations in index design. The SFC encourages fund managers to engage with the investee companies if possible as this could improve companies' information disclosures and enhance their strategic and business resiliency to climate change.

<u>Conflicts with regulations in other jurisdictions</u>

Public comments

103. A respondent was concerned that adhering to the requirements might result in potential conflicts with legal obligations in offshore jurisdictions.

The SFC's responses

104. Mandating that fund managers incorporate the consideration of climate-related or sustainability risks in investment and risk management processes is a regulatory trend globally. International regulatory bodies, such as the Network of Central Banks and Supervisors for Greening the Financial System (NGFS) and the Sustainable Finance Network of the International Organization of Securities Commissions, and national regulatory authorities in the EU, the UK, New Zealand and Singapore, have adopted initiatives to require financial institutions to address climate-related or sustainability risks. Recently, the US government also showed strong support for addressing climate change by re-joining the Paris Agreement and committed to a pledge to reduce GHG emissions by 2030. The US Department of Labour also recognised the important role ESG integration can play in the evaluation and management of retirement plan investments.

105. Nevertheless, the requirements for the management of climate-related risks shall not prohibit or restrict a fund manager from complying with applicable laws and discharging its fiduciary duties and other legal obligations in other jurisdictions.

(c) Risk management

106. Most respondents supported the baseline requirements which would require fund managers to take climate-related risks into consideration in the risk management process. However, some respondents expressed concerns about the enhanced standards, including for engagement policy and scenario analysis, which would apply to Large Fund Managers.

Engagement

Public comments

107. Some respondents proposed specific disclosures in addition to the engagement policy, including the disclosure of engagement progress, investment exclusion principles and policies for managing the climate-related risks of companies in high-risk sectors. One respondent commented that, depending on a fund's strategies or size, not all types of funds may adopt active engagement.

The SFC's responses

108. As stated above, the SFC recognises the importance of engagement in driving investee companies' sustainability and sharpening positive corporate behaviour. Fund managers play an important role in influencing investee companies' actions and improving the quality of climate-related disclosures.

109. Given that fund managers have their own strategies and limitations[14], the SFC is mindful to allow fund managers the flexibility to develop their engagement policies. While Large Fund Managers are required to disclose their engagement policies to investors, they have the discretion to determine their level of engagement having regard to the circumstances of each case. The SFC encourages fund managers to actively engage with investee companies and exercise their proxy voting rights on climate-related issues.

Scenario analysis

Public comments

110. A respondent commented that the implementation of scenario analysis is complicated and requires a lot of resources and expertise as it is relatively nascent and quality data is lacking.

111. Some respondents suggested that feasibility is a prerequisite for scenario analysis and Large Fund Managers should only incorporate scenario analysis when data is available. A respondent sought clarification of how to assess the usefulness of scenario analysis

[14] For example, a fund manager may not be able to engage with an investee company because it only invests in derivatives to gain exposure or only holds a very small position in the company.

to ensure consistency across the industry and requested more guidance on types of scenarios and methodologies.

The SFC's responses

112. Scenario analysis could help fund managers assess how portfolios may be affected by risks and opportunities arising from climate change and evaluate the resilience of investment strategies to climate-related risks under different pathways. As climate-related risks are forward-looking in nature and future events are inherently uncertain, it may be hard to assess them using standard risk modelling based on historical data.

113. Driving the adoption of scenario analysis in the industry is necessary to promote awareness of its usefulness and foster the development of methodologies. Data limitations should not hinder the industry's efforts to begin building capacity and this is in line with the regulatory approaches in other jurisdictions.

114. The SFC acknowledges the operational difficulties at the initial stage and that not all fund managers have the sufficient resources or expertise to conduct scenario analysis. As mentioned in paragraph 74, we have increased the threshold for Large Fund Managers from $4 billion to $8 billion.

115. Large Fund Managers are required to assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different pathways and to keep records of these assessments. If climate scenario analysis is assessed to be relevant and useful, Large Fund Managers should plan to develop and implement scenario analysis which is commensurate with their size and the nature of their business within a reasonable timeframe. It is vital for fund managers to start the learning process sooner rather than later. As mentioned in paragraph 67 of the Consultation Paper, Large Fund Managers may make reference to climate scenarios and scenario data provided by the NGFS and other organisations[15]. Further, the SFC encourages but does not require fund managers to disclose their scenario analysis to investors at this stage.

(d) Disclosures

<u>*General*</u>

Public comments

116. Market participants generally either agreed with or had no comment on the new paragraph 6.2A of the FMCC which requires a fund manager to adequately disclose its governance arrangements for the oversight of climate-related risks and how these risks are taken into account in the investment and risk management processes.

117. A respondent sought clarification of whether the disclosure requirements under paragraph 6.2A of the FMCC are only applicable when climate-related risks are relevant and material.

