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<https://apps.sfc.hk/edistributionWeb/gateway/EN/circular/doc?refNo=21EC27>

11 April 2019

Circular to management companies of SFC-authorized unit trusts and mutual funds

Green or ESG funds

Background

1. Globally, there is a growing trend for asset managers to consider climate change or green or environmental, social and governance (**ESG**) or sustainability factors in their investment process and offering products with green or ESG-related investment mandates.
2. As the development of green or ESG-related investment products gains traction, authorities around the globe have adopted initiatives to require enhanced disclosure on the sustainable features of products to assist investors' understanding and assessment of whether these products meet their investment needs.
3. An international trend in classifying green or ESG-related investment products is emerging in recent years. In some jurisdictions, eligibility and disclosure requirements are stipulated by the regulators for funds seeking to be classified as green or ESG funds, while in some other jurisdictions, certification frameworks are issued by independent labelling agencies (with corroboration from technical expert committees) for funds seeking to obtain the relevant green or ESG certificates or labels.
4. In Hong Kong, there are a number of SFC-authorized funds with investment focus on climate, green, environmental or sustainable development. The SFC has evaluated the disclosure of these funds. Our preliminary review shows that the quality of disclosure varies widely. Although most funds have named the green or ESG factors in their investment objective or strategy, a majority of these funds do not specifically disclose how the management companies (**managers**) incorporate such green or ESG factors in their investment selection process.
5. With an aim to enhance disclosure comparability between similar types of SFC-authorized green or ESG funds and their transparency and visibility in order to facilitate investors to make informed investment decisions in this evolving investment area, this circular sets out the SFC's expectation on how the existing Code on Unit Trusts and Mutual Funds (**UT Code**) and disclosure guidelines for SFC-authorized funds apply to green or ESG funds and provides guidance to narrow the disclosure gap among these funds.
6. Given the evolving nature of green or ESG investment landscape, this circular is an initial step in the SFC's effort to enhance the disclosure standard of green or ESG funds. The SFC will keep in view local and international market and regulatory developments and may provide further guidance or impose additional requirements for green or ESG funds, where appropriate.

Scope of the circular

7. This circular applies to SFC-authorized funds which incorporate one or more of the globally recognized green or ESG criteria or principles (set out in **Annex 1** to this circular) as their key investment focus and reflect such in their name and investment objective or strategy (**Green or ESG funds**).

Name of the scheme

8. In line with the existing requirements set out in the UT Code, a Green or ESG fund should invest primarily in investments to reflect the particular green or ESG investment focus which the fund represents.

Guidance note:

Green or ESG funds may adopt common ESG investment strategies such as screening (positive or negative screening), thematic, ESG integration and impact investing. To substantiate “invest primarily”, the SFC would expect:

- *for a fund adopting screening strategies or thematic investment strategies, it should demonstrate that at least 70% of its total net asset value is invested in securities or other investments reflecting the stated green or ESG related investment focus; or*
- *for a fund adopting other strategies, such as ESG integration or impact investing, it should demonstrate to the SFC, on a case-by-case basis, how the fund could comply with this requirement.*

Disclosure requirements

9. Offering documents of SFC-authorized funds shall contain information necessary for investors to make an informed judgement of the investment. The SFC expects the offering documents (including the product key fact statements (**KFS**)) of the Green or ESG funds to disclose, at a minimum, the following:
 - a) a description of the key investment focus (e.g. climate change, green, low carbon footprint, sustainability, etc.) and targeted objective (e.g. financial return, mitigating climate change or environmental damage, etc.) of the Green or ESG fund, and where applicable how the key investment focus is considered as green or ESG-related;
 - b) a description of the investment strategies adopted by the Green or ESG fund, including but not limited to:
 - (i) the relevant green or ESG criteria or principles considered;

