

29 June 2021

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

ESG funds

A. Background

1. As environmental, social and governance (“**ESG**”) related investment products continue to gain traction globally, authorities around the globe have developed initiatives to require enhanced disclosure on the ESG-related features of products to assist investors’ understanding and assessment of whether these products meet their investment needs.
2. In April 2019, the SFC issued the Circular to management companies of SFC-authorized unit trusts and mutual funds – Green or ESG funds (“**2019 Circular**”) as an initial step in the SFC’s effort to enhance the disclosure standard of ESG funds and with an aim to improve their comparability, transparency and visibility.
3. In view of local and international market and regulatory developments, the SFC now revises the 2019 Circular to provide further guidance on enhanced disclosure including periodic assessment and reporting for ESG funds and with additional guidance for funds with climate-related focus.
4. This circular supersedes the 2019 Circular and sets out the SFC’s expectations with respect to how requirements under the SFC Handbook for Unit Trusts and Mutual Funds, Investment-Linked Assurance Schemes and Unlisted Structured Investment Products (“**Handbook**”) apply to SFC-authorized funds which consider climate change or green or ESG or sustainability factors (collectively, “**ESG factors**”)¹ in their investment process.
5. Given that the ESG investment landscape is rapidly developing, the SFC will continue to monitor local and international developments and may provide further guidance or impose additional requirements for ESG funds, where appropriate.

B. Scope of ESG funds

6. This circular applies to SFC-authorized funds which incorporate ESG factors as their key investment focus and reflect such in the investment objective and/or strategy (“**ESG funds**”).
7. An ESG fund may adopt different investment strategies to achieve its ESG focus. Illustrative examples of ESG funds are set out in Annex 1 to this circular. These examples are not meant to be exhaustive.

¹ ESG factors may include those that are aligned with one or more of the ESG criteria or principles recognized globally or nationally (such as United Nations Global Compact Principles, United Nations Sustainable Development Goals, Common Principles for Climate Mitigation Finance Tracking, Green Bond Principles of the International Capital Market Association, Climate Bonds Taxonomy of the Climate Bonds Initiative or any other ESG or sustainability criteria or principles or taxonomies).

8. Where a fund does not fall under the scope of ESG funds mentioned in paragraph 6 above, the SFC would expect the fund to observe the requirements on its name in Section D below.

C. Dedicated ESG funds webpage

9. To enhance the visibility of ESG funds, a central database of all SFC-authorized ESG funds is accessible through the SFC's website.

D. Name of fund

10. Under 5.1 of the Handbook, a product's name shall not be misleading. In line with the existing requirements set out in the Code on Unit Trusts and Mutual Funds ("**UT Code**"), an ESG fund's primary investments and/or strategy should reflect the particular ESG focus which the fund name represents.
11. The reference to ESG or similar terms in the fund's name and marketing materials should accurately and proportionately reflect the ESG features against other features of the fund and should not overstate or over-emphasize the ESG features.
12. The SFC would generally not expect a fund other than an ESG fund to name or market itself as an ESG fund but may permit exceptions on a case-by-case basis. Fund managers who wish to seek guidance on an exception should provide written submissions with clear explanation as to how the proposed fund name is consistent with and proportionate to the ESG features of the fund as a whole and will not mislead investors as to the importance or role of ESG in the fund's overall objective and/or strategy. The SFC reserves the right not to permit any exceptions and not to grant authorization / approval for fund(s) with misleading fund name(s).

E. Disclosure in offering documents

13. Under 6.1 of the UT Code, offering documents must provide information necessary for investors to be able to make an informed judgement of the investment.
14. In this regard, an ESG fund should disclose in its offering documents:
- a) *The ESG focus of the fund*
 - (i) a description of the fund's ESG focus (e.g. climate change, green, low carbon footprint, sustainability, etc.); and
 - (ii) a list of ESG criteria (e.g. filters, indicators, ratings, third party certificates or labels, etc.) used to measure the attainment of the fund's ESG focus.
 - b) *The ESG investment strategy*
 - (i) a description of the investment strategy(ies) adopted by the ESG fund, the binding elements and significance of that strategy(ies) in the investment process, and how the strategy(ies) is(are) implemented in the investment process on a continuous basis;

- (ii) a summary of the process of consideration of ESG criteria (as described under paragraph 14(a)(ii) above), which may include the methodologies in measuring these ESG criteria, their sequencing relative to the investment strategies, and examples of the most important ESG criteria considered (if any); and
- (iii) a description of whether an exclusion policy is adopted by the ESG fund and the types of exclusion.