[15] Such as the Intergovernmental Panel on Climate Change and the International Energy Agency.

The SFC's responses

118. The SFC will retain the proposal to require fund managers responsible for the overall operation of a fund to make adequate disclosures covering its governance arrangements for overseeing climate-related risks and how these risks are integrated into the investment and risk management processes. This is on par with overseas regulatory developments[16].

119. We have also made amendments to the new paragraph 6.2A of the FMCC to clarify that these disclosure requirements are applicable to the extent that climate-related risks are relevant and material. Nevertheless, fund managers are required to disclose the types of investment strategies or funds under their management for which climate-related risks have been assessed to be not relevant.

<u>*Reliance on group disclosures*</u>

Public comments

120. Market participants generally appreciate that they could rely on group-based disclosures for complying with the SFC's disclosure requirements. A respondent sought clarification of whether it would suffice to demonstrate compliance if a fund manager's disclosure states that the group-wide policies and practices are adopted and applied consistently across the group.

The SFC's responses

121. If a fund manager, after internal assessment, confirmed that group-wide policies and procedures are applied consistently in its operations in Hong Kong and they also meet or exceed the SFC's requirements, it is acceptable for the fund manager to adopt its group disclosure if it provides it to investors. However, if local adoption deviates from the group policies, procedures or disclosures, the fund manager should supplement the group disclosures with additional information at the local level.

<u>*Informing fund investors of material changes*</u>

Public comments

122. Some respondents suggested allowing fund managers to make their own judgement about what information to provide to investors based on practical considerations as climate-related risks are evolving and they foresee frequent changes to policies and procedures. Timely notification to investors of any material changes may create practical difficulties.

[16] Under the EU's SFDR, fund managers have to publish information about their policies for the integration of sustainability risks in their investment decision-making processes. If principal adverse impacts of investment decisions on sustainability factors are being considered, fund managers have to describe their policies for the identification and prioritisation of these impacts and indicators and any actions taken as well as their engagement policies.

The SFC's responses

123. Some industry participants subsequently enquired whether they need to amend fund prospectuses and expressed concerns that this may entail considerable legal and administrative costs.

124. Fund managers have the flexibility to disclose the required information to investors in a way they deem appropriate. As mentioned in paragraph 82 of the Consultation Paper, disclosures can be made via various channels such as websites, newsletters or reports as long as investors' attention is drawn to the information. Disclosures can be made across channels to bring fund investors' attention to changes determined to be material to them.

(e) Disclosure of where climate-related risks are not relevant

Question:
6. To provide clarity for investors on whether climate-related considerations have been integrated into a fund or its investment strategies, do you agree that if a fund manager considers that climate-related risks are not relevant to certain investment strategies or funds, it should make disclosures and maintain appropriate records to explain the rationale for its assessment?

Public comments

125. The majority of the respondents agreed that fund managers be required to make disclosures if they consider that climate-related risks are not relevant to certain investment strategies or funds and maintain appropriate records to illustrate the rationale for this assessment. A few respondents welcomed the proposal as it imposes accountability on fund managers and addresses growing concerns about greenwashing. Some respondents also saw this as consistent with international standards and those in other jurisdictions[17].

126. Some respondents further suggested that the rationale for irrelevance should also be disclosed to investors together with the statement of irrelevance, while one respondent considered that negative disclosure of particular risk factors was not aligned with requirements for other investment risks and may confuse investors.

127. Some respondents enquired about the frequency of the disclosure of irrelevance and the record-keeping standard. In addition, some respondents asked about the differences between making such disclosures at the entity and fund levels and whether fund managers have any other obligations after disclosing the exceptions.

The SFC's responses

128. As mentioned in the Consultation Paper, investors are demanding more information about how climate-related risks might affect the performance of assets and how these risks are managed. In addition, this is a relatively new type of risk which is not usually

[17] Such as the EU's SFDR.

covered in the information currently available to investors and disclosures are important for investors with a specific interest in climate change to identify strategies and funds which do not consider climate-related factors. Given the wide support for the proposal, the SFC retains the requirement that fund managers disclose the types of investment strategies or funds under management for which climate-related risks have been assessed to be not relevant.

129. To strike a balance between costs and benefits, rather than disclosing the rationale for the assessment to investors at the outset, the SFC considers it acceptable for a fund manager to maintain internal records which clearly illustrate its rationale for its assessment and explain it to investors when asked or for compliance review purposes.

130. Fund managers are expected to reevaluate the relevance of climate-related risks at least annually and update the disclosures as necessary.

131. The SFC intends to provide flexibility to make disclosures either at the entity or fund level. To facilitate comparison, for example, fund managers may consider stating at the entity level the types of investment strategies or funds for which climate-related risks are not relevant. On the other hand, some fund managers may prefer to disclose this in the fund documents to make it clearer to investors.