- (ii) the expected exposure to the securities or other investments that reflect the stated green or ESG investment focus;
- (iii) the investment selection process and criteria adopted by the Green or ESG fund, such as:
 - assessment criteria of the underlying investments (e.g. reference to any ESG ratings or third party certificates or labels, constituents of any green or ESG-related indices, the carbon footprint and environmental impact associated with companies, the proportion of revenue or profits generated from the relevant green or ESG activities of the issuer companies, etc.);
 - ESG analysis and evaluation methodology (e.g. proprietary tool with internal ESG ratings, research provided by third party agencies on ESG rating or certificates or labels, engagement with issuer companies, etc.);
 - reference ESG benchmark being tracked and the characteristics and general composition of the benchmark;
- c) a description of whether an exclusion policy is adopted by the Green or ESG fund and types of exclusion (e.g. activities, sectors, countries, etc.);
- d) a description of risks associated with Green or ESG fund's investment theme (e.g. lack of standardized taxonomy, subjective judgment in investment selection, reliance on third party providers for environmental scoring / certification / labelling, style drift, concentration in investments with environmental or ESG focus, etc.); and
- e) any other information, considered necessary by the manager.

Ongoing monitoring

10. Manager of the Green or ESG fund should regularly monitor and evaluate the underlying investments to ensure the Green or ESG fund continues to meet the stated investment objective and requirements set out in this circular.

Dedicated Green or ESG funds webpage

11. To enhance visibility of Green or ESG funds, a central database of these funds accessible through the SFC's website (**dedicated webpage**) will be launched. All SFC-authorized Green or ESG funds complying with the requirements set out in this circular will be posted on the dedicated webpage.
12. The dedicated webpage will be launched by end of 2019.

Implementation

Initial confirmation of compliance

13. For existing SFC-authorized funds or new funds seeking SFC authorization which fall within the scope of this circular, managers should provide to the SFC one of the confirmations set out in **Annex 2** of this circular:
- self-confirmation of compliance; or
 - confirmation supported with independent third party certification or fund label¹ to demonstrate compliance.

For existing SFC-authorized funds

14. For an existing SFC-authorized fund to be classified as a Green or ESG fund pursuant to this circular, managers should review the fund's offering documents in view of the requirements set out in paragraph 9 above, and make the necessary updates and revisions as soon as practicable, and in any event no later than 31 December 2019.
15. Where the fund's offering documents require updates or revisions, managers should assess whether SFC's prior approval is required under 11.1 of the UT Code and the applicable post-authorization application requirements².
16. The SFC may send requisition letter for any clarifications when necessary. The Green or ESG fund will be posted on the dedicated webpage once the SFC is satisfied with the fund's compliance with the requirements set out in this circular.

For new funds seeking SFC's authorization

17. For new funds seeking SFC's authorization to be classified as a Green or ESG fund pursuant to this circular, managers should observe the requirements set out in this circular in addition to the applicable provisions of the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (including the UT Code) and the circulars, guidelines and other requirements as may be issued by the SFC from time to time.
18. Any requisition(s) by the SFC shall fall within the authorization process adopted by the SFC in processing new fund applications. The new Green or ESG fund will be posted on the dedicated webpage once its authorization becomes effective.

¹ The SFC expects the independent third party or fund labelling agency as part of the certification or labelling process to review, at a minimum, the Green or ESG fund's primary investments to reflect the particular green or ESG investment focus which the fund represents, investment selection and ongoing monitoring process, and adherence to globally recognized green or ESG criteria or principles.

² For details, please refer to the Circular to Management Companies of SFC-authorized unit trusts and mutual funds - Formal adoption of the revamped post authorization process dated 25 January 2018.



General

19. The SFC will keep in view local and international market and regulatory developments in respect of Green or ESG funds and other environmental, social and sustainable investments and may provide further guidance or impose additional requirements, where appropriate.
20. Should you wish to seek clarification of any aspect of this circular, please contact our case officers in charge of your portfolio.

Investment Products Division Securities and Futures Commission

Annex 1

Globally recognized green or ESG criteria or principles

1. Globally recognized green or ESG criteria or principles that may be considered by a Green or ESG fund include:
 - United Nations Global Compact Principles¹;
 - United Nations Sustainable Development Goals²;
 - Common Principles for Climate Mitigation Finance Tracking³;
 - Green Bond Principles of the International Capital Market Association⁴; or
 - Climate Bonds Taxonomy of the Climate Bonds Initiative⁵.
2. The list above is not intended to be exhaustive. Other green or ESG criteria or principles recognized globally or nationally, or reference benchmarks or indices which in their construction and management adopted any of the green or ESG criteria or principles above, may also be considered on a case-by-case basis.