c) *Asset allocation*

- (i) the expected or minimum proportion of securities or other investments (e.g. in terms of net asset value of the ESG fund) that are commensurate with the fund's ESG focus.

d) *Reference benchmark*

- (i) Where an index is designated as a reference benchmark for the purpose of attaining the ESG focus of an ESG fund:
 - where the fund is tracking an ESG benchmark (e.g. an index fund), details of the benchmark being tracked including the characteristics and general composition of the benchmark; or
 - where the fund seeks to measure its ESG focus against a designated reference benchmark, an explanation of how the designated reference benchmark is relevant to the fund.

e) *Additional information reference*

- (i) an indication of where investors can find additional information about an ESG fund as required under paragraph 15 below (e.g. website).

f) *Risks*

- (i) a description of risks or limitations associated with the fund's ESG focus and the associated investment strategies (e.g. limitation of methodology and data, lack of standardized taxonomy, subjective judgment in investment selection, reliance on third party sources, concentration in investments with the particular ESG focus, etc.).

Additional guidance for funds with climate-related focus ("**Climate funds**"):

- For 14(a)(i), examples of a Climate fund's climate-related focus include: investing primarily in companies which engage in economic activities that contribute to climate change mitigation or adoption, seek lower carbon footprint as compared to reference benchmark, contribute to reduction of greenhouse gas emission, achieve positive impact to mitigate or adapt to climate change, facilitate transition to a low carbon economy, etc.

- For 14(a)(ii), examples of climate-related indicators (“**Climate Indicator(s)**”) that a Climate fund may consider include: carbon footprint, weighted average carbon intensity, greenhouse gas emission, revenue or profit generated from or capital or operating expenditure commitment in activities considered as having favourable contribution to climate change mitigation or adaption, etc.
- For 14(d), if a Climate fund has a designated climate benchmark, the disclosure should include: (i) an explanation of how the reference benchmark is continuously aligned with or relates to the fund’s climate-related focus, and (ii) an explanation as to why and how the designated index differs from a broad market index, where appropriate.

F. Disclosure of additional information

15. An ESG fund should disclose the following additional information of the ESG fund or the fund manager or the index provider (where the ESG fund tracks an ESG benchmark), as appropriate, to investors to complement the disclosures in the offering documents:
- a) a description of how the ESG focus is measured and monitored throughout the lifecycle of the ESG fund and the related internal or external control mechanisms;
 - b) a description of the methodologies adopted to measure the ESG focus referred to in paragraph 14(a)(i) above and the fund’s attainment of the ESG focus;
 - c) a description of due diligence carried out in respect of the ESG-related attributes of the fund’s underlying assets;
 - d) a description of the engagement (including the proxy voting) policies (if any); and
 - e) a description of the sources and processing of ESG data or a description of any assumptions made where relevant data is not available.
16. This additional information may be disclosed on the fund manager’s website or by other means.
17. The additional information should be reviewed and updated from time to time to ensure accuracy.

Additional guidance for Climate funds:

- For 15(b) and (e), a Climate fund should disclose clearly the methodologies of measuring the Climate Indicator(s) (including, where appropriate, the metrics used and their calculation basis or formulas, the relevant data sources, any assumptions or estimations made and their limitations, etc.).

G. Periodic assessment and reporting

18. An ESG fund should conduct periodic assessment, at least annually, to assess how the fund has attained its ESG focus.
19. The fund should disclose the following information about its periodic assessment to investors in appropriate means (e.g. annual reports):
- a) a description of how the fund has attained its ESG focus during the assessment period, including, where appropriate:
 - (i) the actual proportion of underlying investments that are commensurate with the fund's ESG focus;
 - (ii) the actual proportion of the investment universe that was eliminated or selected as a result of the fund's ESG-related screening;
 - (iii) a comparison of the performance of the fund's ESG factors against the designated reference benchmark (if any);
 - (iv) actions taken by the fund in attaining the fund's ESG focus (e.g. shareholder engagement activities, proxy voting records of the ESG fund with respect to its investee companies, etc.); and
 - (v) any other information, considered necessary by the fund manager.
 - b) a description of the basis of the assessment performed referred to in paragraph 19(a) above, including any estimations and limitations; and
 - c) where the fund has provided previous periodic assessment, a comparison between the current and at least the previous assessment period.