132. Fund managers can refer to the flowchart in Appendix D for their obligations after making the relevance disclosure.

(f) Entity and fund level disclosures

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 the burden on fund managers?

Public comments

133. The industry generally supported the proposal to allow disclosures to be made at an entity level as governance structures and investment and risk management processes for climate-related risks are likely the same across an entity's investment strategies and funds. If these processes vary, it is reasonable to provide supplementary strategy or fund level disclosure. Some respondents also sought clarification of various technical issues such as the manner of disclosure.

The SFC's responses

134. The requirement to make disclosures at the entity level is designed to reduce the compliance burden of fund managers to disclose information if the same policies and processes apply consistently across different strategies and funds. Fund managers may disclose at the fund level if it is more appropriate.

135. The SFC considers that the disclosures can be made via various channels such as websites, newsletters or reports to investors as long as investors' attention is drawn to the information. Fund managers should observe the following when making the disclosures:

(a) adopt a proportionate approach, ie, the information disclosed should be proportionate to the degree climate-related risks are considered in the investment and risk management processes;

(b) make adequate disclosures of information in writing and communicate to fund investors through electronic or other means (eg, on the company website); and

(c) review disclosures at least annually, update disclosures where considered appropriate and inform fund investors of any material changes as soon as practicable.

(g) Quantitative disclosures

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?

General

Public comments

136. While many respondents supported quantitative disclosures under the enhanced standards as a first step, a number of respondents expressed concerns about mandating a quantitative disclosure or a specific metric mainly because of data quality and availability[18]. They recommended allowing flexibility for quantitative disclosures or making them optional.

137. Some respondents were concerned about the technical knowledge and resources required for making quantitative disclosures. Some respondents suggested quantitative disclosures only for funds with an ESG or climate focus or for SFC-authorised funds.

The SFC's responses

138. The limited availability of data and lack of common standards for disclosures by investee companies may be a challenge at this stage. Therefore, the SFC expects Large Fund Managers to make reasonable efforts to disclose available Scope 1 and Scope 2 GHG emissions data and state the calculation methodology, underlying assumptions and limitations. If data is not available for some assets under the fund, Large Fund Managers are expected to state the proportion of investments which are

[18] For example, listed companies may not disclose relevant climate-related data or data obtained from different sources may not be comparable.

assessed or being covered by the metric disclosed. The SFC also welcomes Large Fund Managers to disclose Scope 3 GHG emissions alongside Scope 1 and Scope 2 emissions, if available.

139. As mentioned in paragraphs 41 to 43 above, it would not be appropriate to confine the disclosure requirements to certain funds or make them optional. Fund managers may adopt different methods to collect climate-related data or information. For example, they could make reference to issuers' published reports, engage with issuers directly or create estimates using official statistics and climate-related information from data providers. Some international organisations, such as PCAF, have provided options for fund managers to estimate the GHG emissions of their investments.

140. The SFC expects that the availability of climate-related data will improve over time. This information is essential for investors to assess the impact of climate-related risks and evaluate the performance of fund managers' climate-related management practices. Nonetheless, it is crucial to take the first step in quantitative disclosure and this should not be deferred by data limitations.

141. The SFC also acknowledges reliability issues around calculating GHG emissions for a number of asset classes such as derivatives, sovereign debts and short positions. Our current approach has provided adequate flexibility for Large Fund Managers to deal with a situation where the industry has not yet developed a consistent and widely acceptable approach by allowing them to state their methodologies, limitations and coverage.

142. The SFC will adopt a reasonable and practical approach in assessing a Large Fund Manager's compliance with the quantitative disclosure requirement. The focus will be on whether the fund manager has established proper procedures to obtain the required information and adhered to them.

Disclosure of WACI

Public comments

143. A number of respondents, in particular industry associations, recommended providing flexibility for fund managers to choose metrics to disclose and not to mandate WACI disclosure at the fund level. Some respondents argued that a single backward-looking WACI may not reflect a company's potential to decarbonise and transition to low carbon economy.

144. A number of concerned organisations noted that GHG emissions metrics in enterprise value terms are more commonly used in other jurisdictions such as the EU. Some respondents recommended making reference to the Global GHG Accounting and Reporting Standard for the Financial Industry developed by PCAF[19] (PCAF Standard), which provides detailed guidance on measurements for various asset classes.

[19] In its Global GHG Accounting & Reporting Standard, PCAF provides guidance on methods to calculate financed emissions for six asset classes. These include calculation of GHG emissions of equity, corporate bonds and business loans as a portion of the enterprise value including cash of an investee company.

The SFC's responses

145. Common data is crucial for investors to compare different funds and make informed investment decisions. The TCFD Recommendations released in June 2017[20] list a number of GHG emissions and exposure metrics[21] to which financial institutions and standard setters have made wide reference. For the TCFD's 2020 Status Report[22], the TCFD analysed disclosures made by PRI[23] signatories, which include asset owners and asset managers, and noted that "portfolio carbon footprint" was the most commonly disclosed metric while WACI was the least common. In TCFD's latest consultation paper, asset managers are recommended to disclose financed-emissions metric based on PCAF's methodology.