¹ <https://www.unglobalcompact.org/what-is-gc/mission/principles>

² <https://www.un.org/sustainabledevelopment/sustainable-development-goals/>

³ <https://www.ifc.org/wps/wcm/connect/65d37952-434e-40c1-a9df-c7bdd8ffcd39/MDB-IDFC+Common-principles-for-climate-mitigation-finance-tracking.pdf?MOD=AJPERES>

⁴ <https://www.icmagroup.org/green-social-and-sustainability-bonds/green-bond-principles-gbp/>

⁵ <https://www.climatebonds.net/standard/taxonomy>



Annex 2

Confirmation from management companies of the Green or ESG funds

Please note that any representation in, or referred to in, any application, and any representation made from time to time in support of any application which is false or misleading in a material particular, the provision of any information to the SFC which is false or misleading in a material particular and the provision of any record or document which is false or misleading in a material particular may constitute an offence under section 383(1), 384(1) and/or 384(3) of the Securities and Futures Ordinance (Chapter 571 of the Laws of Hong Kong).

Name of scheme(s):

a) Name (or such other name :
as may be approved by the
SFC) of the umbrella/single
fund(s)

b) Name (or such other name :
as may be approved by the
SFC) of the relevant sub-
fund(s)

(i) ***(please tick only one of the following boxes)***

- The above scheme(s) has/have been authorized by the Securities and Futures Commission ("Commission");
- The above scheme(s) is/are in the process of obtaining authorization from the Commission;

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(ii) **(please tick only one of the following boxes)**

For scheme(s) without submitting independent third party certification or fund label, we confirm the following:

- (a) the scheme(s) has/have incorporated one or more of the globally recognized green or ESG criteria or principles (“Green or ESG factor(s)”) as the key investment focus of the scheme(s);

(please state and briefly describe the Green or ESG factor(s) being considered and how the key investment focus is considered as green or ESG-related in the following box)

- (b) the scheme(s) invest(s) primarily in investments to reflect the particular green or ESG investment focus which the scheme(s) represent(s);
- (c) manager of the scheme(s) regularly monitors and evaluates the underlying investments with proper procedures in place to ensure the scheme(s) continue(s) to meet the stated investment objective and requirements as set out in the circular to management companies of SFC-authorized unit trusts and mutual funds – Green or ESG funds dated 11 April 2019 (“Circular”);

For scheme(s) submitting independent third party certification or fund label¹, we confirm the issuer of green or ESG fund certification or label is independent from the scheme(s) and its/their associated entities;

(iii) We confirm the scheme(s) has/have met the disclosure requirements as set out in the Circular; and

(iv) We have submitted a soft copy of the following document(s) along with the confirmation:

(a) *(Applicable to scheme(s) which has/have chosen to provide confirmation supported with independent third party certification or fund label)* the relevant green or ESG fund certificate or evidence of green or ESG fund label obtained by the scheme(s);

(b) the offering document(s) (including product key facts statement(s), where applicable) with proper annotation(s) of the required disclosures in text-searchable format.

¹ The SFC expects the independent third party or fund labelling agency as part of the certification or labelling process to review, at a minimum, the Green or ESG fund's primary investment to reflect the particular green or ESG investment focus which the fund represents, investment selection and ongoing monitoring process, and adherence to globally recognized green or ESG criteria or principles.

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Signed for and on behalf of:

Name of management company² :

Signature :

(Insert name of the Responsible Officer (in respect of Type 9 Regulated Activity) of SFC-licensed management company² or at least one executive director (or above)³ of the management company²)

Title / Position :

² For self-managed schemes, references to the management company are deemed to be references to the investment delegate of the scheme(s).

³ Equivalentents include, for example, CEO, managing director, etc. Essentially, the signatory is expected to be a senior-ranking executive with overall responsibility for the confirmation.

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