Additional guidance for Climate funds:

- For 19(a), a Climate fund could demonstrate the attainment of its climate-related focus by comparing the fund's Climate Indicator(s) against those of the previous assessment period or the reference benchmark or the investment universe, etc.

H. Application of this circular on UCITS funds

20. The SFC has been adopting a streamlined approach to the authorization of UCITS funds from specified jurisdictions.

21. Having considered the European regulation on sustainability-related disclosures in the financial services sectors² (“**SFDR**”), UCITS funds will be ESG funds in Hong Kong if they incorporate ESG factors as their key investment focus and reflect such in the investment objective and/or strategy (“**UCITS ESG funds**”). This is irrespective of whether they are classified as falling under Article 8 or Article 9 of the SFDR³.
22. UCITS ESG funds which meet the disclosure and reporting requirements for Article 8 or Article 9 funds under the SFDR will be deemed to have generally complied in substance with the disclosure requirements set out under paragraphs 14 to 19 of this circular.
23. Notwithstanding the above, fund managers are reminded that, where appropriate, the SFC may request enhanced disclosure in respect of the fund’s specific strategies and risks, and impose or vary the requirements in respect of UCITS ESG funds as it may deem fit at any time.
24. The application of this circular on UCITS funds is subject to review and update by the SFC from time to time in view of the legal, regulatory and other development in each relevant jurisdiction, as well as the level of regulatory oversight, supervision, cooperation and assistance of the relevant home regulator and reciprocity accorded to the SFC with respect to the funds it regulates.

I. Ongoing monitoring

25. Fund managers of ESG funds should regularly monitor and evaluate the underlying investments to ensure the ESG funds continue to meet the stated ESG focus and requirements set out in this circular.
26. Where an ESG fund no longer wishes to pursue its stated ESG focus, the fund manager is expected to inform investors and the SFC as soon as reasonably practicable. An ESG fund which is no longer able to meet the requirements in this circular will be removed from the list of ESG funds on the SFC’s dedicated ESG funds webpage.
27. Fund managers should note that in addition to removal of the fund from the SFC’s list of ESG funds, the SFC may take appropriate regulatory action for compliance breaches such as failure to meet the stated investment objective and/or strategy in the offering documents.
28. Fund managers of ESG funds should also comply with the requirements set out in other applicable codes and guidelines⁴ in force from time to time.

² Regulation (EU) 2019/2088 of the European Parliament and of the council of 27 November 2019 on sustainability-related disclosures in the financial services sector.

³ Under the SFDR, Article 8 funds refer to funds that promote, among other characteristics, environmental or social characteristics, or a combination of those characteristics, provided that the companies in which the investments are made follow good governance practices; and Article 9 funds refer to funds that have sustainable investment as their objective.

⁴ In particular, a fund manager licensed by or registered with the SFC is required to comply with the relevant requirements under the Fund Manager Code of Conduct.

J. Effective date and implementation

29. This circular will take effect and will supersede the 2019 Circular on 1 January 2022 (“**Effective Date**”)⁵.

Existing ESG funds

30. For an existing SFC-authorized ESG fund that is on the SFC’s dedicated ESG funds webpage, fund managers should review the fund’s current disclosures in view of the requirements in this circular, and make necessary updates and revisions by the Effective Date.

New ESG funds

31. For new funds or existing funds which are not on the SFC’s dedicated ESG funds webpage, fund managers may continue to adopt the requirements in the 2019 Circular and make necessary updates and revisions by the Effective Date.

32. Applications for new ESG funds submitted on or after the Effective Date are required to submit one of the confirmations (see Annex 2):

- a) self-confirmation of compliance; or
- b) confirmation supported with independent third party certification or fund label⁶ to demonstrate compliance.

33. All requisition(s) by the SFC relating to this circular will be dealt with together with the SFC’s authorization / approval process for new fund and/or post authorization applications. The new ESG fund will be posted on the SFC’s dedicated ESG funds webpage once its authorization / changes become effective.

Investment Products Division Securities and Futures Commission

⁵ Requirements on periodic assessment and reporting set out in Section G above shall apply for any assessment period beginning on or after the Effective Date. Fund managers who wish to seek extension to fully comply with this circular should provide written submission with proper justifications including an explanation that the extension will not be detrimental to investors. The SFC will adopt a pragmatic and holistic approach in assessing whether a reasonable period of time will be given on a case-by-case basis.

⁶ 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 ESG fund’s primary investments to reflect the particular ESG focus which the fund represents, investment selection and ongoing monitoring process.