146. Given the analysis conducted by the TCFD and the number of responses suggesting that GHG emissions be disclosed in terms of enterprise value, the SFC considers it appropriate to revise the quantitative disclosure requirement to require Large Fund Managers to take reasonable steps to identify the portfolio carbon footprint of the Scope 1 and Scope 2 GHG emissions of a fund's underlying investments and disclose them at the fund level accordingly. Large Fund Managers are encouraged to include Scope 3 GHG emissions if data is available. Large Fund Managers can make reference to the PCAF Standard in calculating the portfolio carbon footprint. We believe this change, combined with the higher threshold for Large Fund Managers and alignment with the disclosure requirements under the EU's SFDR, should have the least impact on the industry while providing a comparable metric for stakeholders' information. Below is the formula for calculating portfolio carbon footprint (Appendix E):

$$\sum_{N}^{i} \frac{\left(\dfrac{\textit{Current value of investment}_i}{\textit{Investee company's enterprise value}_i} \times \begin{array}{c}\textit{Investee company's Scope 1}\\ \textit{and Scope 2 GHG emissions}_i{}^{@}\end{array} \right)}{\textit{Current portfolio value (\$ million)}}$$

@ *Fund managers are encouraged to include Scope 3 GHG emissions if data is available.*

147. Large Fund Managers could supplement the quantitative disclosures with additional metrics as they deem appropriate, such as with revenue-based, asset class specific[24], forward-looking or other enterprise value-based metrics.

[20] The TCFD's Final Report – Recommendations of the Task Force on Climate-related Financial Disclosures and its annex – Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures, June 2017.

[21] WACI (recommended), portfolio carbon footprint, total carbon emission, carbon intensity and exposure to carbon-related assets.

[22] The TCFD's 2020 Status Report, October 2020.

[23] Principles for Responsible Investment

[24] For example, in the case of real estate funds, the industry generally regarded metrics such as LEED (Leadership in Energy and Environmental Design) ratings, NABERS (National Australian Built Environmental Rating System) and GRESB (formerly known as Global Real Estate Sustainability Benchmark) to be more decision-useful for investors.

<u>Manner and frequency of quantitative disclosures</u>

Public comments

148. The majority of the respondents agreed that quantitative disclosure, if required, should be made at the fund level instead of the entity level as that would be more useful to investors. Some respondents sought clarification of the required frequency of the calculation and disclosure of the quantitative information. A respondent suggested including historical trend analysis as well.

The SFC's responses

149. The SFC expects the proposed requirements for the disclosure of quantitative climate-related data to be applicable after the transitional period mentioned in Section III below. For funds with a financial year-end date after the effective date of the requirements, Large Fund Managers are required to calculate the portfolio carbon footprint based on the positions as of the financial year end and disclose to fund investors through a channel they consider appropriate by not later than the usual due date of the funds' audited accounts or annual reports (which is usually between three and six months after the financial year end). Large Fund Managers can choose to disclose the portfolio carbon footprint of funds in a more frequent manner.

150. The SFC acknowledges the merit of historical trend analysis and encourages, but does not mandate, that fund managers include it in the scope of GHG emissions and associated metrics at this initial stage. We will keep in view the evolution of sustainable finance tools and metrics and review the quantitative requirements as necessary.

(h) Other comments or clarifications sought

Public comments

151. A respondent also enquired about the terms "robust", "appropriate", "proportionate" and "reasonable efforts" mentioned in the Consultation Paper and requested the SFC to provide guidance on these terms.

The SFC's responses

152. The terms "robust", "appropriate", "proportionate" and "reasonable efforts" should be given their natural and ordinary meaning. In light of the evolving nature of sustainable finance, we are mindful of the need to adopt a principles-based approach and to allow fund managers the flexibility to implement the SFC's requirements having regard to their own circumstances.

Section III – Implementation timeline

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.

Public comments

153. Some respondents agreed with our proposed transition periods for the baseline requirements and enhanced standards, whereas others, mainly industry participants, suggested extending the transition periods from nine months and 12 months at least to 12 months and 18 months for Large Fund Managers, while extending the transition period from 12 months to 18 months for other fund managers.

154. Most respondents who suggested extending the transition period stated that more time is needed as the proposals concerning climate-related risks are new and the work required for fund managers to enhance their systems, policies and procedures and arrange operational support is expected to be significant. In addition, some respondents proposed that the implementation timeframe should be aligned with overseas developments to cushion global fund managers' compliance burden.

155. Separately, some respondents considered that there is no merit in a staggered implementation timeline for different size fund managers, as it would create inconsistency and cause market fragmentation. They suggested a single timeline for all fund managers to comply with both the baseline requirements and enhanced standards.

The SFC's responses

156. The SFC will retain the original phased implementation proposal and allow fund managers other than Large Fund Managers a longer transition period to review their systems and controls and arrange the necessary operational support to comply with the baseline requirements. For the enhanced standards, the SFC appreciates that the workload required for Large Fund Managers to collect Scope 1 and Scope 2 GHG emissions data and make corresponding carbon footprint disclosures at the fund level warrants additional time.

157. Having regard to the above and the respondents' feedback, the SFC has decided to extend the transition periods as follows:

(a) a 12-month transition period for Large Fund Managers to comply with the baseline requirements and a 15-month transition period for enhanced standards, and

(b) a 15-month transition period for other fund managers to comply with the baseline requirements.

158. The disclosures relating to baseline requirements and enhanced standards must be made after the transition periods specified in paragraph 157, except for the portfolio carbon footprint disclosure which must be published after the end of the fund's next financial year end.

159. When the enhanced standards become effective in November 2022, Large Fund Managers are only expected to calculate and disclose portfolio carbon footprints for financial years ending on or after 20 November 2022. The SFC's implementation timeline for quantitative disclosure is similar to that in the EU[25]. The following examples illustrate when a Large Fund Manager has to comply with the baseline requirements and enhanced standards:

Scenario	**Fund's year-end date**	**First application date of baseline requirements**	**First application date of enhanced standards**
Firm A	31 March	20 August 2022	• 20 November 2022 except the disclosure of portfolio carbon footprint • First disclosure of portfolio carbon footprint at the fund level shall be at least based on the fund's positions as of 31 March 2023
Firm B	31 December	20 August 2022	• 20 November 2022 except the disclosure of portfolio carbon footprint • First disclosure of portfolio carbon footprint at the fund level shall be at least based on the fund's positions as of 31 December 2022

160. For other fund managers, the effective date to comply with the baseline requirements is 20 November 2022.

[25] European-based fund managers subject to the SFDR will be required to publish a principal adverse sustainability impacts statement which includes quantitative sustainability indicators for years ending on 31 December 2022 and after.

Conclusions and the way forward

161. The SFC will proceed to implement the proposals with the modifications and clarifications set out in this paper. The final forms of the amendments to the FMCC and the proposed baseline requirements and enhanced standards are set out at Appendices B and C.

162. The SFC would like to take this opportunity to thank all respondents for their contributions.

Appendix A – List of respondents

(in alphabetical order)

1. AEC Capital Limited
2. AIA Investment Management HK Limited
3. Allianz Global Investors Asia Pacific Limited
4. Allied Sustainability and Environmental Consultants Group Limited
5. Asia Debt Management Hong Kong Limited
6. BCT Group (BCT Financial Ltd. & Bank Consortium Trust Co. Ltd.)
7. BlackRock, Inc.
8. Bloomberg L.P.
9. BMO Global Asset Management
10. Boswell Capital Management Limited
11. Carbon Care Asia Limited
12. CFA Institute
13. China Real Estate Chamber of Commerce Hong Kong and International Chapter Limited and Allied Sustainability and Environmental Consultants Group Limited
14. ComplianceAsia Consulting Limited
15. CompliancePlus Consulting Limited
16. Ernst & Young
17. Family Office Association (Hong Kong) Limited
18. Friends of the Earth (HK)
19. GoImpact
20. HSBC Global Asset Management Limited
21. ICI Global
22. Moody's ESG Solutions Group with affiliates Four Twenty Seven and Vigeo Eiris
23. Morningstar
24. Mr. Chi Kit Kevin Liem
25. Ms. Helena Hu
26. MSCI ESG Research
27. Red Links
28. Stephenson Harwood
29. Sustainable Finance Initiative
30. Telligent Capital Management
31. The Alternative Investment Management Association
32. The Asia Securities Industry & Financial Markets Association
33. The Hong Kong Green Finance Association
34. The Hong Kong Institute of Certified Public Accountants
35. The Hong Kong Investment Funds Association
36. The Hong Kong Venture Capital and Private Equity Association
37. The Hong Kong Women Professionals & Entrepreneurs Association
38. The International Capital Market Association
39. The Law Society of Hong Kong
40. The Principles for Responsible Investment
41. The Standards Board for Alternative Investments
42. Vivien Teu & Co LLP
43. Submissions of 3 respondents are published on a “no-name” basis upon request
44. Submissions of 7 respondents are withheld from publication upon request

Appendix B – Final form of the amendments to the Fund Manager Code of Conduct

The highlighted parts indicate revisions made to the FMCC which differ from the proposed amendments set out in the Consultation Paper.

Governance	
Existing	▪ Responsibilities of senior management - Paragraph 1.6 of the FMCC ▪ Organisation and resources - Paragraphs 1.2(a), (b) and (d) of the FMCC ▪ Compliance - Paragraphs 1.2(c) and 1.8 of the FMCC
Investment management	
New	Paragraph 3.1A of the FMCC A Fund Manager should identify relevant and material climate-related risks and ensure that material~~ climate-related~~ risks are taken into account in its investment management process for funds.
Risk management	
Existing	▪ Risk management - Paragraph 1.7.1 of the FMCC
Amendment	Paragraph 3.11.1(b) of the FMCC 3.11.1 For risk management at the fund level, a Fund Manager should implement adequate risk management procedures (including risk measurements and reporting methodologies) in order to identify, measure, manage and monitor appropriately all risks: (a) relevant to each investment strategy; and (b) to which each fund is or may be exposed, such as market, liquidity, counterparty **and climate-related risks**, and other risks, including operational risks, which may be material for each fund it manages, taking into account the nature, scale and complexity of its business and of the investment strategy of each of the funds it manages.
New	Paragraph F under Appendix 2 to the FMCC – Suggested risk-management control techniques and procedures for funds F. Climate-related risks 1. Climate-related risks may represent physical risks which stem from the direct impact of extreme weather events and progressive, longer-term shifts in the climate patterns and transition risks associated with the transition to a low-carbon economy. ~~Liability risks may also be triggered by the responsibility to compensate financial losses related to p~~Physical or transition risks may trigger liability risks which Fund Managers should also take into consideration in the risk assessment processes. In addition, climate-related risks may have implications for other financial risks such as credit, market and liquidity risks. 2. A Fund Manager should establish and maintain effective systems, policies and procedures to: (i) identify relevant climate-related risks; (ii) assess the potential impact of the identified risks on each investment strategy and fund; and (iii) monitor and manage these risks on an ongoing basis.

Disclosure requirements	
New	Paragraph 6.2A of the FMCC Where a Fund Manager is responsible for the overall operation of a fund, it should make adequate disclosure of information in relation to climate-related risks to allow fund investors to make an informed judgement about their investment into the fund, including: (a) its governance arrangement for oversight of climate-related risks; and (b) how it takes climate-related risks into account in its investment and risk management processes, including the tools and metrics used to identify, assess, manage and monitor the risks. Notes: (i) If climate-related risks have been assessed to be relevant but immaterial to all investment strategies or funds under its management, the Fund Manager should disclose (a) its governance arrangement and (b) its investment and risk management processes but only in relation to how it identifies and assesses the risks. (ii) If climate-related risks have been assessed to be irrelevant to certain types of investment strategies or funds under its management, the Fund Manager is required to disclose such exceptions.
Scope of application	
New	Paragraph in Appendix 1 to the FMCC under “Particular requirements in the Code which are not applicable to Discretionary Account Managers” (aa)Climate-related risks The requirements in relation to the consideration of climate-related risks and the corresponding disclosure requirements are not mandatory for a Discretionary Account Manager. The Discretionary Account Manager may however have the contractual obligation~~, except in cases where the client has requested the Discretionary Account Manager~~ to take climate-related risks into consideration in the investment mandate. (Paragraphs 3.1A, 3.11.1(b) (for climate-related risks only) and 6.2A of this Code)

Appendix C – Final form of baseline requirements and enhanced standards

The highlighted parts indicate revisions made to the baseline requirements and enhanced standards which differ from the proposals set out in the Consultation Paper.

<table>
<tr><th colspan="2">Governance</th></tr>
<tr><td rowspan="2">Baseline requirements</td><td>Board’s and management’s roles and responsibilities

Board
▪ Define the board’s or the board committee’s role in overseeing the incorporation of climate-related considerations into the investment and risk management processes;

▪ oversee progress against goals for addressing climate-related issues; and

▪ determine how the board or the board committee executes this role, including the process and frequency by which the board or the board committee is informed ~~of the status of incorporating climate-related considerations into the investment and risk management processes through appropriate reporting and escalation~~ about climate-related issues.</td></tr>
<tr><td>Management
▪ Assign roles and responsibilities for managing climate-related risks to management-level positions or management committees which report to the board or the board committee, and determine the appropriate management structure;

▪ determine how the management (through specific positions or management committees) will monitor the status and progress of efforts to manage climate-related risks;

▪ establish a process for the management to be regularly informed about the status and progress of efforts to manage climate-related risks;

▪ devote sufficient human and technical resources for the proper performance of the duty to manage climate-related risks (eg, provide training to staff, engage subject experts and acquire climate-related data from external sources);

▪ establish satisfactory internal controls and written procedures to ensure compliance with internal policies and procedures as well as regulatory requirements related to the management of climate-related risks; and

▪ set goals for addressing climate-related issues and develop action plans for managing climate-related risks.</td></tr>
</table>

Investment Management

Baseline requirements	▪ Identify relevant and material physical and transition climate-related risks for each investment strategy and fund it manages; ▪ where relevant, factor the material climate-related risks into the investment management process. For example, include climate-related risks in the investment philosophy and investment strategies and incorporate climate-related data into the research and analysis process; and ▪ take reasonable steps to assess the impact of these risks on the performance of underlying investments. Note: Where a fund manager assesses that climate-related risks are irrelevant to certain types of investment strategies or funds under its management, the fund manager should disclose these exceptions when it discloses how it incorporates climate-related risks into its investment and risk management processes. It should also maintain appropriate records which explain why climate-related risks are irrelevant. For the avoidance of doubt, the above requirements shall not prohibit or restrict a fund manager from complying with applicable laws and discharging their fiduciary duties.

Risk Management

Baseline requirements	Risk management ▪ Take climate-related risks into consideration in risk management procedures and ensure that appropriate steps have been taken to identify, assess, manage and monitor the relevant and material climate-related risks for each investment strategy and fund it manages. Tools and metrics ▪ Apply appropriate tools and metrics to assess and quantify climate-related risks.
Enhanced standards	Tools and metrics Large Fund Managers, to the extent climate-related risks are assessed to be relevant and material to an investment strategy or a fund they manage, are also required to follow the standards below: ▪ Assess the relevance and utility of scenario analysis in evaluating the resilience of investment strategies to climate-related risks under different pathways. If the assessment result is deemed to be relevant and useful, fund managers are required to develop a plan to implement scenario analysis within a reasonable timeframe; and ▪ if climate-related risks are assessed to be relevant and material, take reasonable steps to identify the ~~weighted average carbon intensity~~portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments, where data is available or can be reasonably estimated, and define the calculation methodology and underlying assumptions. Large Fund Managers refer to licensed corporations with CISs under management equalling or exceeding $8 billion in terms of fund assets for any three months in the previous reporting year.

<table>
<tr><th colspan="2">Disclosure</th></tr>
<tr><td>Baseline requirements</td><td>
Entity level disclosures

Governance
▪ Describe the governance structure;

▪ describe the board's roles and oversight, including:
➢ whether the board or the board committee will review the risk management framework covering climate-related risks; and
➢ the process and frequency by which the board or the board committee is informed ~~of the status of incorporating climate-related considerations into the investment and risk management processes~~ about climate-related issues; and

▪ describe the management's roles and responsibilities, including:
➢ how the management will monitor the status and progress of efforts to manage climate-related risks; and
➢ the process for the management to be regularly informed about the status and progress of efforts to manage climate-related risks.

Investment management and risk management
▪ Disclose the steps taken to incorporate relevant and material climate-related risks into the investment management process; and

▪ describe the processes for identifying, assessing, managing and monitoring climate-related risks, including the key tools and metrics used.

Entity level or fund level disclosures

▪ If climate-related risks have been assessed to be irrelevant to certain types of investment strategies or funds under its management, disclose such exceptions at the entity or fund level.
</td></tr>
<tr><td></td><td>
Manner and frequency of disclosures

▪ Adopt a proportionate approach, ie, the information disclosed should be proportionate to the degree climate-related risks are considered in the investment and risk management processes;

▪ make adequate disclosures of information in writing and communicate to fund investors through electronic or other means (eg, on the company website ~~rather than individual communications to investors~~); and

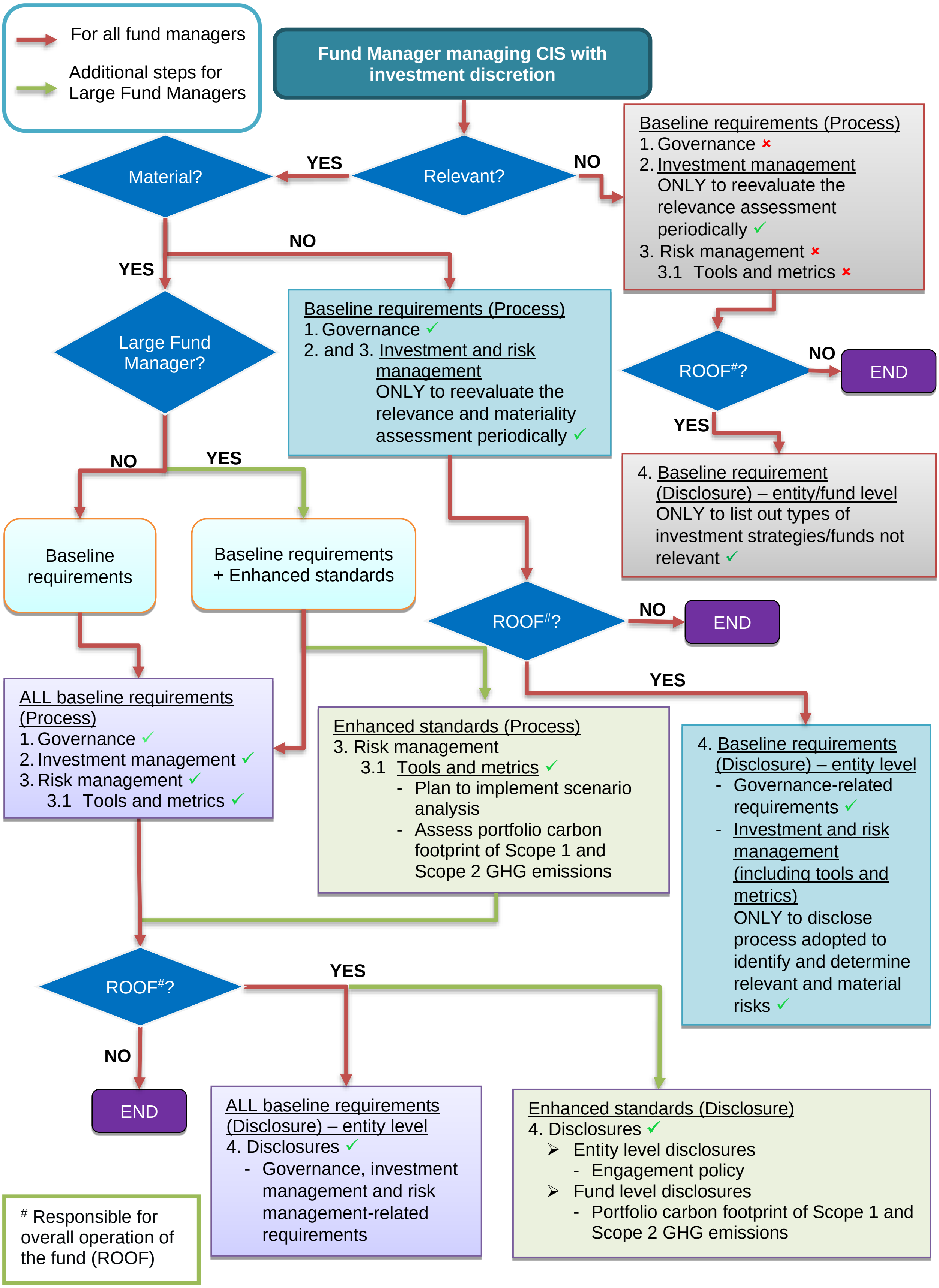
▪ review ~~and update~~ disclosures at least annually, update disclosures where considered appropriate and inform fund investors of any material changes as soon as practicable.
</td></tr>
<tr><td>Enhanced standards</td><td>
Large Fund Managers are also required to follow the standards below:

Entity level disclosures

▪ Describe the engagement policy and preferably provide examples to illustrate how material climate-related risks are managed in practice, including how the engagement policy is implemented.
</td></tr>
</table>

	Fund level disclosures ▪ At a minimum, provide the ~~weighted average carbon intensity~~portfolio carbon footprints of the Scope 1 and Scope 2 GHG emissions associated with the funds' underlying investments at the fund level, where data is available or can be reasonably estimated, and indicate the calculation methodology, underlying assumptions and limitations, and the proportion of investments (eg, in terms of the net asset value of funds) which are assessed or covered.

Appendix D – Flowchart for the applicability of the requirements



Appendix E – Portfolio carbon footprint

Portfolio carbon footprint is a representation of carbon emissions normalised by the portfolio's market value and expressed in tons of carbon dioxide equivalent emissions (CO_2e) per million dollars invested.

Portfolio carbon footprint	
Formula	$$\sum_{N}^{i} \frac{\left(\frac{\text{Current value of investment}_i}{\text{Investee company's enterprise value}_i} \times \text{Investee company's Scope 1 and Scope 2 GHG emissions}_i{}^{@} \right)}{\text{Current portfolio value (\$ million)}}$$ ^@^ *Fund managers are encouraged to include Scope 3 GHG emissions if data is available.*
Methodology	Scope 1 and Scope 2 GHG emissions (and Scope 3 GHG emissions if available) from investments and debts are allocated to the reporting institution based on the proportional share of investment or debt in the investee company. For example, if an institution's investment represents 5% of a company's enterprise value, then that institution accounts for 5% of the company's GHG emissions. Enterprise value means the sum, at financial year end, of the market capitalisation of ordinary and preferred shares and the book value of total debt and non-controlling interests, without deducting cash or cash equivalents. For other asset classes, please make reference to the PCAF Standard in calculating the portfolio carbon footprint. The current portfolio value is used to normalise the data.
Key points + / -	+ May be used to compare portfolios to one another or to a benchmark. + Uses portfolio market value to normalise data, which is fairly intuitive to investors. + Allows for portfolio decomposition and attribution analysis. - Changes in the enterprise value of underlying companies can be misinterpreted.